

## Q2 2018 Earnings Call

### Company Participants

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

### Other Participants

- Carolina Carneiro, Sector Head
- Gustavo Miele, Analyst
- Marcelo SÃi, Associate Director and Analyst
- Unidentified Participant, Analyst
- Vinicius Tsubone, Analyst of Latam Utilities, Oil & Gas

### Presentation

#### Operator

Good afternoon, everyone. And thank you for waiting. Welcome to Equatorial Energia S.A. Second 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 S.A. website at [www.equatorialenergia.com.br](http://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 the conference is finished.

Before proceeding, let me mention that forward 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 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. Haiama, you may begin your presentation.

#### **Eduardo Haiama** {BIO 7279971 <GO>}

Good morning, everyone. First of all, I'd like to thank you all for joining us on our Second 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, we open the Q&A session.

As for the highlights for the quarter on Slide 3. Equatorial won the auction to acquire CEPISA distribution company serving the state of Piauí. We expect to close the acquisition in Fourth Quarter this year. In the transmission segment, we have now construction license for lots 23 and 31. And preliminary license for all the remaining lots. As for the quarterly results, CEMAR volumes grew by 2.6%. And basically due to loss reduction and increase in the number of consumers. As for CELPA, demand dropped by 1.4%, impacted by unfavorable weather conditions and also the truckers' strike, that impacted the industrial plants, mainly.

Total losses in CEMAR amount to 16.2%, a drop of 0.6percentage points compared to that same -- First Quarter '18. And at CELPA, total net losses were 27%, flat quarter-on-quarter. Finally, adjusted EBITDA amount to BRL 431 million, basically flat quarter-on-quarter.

Moving on to Slide 5. The energy sales grew by 2.6% in CEMAR, mainly due to loss reduction and the growth of number of consumers of 3.1%. The Industrial segment was impacted by the shutdown of a relevant client. Had it not happened, volumes had grown by 4.8% instead of the drop of 1.9%.

On Slide 6, CELPA's energy volumes fell by 1.4% in the quarter, basically explained by unfavorable weather conditions and also the truckers' strike. The Industrial segment was particularly impacted by the strike and fell by 4.8%. And also volume was also impacted by the World Cup.

On Slide 7, CEMAR's total losses in the quarter, 16%, a 0.6percentage drop. In the recent quarters, the company has been successful to continue to reduce the losses despite being considered by the regulators as one of the most complex concessional areas in Brazil. In terms of quality indicators, DEC and FEC, we continue to be below regulatory targets. And the improvement in the quarter, the increase in the quarter -- slight increase is basically due to the higher level of rainfall relative to last year.

Moving on to Slide 8. CELPA's energy losses in the quarter, 27%, basically flat quarter-on-quarter. Despite being the most complex concessional area in the country, CELPA has been able to reduce losses revenue over the years. And it's closing the gaps in regulatory level. In terms of quality indicators, we continue to post improvement, both in terms of DEC and FEC. In this quarter, the productivity of the maintenance and stand-by teams in the field, they are -- basically, they're mainly responsible for this improvement, despite the weather effect.

Moving on to Slide 10. Adjusted EBITDA was BRL 205 million at CEMAR, or a drop of 1.7% year-on-year. If you were to disregard the financial asset update, CEMAR's EBITDA would have been BRL 191 million. The EBITDA drop, despite the growth in view of the volume, is basically the result of an increase in the bad debt provisions year-on-year. It's important to

mention that in the Second Quarter '17, we posted an unusually low allowance to the -- due to the recovery from the previous quarter.

As for the net income, adjusted figure amounts to BRL 116 million in the quarter, or an increase of almost 3% year-on-year.

On Slide 11, CELPA's adjusted EBITDA amounts to BRL 224 million or an increase of almost 3%. In this quarter, the growth is basically the result of the good manageable costs and also due to the reduction in bad debt provisions.

On Slide 12, we show the consolidated figures for Equatorial. Adjusted for the non-recurring impacts that are affecting CEMAR and CELPA, consolidated EBITDA amounted to BRL 431 million, basically flat year-on-year. And net profit, BRL 144 million or a drop of almost 2%. It's important to remember that Intesa's figures as well as Geramar's figures, they are not consolidated and we only see that pickup impacting net income, not EBITDA.

On Slide 13, we look at the delinquency provision over the quarters. CEMAR posted an allowance representing 2.5% of the gross revenues, while CELPA's was slightly higher, representing 3% of its revenues. Given the continued tough economic environment, we have reinforced many of the actions (therewith) before. And also revised some of the procedures. The main actions are the increase in the number of disconnections, the use of automated system and improvement in renegotiations of bad debt. With these measures, we do expect it should bring back provisions to around 2.5%, 3% at CELPA and 1.5% at CEMAR by year-end, looking at the 12-month period.

On Slide 14, we present the debt amortization schedule and the leverage for the company. Considering 100% consolidation, Equatorial's net debt would have amounted to 1.9x at the end of the Second Quarter, representing BRL 3.4 billion of total net debt. It's important to highlight that the group ended with almost BRL 4.4 billion in cash positions, which is more than enough to cover the debt amortization of the next four years. In this quarter, we have concluded the issuance of BRL 1 billion in debentures at CELPA with a five years bullet. In addition, we have secured BRL 1.1 billion of long-term financing for part of our transmission lines, lots 8, 9 and 12, with Banco de Nordeste at very competitive cost. With that, we can say that we have basically accomplished most of our fundraising efforts since we won our first transmission lines back in 2016 auction.

On Slide 15, we show main CapEx made by Equatorial in the recent quarters. As can be seen, the investment in transmission segment have started to pick up in the recent quarters and reached BRL 123 million in the Second Quarter. It's important to highlight that we haven't yet started construction, only in the Third Quarter we have started some of the lines. And basically, these extensions that we have, they are related to the conclusion of the environmental license, securing for land rights and on-field studies.

Following the construction license for the Lot 31 in Pará state, we have recently started construction work in this lot. And also, with the issuance of the construction license for Lot 23, we should soon start the construction work as well.

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Moving on to Slide 17. In July, we announced that lots 14, 15, 16, the Block 3, have obtained a preliminary license, environment license, from IBAMA. And once certain conditions are met, we should receive the construction license that would allow us to start construction.

It is important again to highlight that this week, we received the construction license for Lot 23. It's a partial license for 3 out of the 4 segments, representing 87% of the total (req). And once we conclude this CapEx, we should receive this partial req .

On Slide 18, we show the current status of our lines project by project. The main reason to highlight for (inaudible) permanent environmental license already mentioned is the evolution of the land rights secured -- securing. We have already reached above 70% in most of the lots. And these 2 points, environmental rights and land rights, they are crucial to the start of the construction phase.

And finally, on Slide 20, we show the conditions and rationale behind acquisition of CEPISA in July. We won the privatization auction of CEPISA distribution company serving the state of Piauí. At the auction, Equatorial offered a combined discount index of 119, which means that CEPISA is basically waiving the tariff flexibilization that was approved by ANEEL. And also the potential extra tariff to cover for the RGR debt. In -- and also, Equatorial will pay BRL 95 million to the federal government as grants.

With this transaction, we are acquiring now 90% of the total shares of CEPISA, paying roughly BRL 45,000 to Eletrobras. And we must make net increase of at least BRL 721 million as a company.

Among the key topics to ensure the success of this acquisition, we highlight first the proven experience that we have in turning around complex concessional areas, the operational synergy between CEMAR and CEPISA. And also a more efficient level of OpEx that we believe we're going to be able to deliver, given the lower complex of the concessional area. This differentiated cost of that was the RGR debt. And also the potential gains from the inclusion of new low-income consumers and also loss reduction. With this acquisition, we believe we are starting again a new chapter of growth and value creation for Equatorial.

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

## Questions And Answers

### Operator

(Operator Instructions) Mr. Marcelo SÃ; from (Bank UBS) would like to ask a question.

### Q - Marcelo SÃ;

I have two questions. One, in the earnings release, when you talk about the revenue of the company, you say that there was a positive impact in the quarter on the back of sale of energy in the spot market. When I look at the table that you guys provide, I think that

impact was BRL 15 million in CEMAR and around BRL 34 million in CELPA. So my question here is, is -- are these companies overcontracted or not? I mean, it's within the range of 105%. So in this case you don't need to adjust your EBITDA? Or is above that? This was not clear to us.

**A - Eduardo Haiama {BIO 7279971 <GO>}**

Thank you, Marcelo. Regarding the spot sales, basically today, it's (mature) in our results. So we did recognize sales from that. But given that we -- today, we're within the 105%, we have accrued a regulatory liability, let's say, right, to compensate for that. By year-end, it's still unclear to us if we are going to be above the 105%. So that we might recognize some gains. But today it's hard to tell you.

**Q - Marcelo SÃ;**

Got it. It's clear. Another question, if you can -- if you guys can comment a little bit more about the call option that Eletrobras has to buy CEPISA shares six months from now. I think in the last conference call, what I understood from you guys was that a valuation would be based by -- let's say, a valuation report was not going to be based on book value. But then I talked to some clients that understood that the valuation of the call option would be book value. So can you comment a little bit more on that?

**A - Eduardo Haiama {BIO 7279971 <GO>}**

We stick to what we said. I mean, it's an appraisal, in order to make the first capital increase. So it's all I can say.

**Q - Marcelo SÃ;**

So in theory, it could be more than book value. For example, if -- I'd say, people start to -- the valuation report, it starts to pricing and potential synergy that you guys might have. And then it could be something like this? Or it would be something more close to book?

**A - Eduardo Haiama {BIO 7279971 <GO>}**

Marcelo, do you agree that today book to value is negative, right? The book value, per se, is negative. So...

**Q - Marcelo SÃ;**

Yes. But then it's going to be based on the capitalization, right? How much money you put there?

**A - Eduardo Haiama {BIO 7279971 <GO>}**

Yes. And so -- but it's -- what is book value if it's already -- the negative -- the net worth is negative. So there's really no book value, let's say. So it's pure valuation in the end, right? Because otherwise, if we believe that the value of the company would be book value, it would require them to pay us, not like us to pay them. So that's why it's -- I don't understand this reasoning that it needs to be book value. Book value would be negative. So...

## Q - Marcelo SÃ;

For example, you guys are going to do a capital injection in the company right now, right? So you're going to inject BRL 700 million in the company. So let's say that Eletrobras wants to buy a stake in the company. So would you value the company as something close to BRL 700 million? So to buy 30%, it'll be something proportional to the amount of the capitalization? That is my question. Or can it be, like, a valuation will be different from that?

## A - Eduardo Haiama {BIO 7279971 <GO>}

No. We're still, like, preparing this appraisal. I'd rather not answer exactly value that is going to be set. But all I can tell you is, firstly, book value, for me, doesn't represent anything in this case, right? Because it's -- like I said, it's a -- the book numbers shows a deeply negative net worth. So in the end, it was really economic value, right? And the economic value of profits, until we disclose it, again, I cannot tell you, right? But it's going to be economic because, otherwise, it doesn't make sense at all.

## Operator

Mr. (Gabriel Francisco) from (inaudible) will like to pose a question.

## Q - Unidentified Participant

My first one would be regarding Tesa. There was this ruling from the TCU against the recent acquisition of the remaining participation. Would you -- what would be the approach from the company from here? Either take it to the courts? Or if you choose to participate in the probable SPEs auction, would you have preferred rights for the remaining participation? That's my first question.

## A - Eduardo Haiama {BIO 7279971 <GO>}

Thank you, (Gabriel). Regarding the question, yes, we do have preferred rights. So in essence, even if we believe, like, that we're going to have to buy through the auction or asset auction, we have the rights, right? Regarding what we're going to do is, we haven't yet analyzed exactly because we were not given any notes of what -- how they're going to proceed from now. So that's why we're still analyzing this transaction.

## Q - Unidentified Participant

Okay. No, no, very clear. My second one, there were some news that the governor of Piauí is requesting a reimbursement of -- to the order of BRL 800 million, if I'm not wrong, regarding this auction. I just wanted to confirm, is this something that only pertains to the government and Eletrobras and has no relationship with Equatorial at all? Or do you see this as a possible risk?

## A - Eduardo Haiama {BIO 7279971 <GO>}

No. It's -- we don't see it as a risk for Equatorial, right? As far as I'm concerned, it's an agreement that was made in the past through the privatization back in the '90s. But nothing to do with the sale itself.

## Operator

Mrs. Maria Carolina Carneiro from Cr dit Suisse would like to pose a question.

### Q - Carolina Carneiro

I have 2 questions. First, starting with the loss ratio trend for CEMAR. We noticed in the fiscal in this quarter an acceleration of the loss reduction. I just wanted to check if there was any nonrecurring related to that, or new action plan here that provided these better results? And if not, if this is the type of trend that we could see for the next quarters in relation to this unit? And secondly, if you could comment a little bit just on the expectations that we could have right now, given the federal government has not been able thus far to put the project of law regarding the other distribution units of Eletrobras to the voting floor of the Senate, if you guys think there is any alternative option for the auction to occur? And if not, of course, if the company would still be interested in taking a look at the assets available for sale in case the project of law is not placed in Senate?

### A - Eduardo Haiama {BIO 7279971 <GO>}

Thank you, Carolina. Regarding the loss ratio at CEMAR, we are continuously revising what kind of load levels we can reach. Certainly, it's not going to be 0, right? It's not going to be like 12%, (so they're) going to 0 the nontechnical loss. And the pace of the loss reduction, you cannot keep estimating that we're going to be able to reduce at that aggressive levels each quarter, given the low levels we have already reached. So trying to answer in a simple way, I mean, we believe we have room to reduce in -- without increasing costs. But given that it's become scarce and costs are spread out for the concession, it's not going to be the kind of a drop you're going to see every quarter, right? It can be like a fluctuating a little bit up, a little bit down. But on a downward trend, okay? I don't know if it helps you.

### Q - Carolina Carneiro

Yes, okay. It's clear.

### A - Eduardo Haiama {BIO 7279971 <GO>}

Regarding the privatization, if there are other alternatives for the potential sale. First, I believe, like, we haven't yet excluded the potential of a sale without the law that's going to be (a in that turnoff) because there are at least 1 company that has nothing to do with that itself, (inaudible), right, distribution company. As for the others, of course, it makes harder from a valuation-centered point. But we continue to analyze because the way we see it, of course, it's for some companies probably going to be almost impossible. But if you remember, when we bought CELPA back in 2012, CELPA had a (regulated) system. And by the time, it was big relatively to the size of the company, right. The company by that time has an EBITDA around like a BRL 200 million, BRL 200-something million. And the regulated system represented an annual subsidies around like a BRL 300 million, BRL 300-something million. So it got big. And it didn't prevent us to go after CELPA. So not necessarily. For some assets we might need this -- a new law. But we, like I said, we are (starting), we haven't yet concluded in the analysis.

## Operator

Mr. Vinicius Tsubone from HSBC would like to pose a question.

### Q - Vinicius Tsubone {BIO 20139966 <GO>}

I have a question regarding the SUDENE tax benefits for CEMAR and CELPA. I know these expire in 4, five years from now. But I wanted to know if you can request the renewal of these in advance. And if you have a deadline to do that.

### A - Eduardo Haiama {BIO 7279971 <GO>}

Vinicius, yes, you can request before the expiration of the current benefit that we have. And yes, we have already applied for that. So we are already, like, discussing all the paperwork to renew again.

### Q - Vinicius Tsubone {BIO 20139966 <GO>}

And do you have an estimate on when will you receive an answer?

### A - Eduardo Haiama {BIO 7279971 <GO>}

No. I mean, we don't have a specific date. But I can say, like, that the analysis and discussions, they're already advanced. So we do expect to renew it soon. But to say a specific date is difficult.

## Operator

Mr. Gustavo Miele with Itau BBA would like to pose a question.

### Q - Gustavo Miele {BIO 21077665 <GO>}

I have 2 questions on CELPA. The first one is that you mentioned that you have, like, a quarter-over-quarter decrease in Commercial losses in the disco. And you plan to close this gap even more in the following quarters. My question is, how do you plan to do so? Should we expect like a minor hike in SG&A expenses in the future to do so, or no? Maybe this would come through like a modernization CapEx or another measure that wouldn't pose like a very relevant risk for SG&A expense in the future. That's my first question.

### A - Eduardo Haiama {BIO 7279971 <GO>}

Thank you, Gustavo. Regarding CELPA's losses, we believe, like, we're going to continue to be able to reduce some losses without any increasing costs. And the reason is, over time, when we start to cut losses back in 2013, '14, you can say, like, you have lots of low-hanging fruit. So it was really visual for you to spot losses. Then as you keep reducing losses, of course, it's becoming harder and harder. If you look at what we did at CEMAR, every single year that we reduced losses, our costs didn't go up. And it's simple, why is that? Because over time, when losses becomes not like a low-hanging fruit, like very big ones like it was back in 2012, '13, we have to start to increase some tools that we implemented in CEMAR that allow us to keep monitoring losses at smaller and smaller regions. So that whenever we go to that region to eliminate the losses, we can spot very



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fast if the losses are going up again. So instead of having losses becoming completely uncontrolled, then we're going to have to make a very big work again to reduce the losses. We spot it much earlier when there's a symptom of losses bouncing back so that we can keep the maintenance costs low. So over time, what is going to happen. And you're going to see us, we have been monitoring, for example, BelÃ©m, that is the capital, one of the biggest cities, smaller and smaller regions, right. So that we can in every single month or shorter period of time, we can see if there is a pickup in losses in the region where we have already eliminated losses, right. So that we can send a team to inspect to make sure, like, it won't bounce back.

**Q - Gustavo Miele** {BIO 21077665 <GO>}

Perfect, Eduardo. It's very clear. Just another very quick question (concerning) CELPA. Can you provide us a very short summary of how is the energy recovery program in the disco, please?

**A - Eduardo Haiama** {BIO 7279971 <GO>}

Regarding energy recovery (inaudible), is that right?

**Q - Gustavo Miele** {BIO 21077665 <GO>}

The energy recovery program.

**A - Eduardo Haiama** {BIO 7279971 <GO>}

From the past that we collect, right? The charge for the past consumption, right?

**Q - Gustavo Miele** {BIO 21077665 <GO>}

Exactly.

**A - Eduardo Haiama** {BIO 7279971 <GO>}

Well over time, it's going down for the simple fact that I've given that our total loss is going down. We find less energy to collect, right, from the past. So that the amount of energy we are charging consumers over time, the cost is going to smaller and smaller. In terms of how low we have been charging for past consumption, if I'm not wrong, today, it's not that different from the past. It's around probably nine months of consumption, more or less, right, of past consumption. Then this number is more or less stable since we started the loss-reduction program.

**Operator**

(Operator Instructions) 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 would like to reinforce our commitment in delivering differentiated appreciation to our shareholders through exceptional financial and operating results. We

also would like to highlight our adherence to the highest level of transparency in corporate governance and reassure that both me and our investors relations team are available should you have any further questions. Thank you, all, again, for participating in our Second Quarter conference call. And have a good day.

## Operator

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

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