

Q3 2017 Earnings Call

Company Participants

- Eduardo Haiama, Chief Financial & Investor Relations Officer

Other Participants

- Marcelo Sa, Analyst
- Maria Carolina Carneiro, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good afternoon, everyone, and thank you for waiting. Welcome to Equatorial Energia SA Third Quarter of 2017 Results Conference Call.

With us here today, we have Mr. Eduardo Haiama, Chief Financial and Investor Relations Officer. This event is being recorded and all participants will be in a listen-only mode during the company's presentation. After Equatorial Energia SA remarks, there will be a question-and-answer session. At that time, further instructions will be given. This event is also being broadcast live via webcast and maybe accessed through Equatorial Energia SA website at www.equatorialenergia.com.br and in the IQ platform www.nviq.com, where the presentation is also available.

Participants may view the slides in any order they wish. The replay will be available shortly after the event is concluded. Following the presentation via the webcast may post their questions on our website. They will be answered by the IR team after the conference is finished.

Before proceeding, let me mention that forward-looking statements are based on the beliefs and assumptions of Equatorial Energia SA management, and on information currently available to the company. They involve risks and uncertainties because they relate to future events, and therefore, depend on circumstances that may or may not occur.

Investors and analysts should understand that conditions related to macroeconomic conditions, industry and other factors could also cause results to differ materially from those expressed in such forward-looking statements.

Now, I'll turn the conference over to Mr. Eduardo Haiama. Mr. Haiama, you may begin your presentation.

Eduardo Haiama {BIO 7279971 <GO>}

Good morning, everyone. First of all, I would like to thank you all for joining us in our third quarter conference call. As for our agenda for today, I'll start the conference call describing the highlights of this quarter, then I'll comment on our operating and financial results. And finally, open the Q&A session. As for the highlights for the quarter, on slide 3, adjusted EBITDA reached BRL 500 million with CELPA reduce its bad debt provisions for the third consecutive quarter.

Our total sales volumes in Equatorial (3:06) amounted to 3.8 terawatt hour represent the growth of 2.5% in CEMAR and a contraction of 1.5% at CELPA. At the end of third quarter, total loss in CEMAR amount to 18.3% or drop of 0.3% compared to net saving in second quarter. As for CELPA, total losses closed at 27.5% or 0.7% above second quarter levels. As for first quarter, we start to approve financial asset update and operating revenue settled in the financial results, those impacting net revenues and EBITDA. For comparison purpose, third quarter 2016 and nine months 2016 figures are also just accordingly. Adjusted EBITDA were just BRL 500 million or 13.7% increase from third quarter last year. These are regarded to adjusting the financial assets update, EBITDA would have a record BRL 486 million or an increase of 13.4% from last year.

Finally, Equatorial Transmission has already delivered all the environmental studies from the lots acquired in October 2016, auction remaining only one that's related to (4:38) 2017 auction.

Moving onto slide 5, Energia sales grew by 2.5% this summer, mainly due to the recovery in the company generated losses in the quarter and beginning of the dry season, which (4:53) 1.1% growth (4:57)

Moving to slide 6, CELPA's group volumes decreased by 1.5% in the quarter, despite increase in the required energy. This is the profit is off the (5:10) seasonality also impacts, and the losses, which we explained (5:16) their own presentation.

Moving to slide 7. Total losses at CEMAR in the quarter, 18.3% or 0.3% drop compared to second quarter this year, in the company's recent tariff (5:35), technical losses were increased from 9.9% to 12.1%, (5:40) and that's why when you compare to our non-technical losses, they have failed to drop, it was more significant than it was - the required energy losses, total losses.

In terms of our quality indicators, both DEC and FEC continue to improve, reaching 14 hours at DEC and 7.2 times in FEC.

Moving on to slide 8. CELPA energy losses in the quarter 27.5% or 0.7 percentage point increase compared to the second quarter. Non-technical losses reached 35.7% in the quarter (6:31) seeing that that we saw in the first quarter of 2017.

As we commented in the previous quarter conference call, we believe that the reduction in loss in the second quarter is for (6:43) was a combination of successful Loss Combat

Program and also a milder than average weather that led to lower unit of air conditioning and refrigerators commonly (6:57); starting in third quarter, the weather is much hotter, leading to much higher use of those appliance, hence impacting losses in the short-term. As we're continuing our Loss Combat Program, which showed we should recover this over the next quarter. In terms of quality indicators, we continued to show improvements in both metrics, DEC and FEC, reaching 27.9 hours and 18.1 times.

Moving on slide 10, which showed the evolution of bad debt provision, with CEMER offer a higher first quarter 2017 provision, we were able to recover those during the second quarter, reaching a lower provision and would be the historical average in the third quarter. And we are back to normality with the provision representing 1.1% of the gross revenues. As for CELPA, this is the third consecutive quarter that we show improvements in this provision. You would like to remember that in the previous three quarters, the provision was affected by the commercial systems implementation in 2016, which impacted our billings in collection activities. From this quarter on, there should be no longer an impact from the system implementation and we expect to keep a (8:27) in line with the current environment and the (8:29) initiatives.

Moving on to slide 11. As we have mentioned before, starting next quarter we are showing (8:41) financial assets update in this grading lines that have impacted net revenues and EBITDA. Adjusted EBITDA listed BRL 233 million or an increase of 16% compared to third quarter of last year. Had we not changed the accounting of the financial update from financial to operating lines. Adjusted EBITDA would average BRL 270 million versus BRL 185 million in the third quarter of last year. The EBITDA growth is a result of further growth in billed volumes and manageable cost control and also the positive impact coming from 2017 (9:22)

As for our net income, adjust net income amounted to BRL 150 million versus BRL 117 million of last year.

Moving on to slide 12, CELPA's adjusted EBITDA amounted to BRL 277 million or 11.5% increase year-on-year. And the main reason behind this growth despite the (9:51) its own volumes is a growth of (9:53) coupled with tight cost control. And for adjusted net income, it amounted to BRL 152 million or 19.5% decrease compared to last year.

Moving onto slide 13, which show consolidated figures for Equatorial, adjust for all non-recurring events (10:20) CEMAR and CELPA, consolidated EBITDA amounted to BRL 500 million or 13.7% growth year-on-year, while our net income amounted to BRL 252 million or 15% increase year-on-year.

On slide 14, represent (10:41) for the company, consider 100% consolidation from CEMAR and CELPA, the consolidated net debt to EBITDA ratio fell to 1.5 times, represents BRL 2.6 billion. The quarter's (10:56) debt grew in accordance (10:58) with more than BRL 2.6 billion in cash, which is more than enough to go over the first two years of debt maturity. It is also important to highlight that in October of this year, CEMAR conclude the insurance of BRL 500 million in debentures worth of (11:18) would be five years, with the initial (11:20) rollover in short term debt of BRL 972 million.

FINAL

Bloomberg Transcript

FINAL

Moving onto slide 16, regarding our Transmission business, these figures highlight the company's views in a steady market trend directly moving to capture opportunities. In the last two auctions, we were able to secure the development of structural operation of eight different transmission lines amounting to approximately BRL 870 million of annual revenues with a total estimated CapEx ANEEL of BRL 4.7 billion. In this figure, (12:03) September 2017 figures. In August 2017, we also announced the acquisition of 51% of Intesa's, an acquisition transmission line of operating in the States of Tocantins and Goiás. The conclusion of this deal (12:24) announced approval, the approval by CADE has already been obtained.

Moving onto slide 17, we showed the progress of our each project. As you can see the main highlights, of the conclusion are the environmental studies for all the lots were in October 2016, the auctions and currently, (12:48) concluding the environmental study is the one that we want in the transactions, the last study that we want. (12:56)

I think, now we can start the Q&A session. Thank you.

Q&A

Operator

Thank you. The floor is now open for questions. Our first question comes from Carolina Carneiro of Santander. You may proceed.

Q - Maria Carolina Carneiro {BIO 16342681 <GO>}

Hello, everyone. Thank you for the call. I have two questions. First one regarding M&A growth opportunities. I know maybe it's too early to comment on that, but if you can give an opinion, at least initial opinion regarding the model of sale proposed for electric power distribution units? And what would be the expectation that you have in regards to the competition given the initial guidelines given. And if you have any other assets that you might be taking a look at in the distribution segment? And the second question also if you can comment some companies already comment a lot about the initial regulatory WACC proposed by ANEEL, about 7.2% that was not put for voting by a News Board and the next week, we're going to have the start of the public hearing regarding these regulatory WACC. If you can comment a little bit about your expectation for the beginning of the discussion, possible improvement on the initial number and of course the timetable for the final definition on the WACC for the next (15:11)? Thank you.

A - Eduardo Haiama {BIO 7279971 <GO>}

Thank, you, Carolina. Regarding M&A growth, like you said, it's too early to say if it's going to be attractive or not. We are still (15:26) in setting the numbers to see what - which assets we would be willing to look at and what kind of opportunity we might see. Having said that, it's hard to say how is going to be the competition. We don't expect much of a competition in spot price, basically because many of these assets that will be up for sale, they're looking at more complex professional regions. So having said that, we are not expecting more of a competition, but it's early to say what could be our appetite now and for which asset. As for potential of the rest (16:13) that we might be looking at, I mean, we

are constantly analyzing all kinds of opportunity that might arise and also what kind of opportunity that we might raise.

So I'd say like today, the two main segments we are focusing on are distribution and transmission and we are looking at what kind of opportunity that we might have in these two segments. Of course, we cannot comment on the names specifically. But I would believe like we have a very good business I like to pursue this potential project. So we are optimistic regarding this.

Regarding your second question, WACC, the 7.2%, I believe like first, before like I was discussing the numbers if this is correct or not. I believe like, why do we have today in terms of market condition, should be reflecting the WACC (17:20) propose or not. We like saying that, but if you see recently that was implied in the inflation index bonds trading in Brazil. We hadn't expect (17:38) inflation bond will be trading at 4.5% coupon, right. All of a sudden in say less than a week, the same bond was already traded 5 or plus percent. So what I'm saying is like we still have quite a volatility. Next year is an election year there we do expect, even if it's positive or not for the markets, more volatility. So, I'll say like we should be very careful during this kind of situation, because you're talking about capital revenue impact some companies that have their percent over the next years, and it's going to impact the cost of capital for these companies for four years or five years, when we still have lot of uncertainty regarding how the macro condition of the country will evolve in the short-term, I'm not talking about – even about the medium term.

So, our expectation in general, and I'm not saying specifically a number is that the WACC considering these volatilities, we still have 2018 year that it's hard to predict what could be the outcome and even if we essentially are going to be able enough to approve some of the reform that is important to centralize debt (19:12) across the country, it's hard – I believe like the WACC should be if not (19:18) should be very close to the one that we have today, right, that will be our expectation, but it's I'd say like in development (19:27) it's too early to forecast a number, okay. I don't know if it answers your questions.

Q - Maria Carolina Carneiro {BIO 16342681 <GO>}

It does. Thank you.

Operator

Our next question is coming from Mr. Marcelo Sa of UBS. You may proceed.

Q - Marcelo Sa {BIO 16454581 <GO>}

Hi, guys. Thank you for the call. I have one question regarding the document that was published yesterday with the returns for Petrobras' (20:01) privatization. My question is regarding the debt and the total liabilities of the company that it's not very clear to me who's going to pay for the remaining liability because in the document it states that Petrobras will capitalize BRL 11 billion in the distribution companies. But when we look to the total liability of these companies, maybe it should be something close to BRL 25 billion. So, my question here is, who will pay for the remaining debts if this debt will remain with the distribution company, so the new controlling shareholder will have to pay

FINAL

for that or if let's say, at some point these will be incorporated into (20:42) and then the consumers are going to have to pay for the difference. And also, there are very confusing information in the press. Some people are saying that the total liability will be BRL 21 billion and not BRL 25 billion, BRL 26 billion. So, I don't know if in these calculations maybe the government is already considering a potential hard cut on the batch of the few with Petrobras. So, if you guys can give us some color it would be very helpful because it's very confusing at this point? Thank you.

A - Eduardo Haiama {BIO 7279971 <GO>}

Thank you, Marcelo. I feel like our results having the bidding documents showing this trend (21:22) exactly how the valuation was modeled. It's hard for us to give you a clear figure because we don't have our results. But I mean reading the communication from the NDF, the valuation slide, an EV of BRL 10 billion for the six companies, right. And even then they are selling at almost zero equity value, right. I would say like what's inclined like the net debt that these companies will have, will be imminent. But it's hard to say it's going to be exactly this because we also didn't have, we should have (22:10) to understand how their model and exactly what kind of net debt we are really talking about.

Q - Marcelo Sa {BIO 16454581 <GO>}

Okay. Got it. Because the other point that they mentioned though. For me, I was not clear (22:25). All the liabilities related to the CCC and CED would go to (22:31) and then that's why at the some point, I saw that all the risks and I mean, all the liabilities would go to (22:38) the other time, I kind of realized that part of this will remain with the company? So that was very confusing.

And also the other point is that in the model, so I understood ANEEL did this extraordinary tariff reset for the distribution company. So applied like more than 20% on their side and now the company will have to offer discounts over this tariff. So my question is that, if the tariff is already designed or do you see there is a potential to increase a little bit more this tariff in order to meet the bid more attractive or at least to incorporate part of the cost of this, that will remain with the company because from what I understood, the only thing that I'm now doing, it was like an adjustment related to the OpEx, but you did not incorporate anything related to this potential batch. So I don't know if there is a potential to revise this tariff as well?

A - Eduardo Haiama {BIO 7279971 <GO>}

That's a good question. It's - like I said without having access to the main document and also the kind of evaluation there (23:47), it's hard for us to know exactly what kind of tariff they consider. The only thing that was clear in the communication was like BRL 10 billion of PC (24:03) was the brand threat of the concession contract.

And exactly what kind of assumption they use for PCs (24:13) that occurred that are ANEEL's applied for some of the companies or if it's (24:20) there. It's - should we see the documents for say, it's also the question that we have - that you have.

Q - Marcelo Sa {BIO 16454581 <GO>}

Bloomberg Transcript

Okay. And just regarding the timing the news that we saw is the expectation is of the bidding document, we only be disclosing at the beginning of February, right. So, until this date, probably you don't have the answers for that?

A - Eduardo Haiama {BIO 7279971 <GO>}

I am not interested in it because if they have some kind of debtor loans at least showing me what kind of model, what kind of evaluation, how this is formed. What kind of assumption they use. And yes, you can - we don't have the complete documents, you might have seen some of their - how they market and what kind of assumption they use to reach the evaluation. But what I can say today without having much further information would be a really a wild guess.

Q - Marcelo Sa {BIO 16454581 <GO>}

Okay. Thank you very much.

A - Eduardo Haiama {BIO 7279971 <GO>}

Thank you.

Operator

Please hold while we report the questions. Excuse me. This concludes today's question-and-answer session.

I would like to invite Mr. Eduardo Haiama to proceed with his closing remarks. Please go ahead, sir.

A - Eduardo Haiama {BIO 7279971 <GO>}

To sum up, we'd like to reinforce our commitment delivery and appreciation to our shareholders for exceptional financial operating results. We also would like to highlight over the years, the highest level of transparency and corporate governance and reassure that both me and our Investor Relations team are available, if you should you have any further questions.

Thank you, all, again, for taking part of our third quarter conference call and have a good day.

Operator

That does conclude Equatorial Energia's SA conference call for today. Thank you very much for your participation and have a nice day.

This transcript may not be 100 percent accurate and may contain misspellings and other inaccuracies. This transcript is provided "as is", without express or implied warranties of

FINAL

any kind. Bloomberg retains all rights to this transcript and provides it solely for your personal, non-commercial use. Bloomberg, its suppliers and third-party agents shall have no liability for errors in this transcript or for lost profits, losses, or direct, indirect, incidental, consequential, special or punitive damages in connection with the furnishing, performance or use of such transcript. Neither the information nor any opinion expressed in this transcript constitutes a solicitation of the purchase or sale of securities or commodities. Any opinion expressed in the transcript does not necessarily reflect the views of Bloomberg LP. © COPYRIGHT 2022, BLOOMBERG LP. All rights reserved. Any reproduction, redistribution or retransmission is expressly prohibited.

Bloomberg Transcript