

Second Party Opinion

Equatorial's Green Bond Framework

Dec. 02, 2021

Equatorial Energia S.A. (Equatorial), through its subsidiaries, generates, transmits, distributes, and sells electricity and provides fiber optic networks to businesses and residents. It operates mainly through its regulated electricity distribution network subsidiaries. The company currently distributes energy in six states, in the northern, northeastern, and southern regions of Brazil. We expect that by early 2022, Equatorial's distribution network will cover 9.8 million consumers, including businesses and residents. Following the completion of Echoenergia (see below), which is pending the antitrust approval, the company will start generating renewable energy through wind farms in the northeastern region of Brazil, becoming an integrated energy group. In addition, Equatorial recently won the concession rights to operate water and wastewater utility services in the state of Amapá through a consortium 80% of which the company controls.

In our view, Equatorial's green bond framework is aligned with:

 Green Bond Principles (GBP), International Capital Market Association (ICMA), 2021

Issuer's Sustainability Objectives

Since July 2021, Equatorial is a signatory of the United Nations (U.N.) Global Compact, a voluntary initiative for companies to report on the embeddedness of sustainability principles in their activities. Equatorial commits to report annually on its progress to embed such principles in its operations.

Equatorial is currently developing its strategy to reduce the environmental footprint of its operations, to supplement what's essential for environmental licensing of its projects. Nevertheless, the company is committed to helping expand Brazil's wind and solar power generation capacity, along with the share of such energy sources in the country's energy mix, in line with the country's 2030 Energy Expansion Plan. Equatorial expanded its operations in the past years by acquiring distribution concessions with poor operations from other groups, improving network reliability for its customers. Part of Equatorial's social commitments consists of expanding its distribution networks to previously disconnected areas, in line with the country's Luz Para Todos Program.

Equatorial has developed a green bond framework to finance part of the acquisition of Echoenergia, which the company announced in October 2021. Echoenergia is a pure-play renewable energy entity, currently operating nine wind farms and the related transmission infrastructure, with additional three farms expected to become operational in January 2022. Echoenergia expects to start operating its first solar farm (out of the current five projects in its pipeline) in August 2023. The projects will be located in the states of Bahia, Piauí and Rio Grande do Norte.

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Second Party Opinion Summary

Use of proceeds

Alignment  Equatorial's green bond framework is aligned with this component of the GBP.

Score Not aligned **Satisfactory** Strong Advanced

Equatorial commits to use an amount equivalent to the net proceeds of local bonds issued under its green bond framework to partly fund the acquisition of Echoenergia, providing a clear description of the assets (wind and solar farms) that fit into GBP's eligible green project category of renewable energy.

Process for project evaluation and selection

Alignment  Equatorial's green bond framework is aligned with this component of the GBP.

Score Not aligned **Satisfactory** Strong Advanced

Equatorial's framework outlines the process and criteria to select eligible projects in accordance with the Principles. Although the framework's scope is limited only to a single acquisition, Equatorial has defined which type of projects are eligible for its green bond framework and how the acquisition aligns with its environmental sustainability objective. While the ultimate designation of a project as an eligible green project is the responsibility of Equatorial's board of directors, this framework is limited in its scope to only a single instance of review by this internal group. Finally, Equatorial's framework describes the processes that the company has in place to ensure that the environmental and social risk associated with its projects are identified and managed.

Management of proceeds

Alignment  Equatorial's green bond framework is aligned with this component of the GBP.

Equatorial's framework commits to managing an amount equal to the net proceeds of the bonds issued under its framework on a separate account that will support and document Equatorial's funding of eligible projects until full allocation. The issuer identifies that its treasury department will be responsible for tracking and managing these funds. Even though the framework states that the temporary allocation of the net proceeds will be managed in accordance with its cash management policies and investment mandates, it doesn't specify the timeframe of such temporary allocation, the scope of the investments or whether it involves liability management, which we view as lagging behind market best practices.

Reporting

Alignment  Equatorial's green bond framework is aligned with this component of the GBP.


Score Not aligned **Satisfactory** Strong Advanced

Equatorial commits to report on the allocation of funds toward the acquisition and the environmental impact of Echoenergia's assets until full allocation through an annual green bond investor letter. The allocation of proceeds section of such report will be verified by an external auditor.

Green Bond Framework Assessment

Use of proceeds

The Principles make optional recommendations for stronger structuring practices, which inform our alignment opinion as satisfactory, strong, or advanced. For the use of proceeds, we consider the commitments and clarity on how the proceeds are used.

 Equatorial's green bond framework is aligned with this component of the GBP.

Commitments score

Not aligned **Satisfactory** Strong Advanced

We consider Equatorial's overall use of proceeds commitments to be satisfactory.


Equatorial's framework aligns with the Principles due to its commitment to allocating an amount equal to the net proceeds of issuances made under its green bond framework toward eligible green projects, specifically Echoenergia's wind and solar farms.

The wind power generation assets consist of 12 farms (nine operational and three upcoming in January 2022), with a total installed capacity of 1.2 gigawatts (GW). Echoenergia currently has five solar farms under development, the first expected to become operational in August 2023. Echoenergia expects to have a total of 1.1 GW in installed capacity from its solar farms by 2026. Through these projects, Equatorial will help reduce the use of carbon-intensive electricity sources in Brazil, contributing to the environmental objective of climate change mitigation, as identified in the framework.

In addition, each year, Equatorial will disclose the proportion of proceeds allocated to refinanced projects as part of its green bond investor letter. However, the framework doesn't specify any look-back period for refinanced projects.

Process for project evaluation and selection

The Principles make optional recommendations for stronger structuring practices, which inform our alignment opinion as satisfactory, strong, or advanced. For our process for project selection and evaluation, we consider the commitments and clarity on the process used to evaluate and select eligible projects to fund with the proceeds of the sustainable finance instrument.

 Equatorial's green bond framework is aligned with this component of the GBP.

Commitments score

Not aligned **Satisfactory** Strong Advanced

We consider Equatorial's overall process for project selection and evaluation commitments to be satisfactory.

Equatorial's green bond framework provides a description of the process of selection and evaluation in accordance with the Principles. The ultimate selection and evaluation of eligible green projects is done by the board of directors. As part of this selection process, each potential project is verified by Equatorial, which ensures that the project is fully in compliance with the relevant environmental and social regulations and standards. Furthermore, the company integrates an evaluation of a project's potential to deliver long-term net environmental benefits into the selection process. We believe that these embedded processes help to further align the framework with the Principles, because they serve to identify and manage perceived social and environmental risks associated with the eligible projects.

A strong feature of the framework is reflected in the allocation of responsibility to an internal group at the company as a final decision maker as to the eligibility of a green project under this framework. The inclusion of an internal group with assigned responsibilities is a feature we view positively. However, while we acknowledge that the framework relates to a single acquisition, the evaluation and selection process in the framework doesn't incorporate clear eligibility criteria grounded on market-based taxonomies, standards, or certifications for the eligible project categories, which we typically consider a stronger practice per the Principles.

Management of proceeds

The Principles require disclosure of the issuer's management of proceeds from sustainable finance over the life of the funding. The alignment opinion focuses on how clear in the documentation is the issuer's commitment to ensure that the funds raised will remain dedicated to eligible sustainability projects throughout the life of the sustainable finance funding.

 Equatorial's green bond framework is aligned with this component of the GBP.

Equatorial commits to managing an amount equal to the net proceeds of the local bond issuances under this framework through a separate sub-account, which will be managed by Equatorial's treasury department. Equatorial commits to having the verification of the allocation of funds toward its eligible project (Echoenergia's acquisition) by an external auditor, and will provide such information on its green bond investor letter.

Until the net proceeds are allocated to the payment of the acquisition, Equatorial commits to managing the proceeds in accordance with its cash management policies and investment mandates. While not specified in the framework, we understand these to include potential repayments of outstanding short-term debt maturities, which we view as lagging behind market best practices. We would view a detailed commitment to maintain an amount equal to the net proceeds of the issuances available in cash or other short-term securities to be more in line with market best practices.

Reporting

The Principles make optional recommendations for stronger disclosure practices, which inform our disclosure opinion as satisfactory, strong, or advanced. We consider plans for updates on the sustainability performance of the issuer for general purpose funding, or the sustainability performance of the financed projects over the lifetime of any dedicated funding, including any commitments to post-issuance reporting.

 Equatorial's green bond framework is aligned with this component of the GBP.

Disclosure score

Not aligned

Satisfactory

Strong

Advanced

We consider Equatorial's overall reporting practices to be satisfactory.

As part of the reporting process prescribed by Equatorial's framework, the company will provide an annual green bond investor letter which, until full allocation, will include a description of Echoenergia's assets, the allocated amount, and their main environmental impacts, defined in the framework as the installed renewable energy generation capacity and negative environmental impacts avoided and/or reduced of the projects. Additionally, this annual letter which will be publicly available on Equatorial's website, will contain information about the allocation of the net proceeds between new projects and refinancing and any unallocated balance within the designated sub-account for the local bonds issued under this framework. Finally, the framework commits to disclosing any developments in Equatorial's Green Bond reporting within the letter to investor as well.




A strong feature of the framework is Equatorial's commitment to have an independent third-party verification or audit of its allocation reporting and internal tracking register post-issuance within its investor letter, which we view as mitigating the risk of misallocation of funds. Tempering our assessment of the framework is the company's lack of commitment to disclosing the key underlying methodology and assumptions which could be used to calculate the quantitative performance measures of the main environmental impacts it will be reporting in its annual letter.

Mapping To The U.N.'s Sustainable Development Goals

The Sustainable Development Goals (SDGs), which the U.N. set up in 2015, form an agenda for achieving sustainable development by 2030.

We use the International Capital Market Association's (ICMA's) SDG mapping for this part of the report. We acknowledge that ICMA's mapping doesn't provide an exhaustive list of SDGs and that ICMA recommends each project category be reviewed individually to map it to the relevant SDGs.

Equatorial's green bond framework intends to contribute to the following SDGs:

Use of proceeds	SDGs
Renewable Energy	   *7. Affordable and clean energy *8. Decent work and economic growth 13. Climate action

*The eligible project categories link to these SDGs in the ICMA mapping.

Second Party Opinion

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