

Q3 2018 Earnings Call

Company Participants

- Eduardo Haiama, CFO, IR Officer & Member of the Executive Board

Other Participants

- Carolina Carneiro, Sector Head

Presentation

Operator

Good afternoon, everyone. And thank you for waiting. Welcome to Equatorial Energia Third Quarter of 2018 Results Conference Call.

With us here today, we have Mr. Eduardo Haiama, Chief Financial and Investor Relations Officer. This event is being recorded. (Operator Instructions) This event is also being broadcast live via webcast and may be accessed through Equatorial Energia website at www.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 their questions on our website. They will be answered by the IR team after this conference is finished.

Before proceeding, let me mention that forward statements are based on beliefs and assumptions of Equatorial Energia 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 will turn the conference over to Mr. Eduardo Haiama. Mr. Eduardo Haiama, you may proceed.

Eduardo Haiama {BIO 7279971 <GO>}

Good morning, everyone. First of all, I'd 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 operating and financial results, give an update on the development of the transmission project. And finally, we will open the Q&A session.

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As for the highlights for the quarter on Slide 3. In September, we won the auction to acquire the remaining 49% stake in Intesa. We expect the closing to occur by the end of this year and early next year. In October, we had the closing of CEPISA's acquisition when we also injected BRL 720 million in equity into the company. In transmission, we received the construction license for SPVs 1, 2 and 3, the lots 8, 9 and 12 of Oct 16 auction. We should be starting the -- sorry for interrupting the call. Just telling that like we got the construction license for SPVs 1, 2 and 3. And it's worth reminding that we have already secured the long-term financing for this line. So we can start construction soon.

As for the volume demand, CEMAR dropped by 0.1% due to weak economic recovery. And at CELPA, volumes dropped by 3.1%, mainly due to unfavorable weather conditions and also the increases in energy loss in the quarter.

In terms of delinquency, both companies fell dramatically. At CEMAR, it reached 0.2% of gross revenues. And at CELPA, it fell to 1.3%.

Finally, adjusted EBITDA increased by 14% year-on-year, reaching BRL 576 million.

Moving on to Slide 5. Energy volumes at CEMAR dropped by 0.1%, due firstly from the weak economic recovery in the region and also the reduction in the industry demand. In the Industrial segment, specifically, it was heavily impacted by the shutdown of one client, a big one. Had this not happened, volumes would have grown by 3.4% instead of dropping by 4%.

On Slide 6, CELPA's billed energy volumes fell by 3.1% in the quarter, explained by unfavorable weather conditions and the increase in energy losses. In the Commercial segment, it was particularly affected by the weak performance in service and retail sales performance in the quarter dropping by 2.4%.

Moving on to Slide 7. CEMAR's total losses in the end of the quarter, 16.4%, a 0.2percentage point increase. Despite the recent drop in regulatory losses and high complex of this concessionaire, we have been able to keep an important gap between regulatory and actual energy losses. In terms of quality indicators, DEC and FEC, CEMAR continued to be below regulatory targets.

Moving on to Slide 8. CELPA's energy losses in the end of quarter 27.5%, a 0.3percentage point increase in the quarter. Despite being the most complex concessionaire in the country, according to ANEEL. And the tough economic environment that we have, CELPA has been able to reduce losses over the years and still have, by now, a small gap compared to the regulatory targets. In terms of quality indicators, CELPA continued to improve and be below now regulatory targets in terms of DEC and FEC. In the recent quarter, productivity of maintenance and stand-by teams in the field are mainly responsible for this improvement.

Moving on to Slide 10. Adjusted EBITDA reached BRL 265 million at CEMAR versus BRL 223 million in the same quarter of last year. If you were to disregard the financial asset update, CEMAR's EBITDA would have been BRL 250 million in the quarter. The EBITDA

increase, despite the decrease in view of the volume, is a result of the positive impact coming from the 2017 tariff review and the 2018 tariff readjustments linked to IPCA and inflation, a tight cost control and also the reduction in the bad debt provision. As for net income, adjusted figure amounted to BRL 172 million in the quarter versus BRL 150 million in the Third Quarter of last year.

Moving on to Slide 11. CELPA's adjusted EBITDA amounted to BRL 298 million or an increase of 7.5% year-on-year. In this quarter, the company posted good management in cost control and some reduction in bad debt provision. In terms of adjusted net income, it has reached BRL 139 million in the quarter from BRL 152 million in the same quarter of last year.

On Slide 12, we show the consolidated figures for Equatorial. Adjusted for all -- for the all nonrecurring effects that are already impacting CEMAR and CELPA, consolidated EBITDA amounted to BRL 576 million or 14% growth year-on-year, while net income amounted to BRL 262 million or an increase of -- from BRL 252 million in Third Quarter of last year.

I would like to reinforce that Intesa's figures as well as Geramar's are not being consolidated in the quarter. They only come as a net income. But once we conclude the acquisition for the 49% stake at Intesa, we should start to consolidate the full figures of Intesa into EBITDA. As for Fourth Quarter 2018, we should start consolidating CEPISA's figures within Equatorial's financial statement.

Moving on to Slide 13. We take a look at delinquency provisions in both business. CEMAR posted a provision that represents only 0.2% of its gross revenues, while at CELPA, it reached 1.3%.

After the results have been posted in the first half of this year and given the continued tough macroeconomic environment, we have reinforced many of the actions and also revised some of the collection procedures. And this is exactly what we would have posted now, an improvement in these figures. We continue to -- should say that we should by the end of this year, there's a full 12-month period, have allowance in the range of 2.5%, maybe 3% at CELPA; and at CEMAR, around like 1.5%.

Moving on to Slide 14. We present the debt amortization schedule and the leverage for the company. Considering 100% consolidation for CEMAR and CELPA, Equatorial's net debt to EBITDA ratio amounted to 1.8x at the end of this quarter, representing BRL 3.4 billion, a drop when compared to this year from Second Quarter despite the increase in the CapEx disbursement from the transmission project.

The group ended the quarter with almost BRL 4.8 billion in cash position, which is more than enough to cover three years of debt maturity. We believe we have a comfortable debt profile to accommodate future cash needs as well as future CapEx for the transmission project.

On Slide 15, we show the main CapEx made by Equatorial in the recent quarters. As can be seen, the investments in transmission segment have started to pick up in the recent

quarters, especially after we got the construction license for SPVs 7 and 8. Following the construction license that we just got for SPVs 1, 2 and 3, we are now about to start the construction in these lots as we have our Equatorial long-term financing for these lines.

On Slide 17, in November, we announced that the lots 1, 2 and 3 obtained the construction license for IBAMA. So we can start construction. And in September, we won the auction to acquire the remaining 49% stake in Intesa. And as soon as we get some regulatory approvals, we should start consolidating 100% of this figure.

On Slide 18, we show the current status of our lines project by project. Here, the main highlight, apart from the environmental license, is like we are well advanced in terms of getting the right of way, almost reaching 80% in many of the lots. And it's also important to highlight that in terms of the license per se, we already have secured 5 construction lines out of 8.

On -- from Slide 19 and then 20, we show the current status for the construction for SPV 7 or lot 23 that we won in October 2016 auction. As can be seen in the first slide, Marituba Substation is divided into 3 sections, one for each tension level. The landscaping for the 69; and 230-kilovolt sectors are already concluded. And we have already started the foundation for the equipment. We're also close to conclude the landscaping for the 500-kilovolt sector.

As for Slide 20, for the transmission line between Vila do Conde Marituba, we have already reached 44% of track clearance. It should advance in the foundation then tower assembly stage soon.

Now looking at SPV 8, lot 31, on Slide 21 and 23. First, I would like to remember that this was the last lot acquired by us in October -- in April '17 auction. On Slide 21, we can see how the work in the Tapajás and Rurópolis Substations are evolving. The synchronous condenser from the -- for the Rurópolis Substation has already reached Santarém. And we should start assembly work in the substation soon.

On Slide 22, we're about to conclude the landscaping of the Transamazônica Substation. And as for the line Xingó to Altamira, we have already assembled 23% of the towers, the most advanced part of the line we have so far.

On Slide 23, we began the line of Altamira-Transamazônica. We have just concluded 39% of the foundation. And as for the line Transamazônica-Tapajás, we have reached 38% of track clearance and have started the construction of the foundation.

Now we can start the Q&A session. Thank you.

Questions And Answers

Operator

(Operator Instructions) Ms. Carolina Carneiro from Credit Suisse would like to make a question.

Q - Carolina Carneiro

I have a question in regards to the regulatory discussion on the new potential methodology, which we might have for the regulatory WACC that is a public in the works - public consulting MAU regarding the methodology. And we are not very familiar with the potential timetable for the disclosure of the methodology or the final results of the public hearing as well as the potential timetable for the release of the new WACC calculation. Can you guys provide your best assumptions or your expectations for the timetable when should we expect the final methodology to be published. And consequently, when we might see the new numbers -- the potential new proposals for the regulatory WACC?

A - Eduardo Haiama {BIO 7279971 <GO>}

Thank you, Carolina. Regarding the new WACC methodology, I mean, they need to conclude by next year because they need to implement the new WACC by 2020. So that like for CELPA, in CEPISA, that we also currently anticipate the extraordinary tariff review next year instead of 2021. It was initial -- 2021, that was the initial deal. They should not be impacted by any change in the WACC. So CEPISA and CELPA most probably are going to have the 8.09% of WACC. As for the methodology and then what should be the numbers, I believe it's too early. I mean, we have like so far many discussions -- we also -- of what should be the best way to look at. I don't think we're going to see some big change in the way it should be. There are some proposals that is they want to link it to the inflation-linked bonds in Brazil, others just keeping the way it is today. But in the end, my view is like if you look at what's happening in all the previous discussions, I believe like rationality will prevail. So to say it's going to be a little bit to the right or a little bit to the left, hard to say. But my view is like it should not be meaningful in terms of change or what kind of volatility it could bring to the sector. I know that I'm not really answering your question because my view is like it's too early to give you, let's say, a firm idea of what we should expect from the outcome.

Q - Carolina Carneiro

Okay. It already helps a lot. If I may add the question then on CEPISA. As far as we understood, they -- all the steps needed to conclude the acquisition were already made. So we might expect the consolidation of the asset probably for Fourth Quarter '18, right? I just wanted to check with you guys also when should the company or the company expect to also request for the regulatory agency the extraordinary tariff revision that we -- you guys commented on the last call?

A - Eduardo Haiama {BIO 7279971 <GO>}

Yes. After we concluded the acquisition in mid-October, first, just to make sure that we now have a full team there. So we move like about -- like 13 people to be full time, right, at CEPISA. And we also have our corporate structure helping them work the other turnaround that we need to implement. As for the tariff review, if we want to review next year, what's going to happen is we're going to request soon through this year, right?

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There are 2 things you need to say to the regulator when you request this extraordinary tariff review. One, when, of course, you want. And you need to be one year before. And our tariff review should be in December. That would be when we're going to have the tariff readjustment for the next year. But also, you need to say if you want to revise the asset base. So that's why, today, what's happening now at the company, we are working very hard to have a very good assessment of if it's possible and what kind of request we want to make next month, okay? So next month is the deadline for us if you want to have a -- the tariff review next year.

Operator

(Operator Instructions) This concludes today's question-and-answer section. 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, delivering a differentiated appreciation to our shareholders through exceptional financial and operating results. We should also highlight our adherence to the highest level of transparency in corporate governance and reassure that both me and our Investor Relations team are available should you have any further questions. Thank you, all again for taking part in our Third Quarter conference call. And have a good day.

Operator

That concludes Equatorial Energia conference call for today. Thank you very much for your participation. And have a nice day.

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