

COPEL

35% disco tariff hike at risk – déjà vu

Parent is challenging ANEEL-approved end-user tariff hike for Copel Disco

Thru a filing to local regulator, the co. confirmed its Board decided to study a way to defer the 35% annual Disco tariff adjustment approved this morning by ANEEL (vs. the 32.45% requested by Copel). This news goes in line with local press reports that Parana State Governor Beto Richa tweeted his followers that he was surprised by the high number and that he would work with ANEEL and the company to try to reduce it somehow. The stock started the day up c.3% but closed flattish, in line with Ibovespa. The high number goes in line with the up to 30% granted to other Discos in Brazil. Note that c.19% tariff increase is attributable to the Bz Fed Govt's inability to buy energy on behalf of Copel Disco. With no power contracts to supply its market, Copel Disco had to buy energy at high spot prices and this is a pass-thru as per existing tariff formulas.

We expect deferment w/ time-value-of-money, similarly to June 2013 hike

In June 2013 Copel got ANEEL's blessing for deferring 5pp of the 14.6% granted by ANEEL, w/ time-value-of-money based on co's regulatory ROA of 7.5% post-taxes. This postponement happened amid street protests w/ depredation of co's facilities in Curitiba (see our 06/21/13, 06/25/13 notes). We believe June 2014 will be similar but without clear outcome. This would mean downside risk to 2014 EPS/DPS but upside risk to 2016e numbers, and likely nil impact on valuation. However, the Governor in our view lost an opportunity to embrace better corporate governance practices and put the blame of such high tariff hikes where it belongs: the Bz Fed Govt...

Upside case of R\$48/sh, Downside case of R\$26/sh – details on page 2

Upside/Downside cases assume different power prices/generation shortfall from shortage risks, haircut on CRC receivables, cost savings, corporate governance risks.

Valuation: DCF-based R\$36 PT w/ 9% Ke; Neutral.

Trading at 6-8% yields, 6.4x P/E and 4.5x EBITDA, we remain Neutral the stock.

Equities

Americas
Electric Utilities

12-month rating **Neutral**

12m price target **R\$36.00**

Price **R\$32.80**

RIC: CPLE6.SA BBG: CPLE6 BZ

Trading data and key metrics

52-wk range	R\$34.99-23.64
Market cap.	R\$8.98bn/US\$4.05bn
Shares o/s	274m (PNB)
Free float	44%
Avg. daily volume ('000)	566
Avg. daily value (m)	R\$18.4
Common s/h equity (12/14E)	R\$13.5bn
P/BV (12/14E)	0.7x
Net debt / EBITDA (12/14E)	1.2x

EPS (UBS, diluted) (R\$)

	UBS	Cons.
12/14E	5.15	4.87
12/15E	5.68	5.59
12/16E	5.41	5.96

Lilyanna Yang, CFA

Analyst

lilyanna.yang@ubs.com
+55-11-3513 6514

Carlos Herrera

Analyst

carlos.herrera@ubs.com
+55-11-3513 6518

Luiz Fonseca

Analyst

luiz.fonseca@ubs.com
+55-11-3513 6517

Highlights (R\$m)	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
Revenues	7,776	8,493	9,180	10,601	10,922	10,803	11,579	12,160
EBIT (UBS)	1,303	992	1,113	1,779	1,929	1,702	2,014	2,108
Net earnings (UBS)	1,158	701	1,073	1,410	1,554	1,480	1,701	1,808
EPS (UBS, diluted) (R\$)	4.23	2.56	3.92	5.15	5.68	5.41	6.22	6.61
DPS (R\$)	1.62	1.03	2.15	2.16	2.98	2.84	3.27	3.47
Net (debt) / cash	(679)	(1,372)	(2,809)	(3,076)	(2,616)	(2,528)	(2,386)	(2,243)
Profitability/valuation	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
EBIT margin %	16.8	11.7	12.1	16.8	17.7	15.8	17.4	17.3
ROIC (EBIT) %	11.1	7.5	7.6	11.1	11.4	9.8	11.1	11.1
EV/EBITDA (core) x	6.1	7.9	6.7	5.2	4.7	5.1	4.5	4.1
P/E (UBS, diluted) x	9.3	15.1	8.0	6.4	5.8	6.1	5.3	5.0
Equity FCF (UBS) yield %	(4.3)	(6.6)	(9.2)	1.2	11.5	10.3	12.2	12.8
Net dividend yield %	4.1	2.7	6.9	6.6	9.1	8.7	10.0	10.6

Source: Company accounts, Thomson Reuters, UBS estimates. Metrics marked as (UBS) have had analyst adjustments applied. Valuations: based on an average share price that year, (E): based on a share price of R\$32.80 on 24 Jun 2014 18:42 EDT

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Investment Thesis

We rate COPEL Neutral as the current stock price already fairly reflects i) improvement in use of cash during this current administration (more reasonable ROIC requirements for new projects) and chances of re-election current Parana State Governor Beto Richa from the market friendlier PSDB political party; ii) Copel Genco sales to the spot market or to unregulated customers at unusually high prices in 2014-15e; iii) improved capital structure with 50% earnings payout and payment of extraordinary dividends to shareholders with upfront receipt of CRC receivables, currently under negotiation with the parent.

Key assumptions of our Base Case scenario: i) in line with MP579 and co's decision to reject the extension of genco concession contracts for c.117MW avg that expire by 2017, we assume that COPEL will return these assets to the Bz Fed Govt upon expiration and that it will not bid for its assets under the new, O&M fee model; ii) R\$50/MWh selling price for energy tied to genco concessions that expire post-2017 (>2GWavg); iii) sale of 8-13% of co's firm energy at high spot prices of R\$675-300/MWh for 2014-15e and R\$110/MWh prices for 2016 and onwards vs. GsF or hydro generation shortfall of 7.5-5% for the same period; iv) opex cutting of 5-7% showing up as early as 2014, as a result of recent voluntary dismissal program – mgmt indicated in recent earnings call that savings could be higher at 10% by 2014YE; v) settlement of CRC receivables according to the original schedule (amortization thru year 2025 of 1.4bn), which would be equivalent to cashing this receivable upfront with a c.35% haircut; vi) 40% payout in 2014 and onwards, and nil capital structure upside despite co's low leverage of <1.5x net debt-to-EBITDA; vii) no new Greenfield projects at low returns, i.e., capex going down towards R\$1bn p.a. from cR\$1.8bn in 2012a.

Upside Scenario with R\$48/sh implied fair valuation

Under our Upside case, we assume i) higher power prices of R\$120/MWh net of taxes (as opposed to R\$110/MWh included in our Base Case) for 2015+, meaning R\$3/sh upside; ii) lower, 15% haircut on upfront payment of the R\$1.3bn CRC receivables – this would add R\$1/sh in fair value; iii) R\$50m in additional opex savings as early as 2014 and pocketed by the company in perpetuity, implying another c.R\$1.3/sh increase to our fair value estimate iv) similar spot market price assumptions highlighted in our base case but lower generation shortfall at 5-3% of capacity as opposed to 7.5-5% would mean +R\$1/sh. These combined would lead to a higher R\$41/sh fair value estimate. Moreover, we can also see higher valuation via: v) capital structure upside towards 2.0x net debt-to-EBITDA, which could lead to another R\$5/sh increase in our fair value estimate; and, vi) new projects at positive returns, unlike what we have seen recently with Genco and Transco Greenfield projects.

Downside Scenario with R\$26/sh implied fair valuation

Under our Downside case, we assume: i) R\$30/MWh selling price for energy tied to genco concessions that expire post 2017 (>2GWavg) as opposed to R\$50/MWh – this would mean a R\$6/sh negative impact to our fair value estimate; ii) lower power prices of R\$100/MWh net of taxes (as opposed to R\$110/MWh included in our Base Case) for 2015+, meaning R\$3/sh downside; iii) no opex cost cutting (as opposed to the 5-7% reduction included in the Base case), leading to R\$2/sh downside to our fair value estimate; 4) –R\$1/sh to reflect a poorer parent post-October 2014 elections. Note that we do not foresee higher than 35% haircut on

the CRC receivable because this discount level was the one obtained by CEMIG and CEMIG's CRC yielded a higher, inflation + 8.15% p.a. interest income (vs. inflation + 6.65% for COPEL). These factors combined would mean a lower, R\$26/sh fair value estimate. Alternatively, we believe that lower 25% payout (i.e., the minimum required by Brazilian corporate law) associated with continued high capex at suboptimal returns and a suboptimal capital structure could make the stock de-rate towards our Downside case.

COPEL (CPLE6.SA)

	12/11	12/12	12/13	12/14E	% ch	12/15E	% ch	12/16E	12/17E	12/18E
Income statement (R\$m)										
Revenues	7,776	8,493	9,180	10,601	15.5	10,922	3.0	10,803	11,579	12,160
Gross profit	3,520	3,382	3,449	4,328	25.5	4,598	6.3	4,413	4,867	5,111
EBITDA (UBS)	1,857	1,542	1,716	2,467	43.8	2,751	11.5	2,556	2,899	3,025
Depreciation & amortisation	(553)	(550)	(603)	(689)	14.2	(823)	19.5	(854)	(885)	(917)
EBIT (UBS)	1,303	992	1,113	1,779	59.9	1,929	8.4	1,702	2,014	2,108
Associates & investment income	56	7	114	119	5.0	125	5.0	132	138	145
Other non-operating income	0	0	0	0	-	0	-	0	0	0
Net interest	225	(27)	280	150	-46.3	213	41.6	312	313	358
Exceptionals (incl goodwill)	0	0	0	0	-	0	-	0	0	0
Profit before tax	1,584	973	1,507	2,049	36.0	2,267	10.7	2,146	2,466	2,611
Tax	(407)	(246)	(405)	(610)	-50.6	(684)	-12.2	(638)	(737)	(776)
Profit after tax	1,177	727	1,101	1,438	30.6	1,583	10.0	1,508	1,729	1,835
Preference dividends	0	0	0	0	-	0	-	0	0	0
Minorities	(19)	(26)	(29)	(29)	0.3	(29)	0.7	(28)	(28)	(27)
Extraordinary items	0	0	0	0	-	0	-	0	0	0
Net earnings (local GAAP)	1,158	701	1,073	1,410	31.4	1,554	10.2	1,480	1,701	1,808
Net earnings (UBS)	1,158	701	1,073	1,410	31.4	1,554	10.2	1,480	1,701	1,808
Tax rate (%)	25.7	25.3	26.9	29.8	10.8	30.2	1.4	29.7	29.9	29.7
Per share (R\$)										
EPS (UBS, diluted)	4.23	2.56	3.92	5.15	31.4	5.68	10.2	5.41	6.22	6.61
EPS (local GAAP, diluted)	4.23	2.56	3.92	5.15	31.4	5.68	10.2	5.41	6.22	6.61
EPS (UBS, basic)	4.23	2.56	3.92	5.15	31.4	5.68	10.2	5.41	6.22	6.61
Net DPS (R\$)	1.62	1.03	2.15	2.16	0.6	2.98	37.8	2.84	3.27	3.47
Cash EPS (UBS, diluted)*	6.25	4.57	6.12	7.67	25.2	8.69	13.3	8.53	9.45	9.96
Book value per share	43.22	44.21	46.23	49.32	6.7	52.16	5.8	54.87	57.97	61.28
Average shares (diluted)	273.66	273.66	273.66	273.66	0.0	273.66	0.0	273.66	273.66	273.66
Balance sheet (R\$m)										
Cash and equivalents	1,631	2,095	1,742	3,190	83.2	3,755	17.7	3,665	3,776	3,831
Other current assets	2,071	2,587	2,939	3,128	6.5	3,161	1.0	3,133	3,238	3,318
Total current assets	3,702	4,682	4,680	6,319	35.0	6,916	9.5	6,798	7,014	7,149
Net tangible fixed assets	8,931	9,661	10,019	10,692	6.7	10,522	-1.6	10,671	10,845	11,044
Net intangible fixed assets	0	0	0	0	-	0	-	0	0	0
Investments / other assets	6,489	6,866	8,412	8,767	4.2	9,203	5.0	9,672	10,153	10,672
Total assets	19,122	21,209	23,112	25,778	11.5	26,641	3.4	27,142	28,012	28,865
Trade payables & other ST liabilities	1,807	2,355	2,315	2,468	6.6	2,492	1.0	2,465	2,547	2,607
Short term debt	252	479	1,033	1,578	52.76	1,792	13.50	1,755	1,865	1,919
Total current liabilities	2,059	2,833	3,348	4,046	20.9	4,283	5.9	4,220	4,412	4,525
Long term debt	2,058	2,988	3,517	4,688	33.3	4,579	-2.3	4,438	4,297	4,155
Other long term liabilities	2,935	3,026	3,318	3,269	-1.5	3,227	-1.3	3,192	3,161	3,138
Preferred shares	0	0	0	0	-	0	-	0	0	0
Total liabilities (incl pref shares)	7,052	8,847	10,183	12,003	17.9	12,089	0.7	11,850	11,870	11,819
Common s/h equity	11,827	12,097	12,651	13,497	6.7	14,274	5.8	15,014	15,865	16,769
Minority interests	243	265	277	277	0.0	277	0.0	277	277	277
Total liabilities & equity	19,122	21,209	23,111	25,777	11.5	26,641	3.4	27,141	28,012	28,865
Cash flow (R\$m)										
Net income (before pref divs)	1,158	701	1,073	1,410	31.4	1,554	10.2	1,480	1,701	1,808
Depreciation & amortisation	553	550	603	689	14.2	823	19.5	854	885	917
Net change in working capital	(460)	(67)	(131)	(26)	80.1	13	-	34	23	40
Other operating	(280)	20	(394)	(270)	31.5	(338)	-25.4	(444)	(451)	(503)
Operating cash flow	971	1,203	1,151	1,802	56.6	2,051	13.8	1,924	2,158	2,261
Tangible capital expenditure	(1,430)	(1,903)	(1,937)	(1,694)	12.6	(1,022)	39.6	(1,003)	(1,058)	(1,116)
Intangible capital expenditure	0	0	0	0	-	0	-	0	0	0
Net (acquisitions) / disposals	0	0	0	0	-	0	-	0	0	0
Other investing	0	0	0	0	-	0	-	0	0	0
Investing cash flow	(1,430)	(1,903)	(1,937)	(1,694)	12.6	(1,022)	39.6	(1,003)	(1,058)	(1,116)
Equity dividends paid	(421)	(269)	(561)	(564)	-0.6	(777)	-37.8	(740)	(850)	(904)
Share issues / (buybacks)	0	0	0	0	-	0	-	0	0	0
Other financing	(356)	139	(1,543)	746	-	392	-47.46	(230)	(82)	(147)
Change in debt & pref shares	210	1,399	1,346	1,773	31.74	164	-90.76	(117)	30	0
Financing cash flow	(567)	1,269	(757)	1,955	-	(221)	-	(1,087)	(902)	(1,051)
Cash flow inc/(dec) in cash	(1,026)	569	(1,543)	2,064	-	807	-60.9	(166)	197	94
FX / non cash items	264	(106)	1,190	(615)	-	(243)	60.5	76	(86)	(39)
Balance sheet inc/(dec) in cash	(761)	464	(353)	1,449	-	564	-61.0	(90)	111	55

Source: Company accounts, UBS estimates. (UBS) metrics use reported figures which have been adjusted by UBS analysts.*Cash EPS (UBS, diluted) is calculated using UBS net income adding back depreciation and amortization.

COPEL (CPLE6.SA)

Valuation (x)	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
P/E (local GAAP, diluted)	9.3	15.1	8.0	6.4	5.8	6.1	5.3	5.0
P/E (UBS, diluted)	9.3	15.1	8.0	6.4	5.8	6.1	5.3	5.0
P/CEPS	6.3	8.5	5.1	4.3	3.8	3.8	3.5	3.3
Equity FCF (UBS) yield %	(4.3)	(6.6)	(9.2)	1.2	11.5	10.3	12.2	12.8
Net dividend yield (%)	4.1	2.7	6.9	6.6	9.1	8.7	10.0	10.6
P/BV x	0.9	0.9	0.7	0.7	0.6	0.6	0.6	0.5
EV/revenues (core)	1.5	1.4	1.2	1.2	1.2	1.2	1.1	1.0
EV/EBITDA (core)	6.1	7.9	6.7	5.2	4.7	5.1	4.5	4.1
EV/EBIT (core)	8.8	12.3	10.3	7.3	6.7	7.6	6.5	5.9
EV/OpFCF (core)	8.8	12.3	10.3	7.3	6.7	7.6	6.5	5.9
EV/op. invested capital	1.0	0.9	0.8	0.8	0.8	0.7	0.7	0.7
Enterprise value (R\$m)	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
Market cap.	10,752	10,614	8,538	8,976	8,976	8,976	8,976	8,976
Net debt (cash)	218	1,025	2,090	2,942	2,846	2,846	2,846	2,314
Buy out of minorities	0	0	0	0	0	0	0	0
Pension provisions/other	439	585	834	997	1,057	1,120	1,183	1,248
Total enterprise value	11,409	12,225	11,463	12,915	12,879	12,941	13,005	12,538
Non core assets	0	0	0	0	0	0	0	0
Core enterprise value	11,409	12,225	11,463	12,915	12,879	12,941	13,004	12,538
Growth (%)	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
Revenue	12.7	9.2	8.1	15.5	3.0	-1.1	7.2	5.0
EBITDA (UBS)	25.8	-16.9	11.2	43.8	11.5	-7.1	13.4	4.3
EBIT (UBS)	39.7	-23.9	12.1	59.9	8.4	-11.7	18.3	4.7
EPS (UBS, diluted)	17.2	-39.5	53.1	31.4	10.2	-4.7	14.9	6.3
Net DPS	49.6	-36.2	108.7	0.6	37.8	-4.7	14.9	6.3
Margins & Profitability (%)	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
Gross profit margin	45.3	39.8	37.6	40.8	42.1	40.8	42.0	42.0
EBITDA margin	23.9	18.2	18.7	23.3	25.2	23.7	25.0	24.9
EBIT margin	16.8	11.7	12.1	16.8	17.7	15.8	17.4	17.3
Net earnings (UBS) margin	14.9	8.2	11.7	13.3	14.2	13.7	14.7	14.9
ROIC (EBIT)	11.1	7.5	7.6	11.1	11.4	9.8	11.1	11.1
ROIC post tax	8.1	5.6	5.4	7.6	7.8	6.7	7.6	7.6
ROE (UBS)	10.1	5.9	8.7	10.8	11.2	10.1	11.0	11.1
Capital structure & Coverage (x)	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
Net debt / EBITDA	0.4	0.9	1.6	1.2	1.0	1.0	0.8	0.7
Net debt / total equity %	5.6	11.1	21.7	22.3	18.0	16.5	14.8	13.2
Net debt / (net debt + total equity) %	5.3	10.0	17.8	18.3	15.2	14.2	12.9	11.6
Net debt/EV	6.0	11.2	24.5	23.8	20.3	19.5	18.3	17.9
Capex / depreciation %	NM	NM	NM	NM	124.3	117.5	119.6	121.8
Capex / revenue %	18.4	22.4	21.1	16.0	9.4	9.3	9.1	9.2
EBIT / net interest	NM	37.2	NM	NM	NM	NM	NM	NM
Dividend cover (UBS)	2.6	2.5	1.8	2.4	1.9	1.9	1.9	1.9
Div. payout ratio (UBS) %	38.2	40.3	54.9	42.0	52.5	52.5	52.5	52.5
Revenues by division (R\$m)	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
Others	7,776	8,493	9,180	10,601	10,922	10,803	11,579	12,160
Total	7,776	8,493	9,180	10,601	10,922	10,803	11,579	12,160
EBIT (UBS) by division (R\$m)	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
Others	1,303	992	1,113	1,779	1,929	1,702	2,014	2,108
Total	1,303	992	1,113	1,779	1,929	1,702	2,014	2,108

Source: Company accounts, UBS estimates. (UBS) metrics use reported figures which have been adjusted by UBS analysts.

Forecast returns

Forecast price appreciation	+9.8%/+1.4%
Forecast dividend yield	6.6%/6.3%
Forecast stock return	+16.4%/-
Market return assumption	14.6%/10.2%
Forecast excess return	+1.8%/-

Statement of Risk

The following are key risks to our rating and price target: 1) rising energy deficit for Brazil as it means volume downside risks to Copel Disco and higher short exposure to hydro Gencos; 2) October 2014 elections given state-ownership and negative history of poor corporate governance in the past (we expect re-election of PSDB governor Richa); 3) long-term power price outlook (below or above R\$110/MWh net of taxes) and volume growth at Disco business; 4) changes to regulations, including extension of 2016-expiration Disco concession contract; 5) acquisitions or capex at subpar returns, and mainly in non-core assets and below 35% earnings payout.

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UBS 12-Month Rating	Definition	Coverage ¹	IB Services ²
Buy	FSR is > 6% above the MRA.	47%	33%
Neutral	FSR is between -6% and 6% of the MRA.	42%	34%
Sell	FSR is > 6% below the MRA.	11%	23%
UBS Short-Term Rating	Definition	Coverage ³	IB Services ⁴
Buy	Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event.	less than 1%	less than 1%
Sell	Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event.	less than 1%	less than 1%

Source: UBS. Rating allocations are as of 31 March 2014.

1:Percentage of companies under coverage globally within the 12-month rating category. 2:Percentage of companies within the 12-month rating category for which investment banking (IB) services were provided within the past 12 months.

3:Percentage of companies under coverage globally within the Short-Term rating category. 4:Percentage of companies within the Short-Term rating category for which investment banking (IB) services were provided within the past 12 months.

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UBS Brasil CCTVM S.A.: Lilyanna Yang, CFA; Carlos Herrera; Luiz Fonseca.

Company Disclosures

Company Name	Reuters	12-month rating	Short-term rating	Price	Price date
COPEL ¹⁶	CPL6.SA	Neutral	N/A	R\$32.80	24 Jun 2014

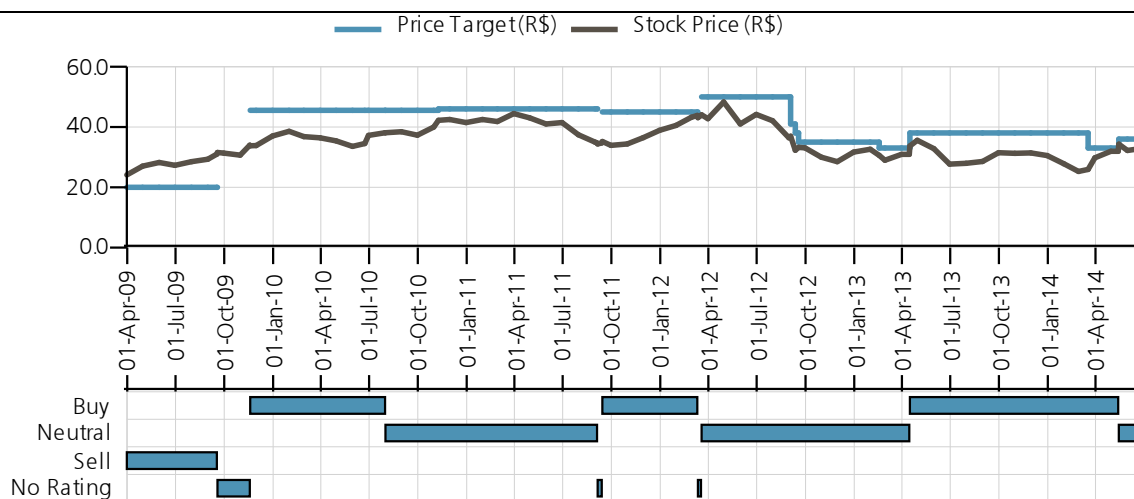
Source: UBS. All prices as of local market close.

Ratings in this table are the most current published ratings prior to this report. They may be more recent than the stock pricing date

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Unless otherwise indicated, please refer to the Valuation and Risk sections within the body of this report.

COPEL (R\$)



Source: UBS; as of 24 Jun 2014

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