

Q2 2020 Earnings Call

Company Participants

- Augusto Miranda da Paz Junior, Chief Executive Officer
- Leonardo da Silva Lucas Tavares de Lima, Chief Financial Officer and Investor Relations Officer
- Unidentified Speaker

Other Participants

- Lilyanna Yang
- Marcelo Sa

Presentation

Operator

Good morning, everyone, and thank you for holding. Welcome to Equatorial Energia S.A.'s Second Quarter of 2020 Results Conference Call. Here with us today, we have Mr. Augusto Miranda, Chief Executive Officer; and Mr. Leonardo Lucas, 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 their remarks, there will be a question-and-answer session. (Operator Instructions)

This event is also being broadcast live via webcast and may be accessed through Equatorial Energia S.A.'s website at equatorialenergia.com.br, 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. Those following the presentation via the webcast, may post your 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 S.A. 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 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 will turn the conference over to Mr. Augusto Miranda. Mr. Miranda, you may begin your presentation.

Augusto Miranda da Paz Junior {BIO 17178608 <GO>}

Good morning, everyone. First of all, I'd like to thank you for joining us at the second quarter 2020 earnings release conference. This was certainly an atypical quarter that we went through because of the pandemic, which had an impact on our results, but that the most recent data, both in terms of market and billing makes us believe that the worse is now behind us. In the midst of so many challenges, we celebrate one year since the beginning of the consolidation of Equatorial Alagoas with significant gains in operational and financial performance since our entry, which we will highlight in the slides below.

I will start by describing the highlights of the quarter, then we will comment on recent events. Then I'll ask Leo to talk about our operating and financial results. So we'll talk about our operating and financial results. And finally, we'll open the Q&A session.

Moving on to the highlights of the quarter on Slide 3. Turning to the main operating and financial results, I highlight that in the second quarter of 2020, the company's recurring consolidated EBITDA reached BRL857 million. This amount was impacted by the increase on the provision for doubtful accounts at DisCos & the Group, lower recognized value of SAU or the update of the financial assets and lower volume of distributed energy. I'd also like to highlight the group's robust liquidity position, which ended June with BRL6 billion in cash. This figure does not include the BRL941 million from quanto COVID [ph] received between July 31st and August 14th.

I would like to highlight our recurring net income of BRL387 million up 22.4% compared to the second quarter of 2019. This is the result of Equatorial's versatility and resilience quickly reacting to adverse scenarios. In our DisCos, I call attention to the continuous reduction of losses in Piaui and Alagoas for the fifth and third consecutive quarters respectively.

The consolidated volume in the second quarter of 2020 grew 3.2%. If we disregard the adjustments in Alagoas billing in the second quarter of 2019, the volume would have decreased by 1.5%. In the transmission segment, the combined physical progress of the project has already reached 84%. And we can say, we're in the final stage of construction of our project with 85% of the long-term funding already disbursed.

In our EBITDA, I'd like to highlight the positive and increasingly representative results of the two recently acquired DisCos. Piaui presented adjusted EBITDA of BRL42 million in the quarter, while Alagoas reached BRL56 million, in addition to the regulatory EBITDA from transmission, which reached BRL84 million this quarter. They are all going into operation, so this is a good result for this year.

And finally, I'd like to highlight one more thing. On Slide 4, we have some actions with digital services. With the displacement challenges and restrictions imposed by the pandemic scenario in our operations, we seek to intensify the use of digital tools in order to improve our collection and negotiation actions during the period.

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Regarding digital channels, we have improved our services and seen greater demand notably the use of our WhatsApp virtual assistant, Clara and our website where we include new features such as the possibility of paying with credit, debit and credit cards, emergency assistant card, sending the self-reading, and registering consumers and social tariffs, the so-called low income. In digital channels, in July, we reached the mark of approximately 2 million calls via digital request. We expect this experience to be positive and we hope that this kind of contact will be different.

In the initiative of collection actions, I'll highlight the creation of the exclusive negotiation channel, the opening of branches on Saturdays in which we are experiencing a very high demand to renegotiate debt, especially at this moment presumption, even having queues in the assistance at some branches, and finally, our collection agents in the field. Due to this high demand, we're implementing an artificial intelligence system, which will accept the renegotiation of direct debt on the website with the same parameters and criteria that we used to make this type of negotiation at the branches. We believe that these measures are here and will help us to a large extent to minimize the impact of the pandemic on our operations.

I'll give the floor to Leo now.

Leonardo da Silva Lucas Tavares de Lima {BIO 17560076 <GO>}

Thank you, Augusto. Good morning, everyone. Now speaking on the evolution of the market on slide 6. The volume of consolidated distributed energy from the Groups 4 DisCos companies grew by 3.2% in the quarter when compared to the same period of the previous year. It's worth mentioning that in the second quarter of 2019, the first quarter in which we consolidated the results of Alagoas, an adjustment was made to the company's revenue. Without the adjustment, consolidated volumes would have decreased 1.5%, and the residential segment would have grown 9.2% on a consolidated basis.

The Maranhao state market was growing strongly influenced by the resumption of POP and mining activity in the state, and despite the pandemic, volumes grew 0.6% when compared to the second quarter of 2019. In Para, the 2.9% decline is explained by the industrial, commercial and government sectors which decreased 9.8%, 14.6% and 27.9% respectively. Together they represent 41% of total consumption.

In Piaui, the decrease was 3% and that's also explained by the restrictive measures and the fight against COVID-19, which mainly impacted the industrial and commercial segments. Finally, Alagoas grew 36.9% this quarter due to a billing adjustment that took place in the second quarter. Without the adjustments, the Alagoas market would have decreased by 1.6%, also influenced by the social distancing measures that mainly affected commerce and the tourism sector industry state.

Moving on to slide 7. On slide 7, we show the behavior of the energy injected in the concessions consolidated in this quarter. On a consolidated basis, energy injected decrease 1.7% in the second quarter. The positive highlight here was Maranhao where

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injected grew 1.3% driven by the increase in temperature and mining activity. Looking only at the month of June, the volume grew by 4%, which shows a gradual recovery in activities after stores reopened there at the end of May.

At other DisCos such as Para, Piaui and Alagoas, we had decreases of 0.7%, 4.8% and 5.9% respectively. Just like in Maranhao, the worst month in terms of volume were April and May. In June, Para injected energy grew 1.2%, while in Piaui and Alagoas, we had decreases of 3.5% and 0.4% respectively. For some quarters, we've been intensifying the registration of consumers classified as low income who are eligible for the social tariff benefit.

Among the efforts made, we highlight the possibility of registering new customers in this class by WhatsApp, as well as implementing tools that integrate information and facilitate registration, in addition, of course, carrying out campaigns together with municipalities to ensure that families that are entitled to social tariffs can enjoy the benefit. Due to campaigns carried out by our DisCos in the last 12 months ended in June, we were able to add 545,000 consumers in this category of which 271,000 were only in the second quarter of 2020, reaching a total of 2.2 million registered families.

On slide 8, we show the schedule for the reopening of local businesses by concession area and the evolution of the energy injected in July this year. After a period in which much of a trade was closed due to the pandemic, we're seeing in all DisCos a gradual reopening of non-essential activities. Most of the schedule is taking place in stages, but even so we're already noticing a recovery in all units which reflects the improvement of the injected energy. In this sense, note that the consolidated volume of injected energy grows 4% mainly driven by Para and Maranhao, which had growth of over 6% this month. This leads us to believe that the second quarter was the worst period in terms of volume.

On slide 9, we show the total losses at our distributors. In Piaui and Alagoas despite restrictions imposed by the pandemic, we followed the downward trend already presented in recent orders due to the adoption of our management and turnaround model implemented in the new DisCos. It's already the fifth month of successive reduction losses in Piaui and the third consecutive quarter in Alagoas. In the specific case of Alagoas, there's the more pronounced drop this quarter, because as we always look at the last 12 months, the adjustment that had been made in the second quarter of 2019 billing left the calculation base. So now, we're observing a clean number of this effect. The clean number fell from 25.6% in the second quarter of 2019 to 24.1%, now a reduction of 150 basis points in this first full year of new management and that concession. In Maranhao, (inaudible) operates with a level of losses considered low. There was a slight worsening in the indicator as well as in Para, which after two quarters showed a slight increase in losses due to the COVID restrictions. At the four DisCos, at the end of the quarter, we were unable to read about 160,000 consumer units, and they were built by the average consumption.

On slide 10, we see that the quality indicators in Para and Maranhao are still well below the regulatory target so much so that in the ANEEL 2019 continuity ranking, Para won the second place and Maranhao reached the eighth place among major distributors as was mentioned last quarter. It's important to highlight that in the new DisCos methodology,

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revision of the calculation of the DEC and SEC were necessary. And in Piauí, the calculation was adjusted based on the consolidation of Equatorial. In Alagoas, it was done retroactively. It's important to highlight the evolution in Alagoas because we can see a drop of 31.5 hours or 57% less in interruptions in a period of just one year of the new management.

Turning to SEC on slide 11. It's important to note that for the second consecutive quarter all of our concessions are within the regulatory framework. The main highlight is on account of Equatorial Alagoas, which decreased 39% in the second quarter of 2020 when compared to the second quarter of 2019, which is the first year of Equatorial's new management. Quality indicators are central point of our business model where we always try to offer the best possible quality to our consumers without losing attention to the operating costs and investments necessary for this.

Moving on to slide 13. Here we show the evolution of manageable expenses at our DisCos. Now that we have four of them, we're constantly looking for opportunities to the use of comparisons, benchmarks, gains and scale, productivity, and standardization. The most emblematic cases of capturing opportunities are in the new ones, which again reported significant drops in OpEx in the quarter.

In Alagoas, we recorded a decrease of 37.4% and 15.8% in Piauí. In the last 12 months in both, we've promoted an approximation to the levels of cost efficiency per consumer presented by Maranhão and Para. Bearing in mind when we acquired these concessions, the OpEx per consumer was over BRL300. Piauí and Alagoas concessions combined have similar characteristics to the Maranhão concession. An interesting comparison is that for the second consecutive quarter, the sum of the recurring OpEx of Piauí and Alagoas is already below the recurring OpEx for Maranhão.

In Para, adjusted OpEx totaled BRL119 million in the second quarter of 2020 versus BRL120 million in the second quarter of 2019, a reduction of 1%. In Maranhão, it was increased by 4% due to the organizational redesign of some activities within the company.

Moving on to slide 14. On slide 14, we show the PDA photo in the second quarter of 2020. First of all, it's worth mentioning that this quarter was strongly impacted by the reduction in economic activity and the restrictions on operational activities imposed by ANEEL through resolution 878. Among them, the prohibition of cutting defaulting residential consumers. For this reason, in the second quarter of 2020, the provision for doubtful accounts was higher than the history presented by all of our DisCos.

In Para, we had a provisioning of BRL96 million, representing 6.8% of gross revenue and an increase of BRL72 million in comparison to the first quarter of 2020. In Maranhão, the provision volume was BRL34 million or 3.5% of NOR, BRL18 million higher than the first quarter 2020. In Piauí and Alagoas, the increase compared to the first quarter of 2020 was only BRL2 million and BRL3million respectively. This was stronger in April and May. Collection rates have evolved significantly over the quarter exceeding 100% in July in many DisCos.

We move on to slide 15. Virtually, all distributors showed a decline in EBITDA this quarter. Maranhao decreased 18.1% due to the increase in the provision for doubtful accounts of BRL17 million, as well as a reduction in the update of the financial asset BRL16 million and a decrease in the gross margins ex-update BRL9 million. This disregards the effect of updating the financial asset non-cash item or -- excuse me, if we were to disregard that affect, the decline in EBITDA would have been 12%.

Now in Para, recurring EBITDA was also 18.1% lower explained by the higher PDA by BRL50 million, a correction of the lowest financial asset by BRL44 million, partially offset by the improvement in gross margin ex-update of the financial asset of BRL52 million. Disregarding the effect of updating the financial asset, a non-cash item, adjusted EBITDA in Para decreased by only 2%. Piaui result which grew 38.3% was positively influenced by the reduction in operating expenses and in Alagoas, EBITDA was BRL56 million, practically flat versus the second quarter of 2019.

Moving on to slide 16. The adjusted EBITDA for the second quarter reached BRL857 million, a 9% decrease compared to that presented in the second quarter of 2019. If we adjust EBITDA without the effects of the correction financial assets and without the IFRS and the transmission, growth this quarter would have been 5.6% going from BRL598 million in the second quarter of 2019 to BRL632 million this quarter and this is mainly due to regulatory EBITDA of the new transmission assets, which add up to an amount of BRL51 million this quarter. If we exclude new assets, EBITDA would be decreasing just under 3% between quarters despite the negative effects of the pandemic on our operations. The slight drop observed in the distribution segment is more than offset by the entry into operation of SPG's 1, 2 and 8 in the transmission segment. We expect that the negative impact of the pandemic on our operations will be less severe in the coming quarters.

Moving on to slide 17, we show the evolution of net debt. Despite this atypical quarter, it remains stable in relation to the previous quarter at the level of BRL11 billion. The net debt by EBITDA ratio, if we consider 100% consolidated assets, reached 2.3x this quarter. The group maintains its solid cash position ending the quarter with BRL6 billion in cash enough to pay for more than two years of debt maturities. I'd like to remind you that we've received BRL941 million related to the COVID account which are not in the BRL6 billion cash I mentioned. And we also have all the funding contracted for transmission and investments in distribution this year.

Moving on to slide 18. Slide 18 shows the main investments made by Equatorial in recent years. As can be seen, investments in the transmission segment intensified in 2019. And as we are already approaching the end of the construction of several lots, there was a sharp drop in the amount spent in the second quarter of 2020. We'd like to remind you that 100% of the funding provided by the transmission loss is already contracted with public banks such as BNDES, FDA and Banco do Nordeste, as well as raised by infrastructure debentures. Of the BRL4.1 billion in funding contracted, 85% has already been disbursed, which independently attests to our high physical progress. With the completion of all transmission projects, a significant part of the group's cash generation will come from these ventures, thus improving the group's perception of risk in the market due to the cash flow stability of this segment. It also contributes to liquidity which can be used in new growth opportunities.

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Finally, I'd like to end this presentation not without first passing on our perception that there is clearly a scenario of economic recovery with the reopening of some activities. As commented, commercial activities in the states of our distributors are returning. Our field team has already returned in full in August and the full return of teams to combat losses, the possibility of cutting delinquent consumers except low income and reopening branches, which has been receiving strong demand in addition to other channels for negotiating and paying debts. In transmission, our new projects are in full swing with no significant delays in the works. So, the final message I'd like to leave is that in our perception, the worst is over and we're in the process of resuming.

Now, let's open the question-and-answer session.

Questions And Answers

Operator

(Question And Answer)

Thank you. The floor is now open for questions. (Operator Instructions). Our first question comes from Mr.Marcelo Sa from Itau Bank.

Q - Marcelo Sa {BIO 16454581 <GO>}

Good morning, everyone. Thank you for this call. I have a couple of questions. There is a potential bill that could come to defer tariff increases at Electra Brass distributors. So in your case, it would be (inaudible). But I'd just like to know if you could tell us a bit more about that? How would that bill work? And would that impact the company's results?

My second question is that there are some auctions that are scheduled for October which we know Equatorial is interested participating in. If you've looked at the Kazal [ph] asset, if you've had any partnerships regarding that, and if you could tell us a bit more? Thank you.

A - Unidentified Speaker

Thank you, Marcelo. About that decree, we see that the government is trying to relieve some of that impact. We've been following up on that. And we know that this is a very difficult process, because it would require base payment. So we have to understand how it unfolds.

We've had meetings with the ministry. We've talked about it. I think, it's great that the government is looking at that because it really is something important so that you can mitigate the tariff impacts. But this is a conversation that is still beginning. We still don't have any clear idea of where it's going to go.

Regarding Kazal [ph], yes, we are looking at it. We've been analyzing it. We've already said that this is a segment that really is interesting for Equatorial and we're assessing it. We're trying to align things so that we can go into that segment.

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Q - Marcelo Sa {BIO 16454581 <GO>}

Great. Thank you. If you'll allow me, I know it's going to have a public hearing tomorrow about the economic impact of COVID-19. Do you have anything to share about what you're expecting? What do you think ANEEL is going to analyze there?

A - Unidentified Speaker

Marcelo, it's a very complex situation. We know that payments were split into two installments. The financial one as you know. And now, we're going to be talking about the economic impact. What we've done is contributing every meeting with directors, and we are trying to guide them on what the best way forward is.

So what I can tell you about is about scenarios. Branch is also offering their contributions, but we still don't have anything set in stone. I think the suggestions we have are numerous to try to guide them, but we don't really have anything concrete.

Q - Marcelo Sa {BIO 16454581 <GO>}

Okay, great. Thank you, everyone.

Operator

(Operator Instructions). Our next question comes from Mr.Marcelo Sa at Itau Bank.

Q - Marcelo Sa {BIO 16454581 <GO>}

Well, everyone, if you'll let me ask another question. During the call, you mentioned that there are many clients renegotiating their bills. Do you think we can reverse part of the PDD from the first quarter to be used in the next ones?

A - Augusto Miranda da Paz Junior {BIO 17178608 <GO>}

Marcelo, I'll give you a quick answer, then Leo will discuss it in detail. Leo had mentioned collecting in June, we're very confident based on that. Leo, tell us a bit more about it.

A - Leonardo da Silva Lucas Tavares de Lima {BIO 17560076 <GO>}

Right, what we understood looking at the second quarter figures, is that the second quarter tends to be the peak of PDD. So when we look at June and July, it looks like we -- the trend is towards defaults going down. So we do believe that the worst is now behind us. We've seen some calls to our call center going up. We've seen queues in branches, which is usually for renegotiating. And we have channels that were prepared for this during the period and they are being more widely used.

So we do hope that the second quarter was the peak of it and that now we will require less provisioning. We also have a campaign about that, a broad campaign which also has raffles of cars and motorcycles and it will last for one year. It's already began and the idea is to have better registration and also to provide incentives for clients to pay. So we're

trying to be nicer about it as opposed to being more restrictive such as cutting power and so on. So we do believe that the worst is now behind us.

Q - Marcelo Sa {BIO 16454581 <GO>}

Okay. So just to confirm one thing. I think one of the factors that increased the level of payments reported by companies have been the emergency payout that the government provided for low-income individuals. Do you think that is going to have any impact to you as it finishes? How will you see that?

A - Augusto Miranda da Paz Junior {BIO 17178608 <GO>}

Well, we're looking at discussions about the emergency aid payout, but as you know, there are many variables. On the other hand, we're also seeing that trade is now reopening and it seems like the economy, as a whole, is speeding up. So ideally things will come back in through the economy.

In August, we again have the possibility to cut power except for the low-income bracket. So that has already generated some movement in itself. There was a certain bottleneck in the past three months. And now that bottleneck is opening up again.

Of course, some people have better conditions than others, but if the aid payouts continue, they will be welcome. But it does seem like the economy is going in a positive trend that seems very clear to us.

Q - Marcelo Sa {BIO 16454581 <GO>}

Okay. Thank you.

Operator

Our next question comes from Ms.Lilyanna Yang from HSBC.

Q - Lilyanna Yang {BIO 14003234 <GO>}

Hi. Good morning. Thank you for taking my question. I have a couple of them. One about sanitation. At what stage you're in and the assessments that used to potentially expand into that sector? And what synergies do you see between sanitation and our concessions? Is it easier to have a new team or would that be unnecessary? And would you have partnerships with companies that already operate in sanitation? That's my question.

Well, my second question. Can I say that PMSO per client in Piaui and Alagoas would need to be structurally the same in comparison to Maranhao and Para? And what companies do you use as benchmarks to have a lower rating than you do now for Maranhao and Para?

A - Augusto Miranda da Paz Junior {BIO 17178608 <GO>}

Thank you for your question. What I would tell you is that there is a lot of similarity between both industries. If you look at the investments that Equatorial has made, it was

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quite good. And although this is a new segment, the commercial side is still the same.

There are many overlapping segments that would provide some synergy. And even the call for bids, the auction process would require a partnership. So Equatorial has had an M&A team in our business for a long time. We're always looking at opportunities. This is an asset we've been looking at for some time.

And I wouldn't like to say too much about this, but I would tell you that that we're looking at it carefully trying to see how it matches in accordance to the public bid rules to see if we can make this investment. I can't tell you too much this is a part of our strategy, but we are looking at this with a lot of responsibility, okay. But there is a lot of synergy with the current assets we hold. There are some business similarities as well. And we understand that it makes a lot of sense.

About the Alagoas and Piaui, PMSO, what happens is when you have an asset, for example, we already operate in Maranhao and Para, which are areas that are already stable. We have gains and we've started a corporate function there. If we look at what we did there, there are things we did in Para that took three years to do, such as having a broad contract there. And in Piaui, this was done in six months. In Alagoas in three months. So it's -- just as in life, you learn things everyday.

With PMSO, with the cost structure we have, we have found good efficiencies, and all of our assets have shown that. The PMSO in Piaui and Alagoas should be lower than in the Maranhao, because it's dryer. It doesn't have forest, and Alagoas is very small. In an area like Maranhao, you have sometime that during the dry season, both are in maintenance for six months. If you look at Para, you also have gigantic forest and that really makes it difficult for maintenance to occur. In Piaui, the weather helps. The grid also is growing in some very specific areas, so that gives us a lot of opportunity to advance and have a much better PMSO in both concessions, okay?

We can also increase third-party services and have more productivity. We're always trying to seek productivity. And what I tell you is, we're a company that has some policies such as looking at things before acting. We analyze and discuss costs every day. We always try to work as if we were starting the business from day one, so we're always looking at resources. And we use Maranhao as a reference as a benchmark and we often see that something -- someone else somewhere else is doing better and we can switch that.

We're always trying to improve our OpEx and CapEx, and this is all reflected in the efficiency the group is delivering. What I'm saying, Lilyanna, is that you have to look at costs every day and wherever you can find an opportunity, you do it. We're always looking at the company's budget, we're always cutting costs. And with the two companies, we are certainly going to do that, okay?

Q - Lilyanna Yang {BIO 14003234 <GO>}

Great. If I could ask a follow-up question. Why is our defaults in Piaui and Alagoas going up by much less than in Maranhao and Para?

A - Augusto Miranda da Paz Junior {BIO 17178608 <GO>}

Leo, if you can answer that, please.

A - Leonardo da Silva Lucas Tavares de Lima {BIO 17560076 <GO>}

Because they were at a higher level in the first quarter, basically why? You already had a higher level in the first quarter, so it took a harder hit. So the levels of non-collecting there were higher because it was a more stable area. That was basically why I'd say that over time we expect that to stabilize. We've always had very good collection levels there. So we expect that this provisioning will go down, but it will take some years until we see the full effect of that in our methodology.

Q - Lilyanna Yang {BIO 14003234 <GO>}

Okay. Thank you.

Operator

This concludes today's questions and answer session. I like to invite Mr. Augusto Miranda to proceed with his closing remarks. Please go ahead, sir.

A - Augusto Miranda da Paz Junior {BIO 17178608 <GO>}

Well, in closing, I'd like to reinforce our commitment to deliver a differentiated appreciation to our investors through operational and financial excellence in results. And we would also like to highlight our turnaround which is very clear. And as a reminder, our PMSO will be flat in five years. And in transmission, although we're newcomers, we were able to get ahead and advance well, and everything is going well.

And we'd also like to highlight our dealings [ph] to the highest level of transparency and corporate governance and reassure that our investor relations team is available to assist you with possible questions you may have. Again, thank you all for being part of our second quarter conference call and have a good day.

Operator

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

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