Financial Statements

Arcoverde Transmissão de Energia S.A.

December 31, 2018
with Independent Auditor’s Report

Arcoverde Transmissão de Energia S.A.

Financial statements

December 31, 2018

Contents

Building a better working world

A free translation from Portuguese into English of Independent Auditor's Report on financial statements prepared in Brazilian currency in accordance with the accounting practices adopted in Brazil

INDEPENDENT AUDITOR'S REPORT ON FINANCIAL STATEMENTS

To the Shareholders, Board of Directors and Officers
Arcoverde Transmissão de Energia S.A.
São Paulo – SP

Opinion

We have audited the financial statements of Arcoverde Transmissão de Energia S.A. (the "Company"), which comprise the statement of financial position as at December 31, 2018, and the statements of profit or loss, of comprehensive income, of changes in equity, and of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of Arcoverde Transmissão de Energia S.A. as at December 31, 2018, and its financial performance and cash flows for the year then ended, in accordance with the accounting practices adopted in Brazil.

Basis for opinion

We conducted our audit in accordance with Brazilian and International Standards on Auditing. Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of financial statements section of our report. We are independent of the Company in accordance with the relevant ethical principles set forth in the Code of Professional Ethics for Accountants, the professional standards issued by Brazil's National Association of State Boards of Accountancy (CFC) and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Responsibilities of management and those charged with governance for the financial statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with the accounting practices adopted in Brazil, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting, unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company's financial reporting process.

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Brazilian and International Standards on Auditing will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with Brazilian and International Standards on Auditing, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

São Paulo, April 29, 2019.

ERNST & YOUNG
Auditores Independentes S.S.
CRC-2SP034519/O-6

Adilvo França Junior
Accountant CRC- 1BA021419/O-4-T-SP

Arcoverde Transmissão de Energia S.A.

Statement of financial position
December 31, 2018 and 2017
(In reais)

	Note	2018	2017
Assets			
Current assets			
Cash and cash equivalents	**6**	15,423,990	1,607,766
Prepaid expenses	**7**	231,352	115,510
Taxes recoverable		4,846	77,499
Advances to suppliers and employees	**8**	13,433,990	6,765,959
		29,094,178	**8,566,734**
Noncurrent assets			
Prepaid expenses	**7**	243,888	329,452
Advances to suppliers	**8**	5,483,654	-
Concession infrastructure – contractual assets	**9**	236,526,719	4,617,928
Judicial deposits and guarantees		39,000	-
Property and equipment		79,924	-
Intangible assets		64,530	-
		242,437,715	**4,947,380**
Total assets		**271,531,893**	**13,514,114**
Liabilities and equity			
Current liabilities			
Trade accounts payable	**10**	49,854,457	12,451
Loans and financing	**12**	68,899,700	12,335,999
Income and social contribution taxes	**11**	2,674,011	177,730
Payroll and related charges		1,506,541	551,659
		122,934,709	**13,077,839**
Noncurrent liabilities			
Deferred taxes	**13**	44,308,695	429,225
		44,308,695	**429,225**
Equity			
Capital	**14a**	65,000,000	100
Accumulated losses	**14b**	39,288,489	6,950
		104,288,489	**7,050**
Total liabilities and equity		**271,531,893**	**13,514,114**

See accompanying notes.

Arcoverde Transmissão de Energia S.A.

Statement of profit or loss
Years ended December 31, 2018 and 2017 (in reais)

	Note	2018	2017
Net operating revenue	**15**	208,768,354	4,192,283
Operating expenses	**16**	(144,339,727)	(4,160,923)
Gross profit		**64,428,627**	**31,360**
Expenses			
General and administrative expenses	**17**	(2,030,953)	-
Income (loss) before finance income (costs)		**62,397,674**	**31,360**
Finance income/(costs)	**18**	(2,370,420)	(20,830)
Finance income		200,735	-
Finance costs		(2,571,155)	(20,830)
Income before income and social contribution taxes		**60,027,254**	**10,530**
Income and social contribution taxes			
Deferred	**19**	(21,857,733)	(3,580)
Net income for the year		**38,169,521**	**6,950**

See accompanying notes.

Arcoverde Transmissão de Energia S.A.

Statement of comprehensive income
Years ended December 31, 2018 and 2017 (in reais)

	2018	2017
Net income for the year	**38,169,521**	**6,950**
Total comprehensive income	**38,169,521**	**6,950**

See accompanying notes.

Arcoverde Transmissão de Energia S.A.

Statement of changes in equity
Years ended December 31, 2018 and 2017 (in reais)

	Subscribed capital	(-) Unpaid capital	Legal reserve	Retained profit reserve	Retained earnings (Accumulated losses)	Total
Company incorporated on May 26, 2017	1,000	(900)	-	-	-	100
Net income for the period	-	-	-	-	6,950	6,950
Allocation of income						
Set-up of legal reserve	-	-	200	-	(200)	-
Set-up of retained profits reserve	-	-	-	6,750	(6,750)	-
Balances at December 31, 2017	**1,000**	**(900)**	**200**	**6,750**	**-**	**7,050**
Payment of capital	-	900	-	-	-	900
Capital increase as per AGE of July 31, 2018	8,500,000	-	-	(6,683)	-	8,493,317
Capital increase as per AGE of October 31, 2018	40,960,000	-	-	-	-	40,960,000
Capital increase as per AGE of November 13, 2018	15,539,000	-	-	-	-	15,539,000
Net income for the year	-	-	-	-	38,169,521	38,169,521
Adoption of CPC 47, effective as from January 1, 2018	-	-	-	-	1,118,701	1,118,701
Set-up of legal reserve	-	-	1,964,411	-	(1,964,411)	-
Set-up of retained profit reserve	-	-	-	37,323,811	(37,323,811)	-
Balances at December 31, 2018	**65,000,000**	**-**	**1,964,611**	**37,323,878**	**-**	**104,288,489**

See accompanying notes.

Arcoverde Transmissão de Energia S.A.

Statement of cash flows
Years ended December 31, 2018 and 2017 (in reais)

	2018	2017
Cash flow from operating activities		
Net income for the year	**38,169,521**	**6,950**
Non-cash P&L items		
Deferred income and social contribution taxes	21,857,733	3,580
Deferred federal contribution taxes on gross revenue for Social Integration Program (PIS) and for Social Security Financing (COFINS)	21,279,419	425,645
Adoption of CPC 47, effective as from January 1, 2018	1,854,236	-
Interest on loans and financing	185,230	19,705
(Increase) decrease in operating assets		
Concession infrastructure – contractual assets	(231,908,791)	(4,617,928)
Judicial deposits and guarantees	(39,000)	-
Taxes recoverable	(4,846)	-
Prepaid expenses	(30,278)	(444,962)
Advances to suppliers and employees	(12,151,685)	(6,765,959)
Other	77,499	(77,499)
Increase (decrease) in operating liabilities		
Trade accounts payable	49,842,006	12,451
Interest paid	(1,345,198)	-
Income and social contribution taxes	1,396,552	177,730
Payroll and related charges	2,364,278	551,659
Cash flow used in operating activities	**(108,453,324)**	**(10,708,628)**
Cash flows from investing activities		
Acquisition of property and equipment	(79,924)	-
Acquisition of intangible assets	(64,530)	-
Cash flow used in investing activities	**(144,454)**	**-**
Cash flow from financing activities		
Capital increase	64,993,219	100
Loans raised	83,418,143	12,316,294
Loans repaid	(25,997,360)	-
Cash flow from financing activities	**122,414,002**	**12,316,394**
Changes in cash and cash equivalents	**13,816,224**	**1,607,766**
Cash and cash equivalents at beginning of year	**1,607,766**	**-**
Cash and cash equivalents at end of year	**15,423,990**	**1,607,766**

See accompanying notes.

Years ended December 31, 2018 and 2017 (In reais)

1. Operations

Arcoverde Transmissão de Energia S.A. ("Company" or "SE Vineyards") was incorporated on May 26, 2017 as a privately-held corporation engaged specifically and solely in exploring transmission utility concessions, provided by means of implementation, construction, operation, and maintenance of transmission facilities, including support and administrative services, provision of equipment and reserve materials, programming, measurements, and other supplementary services required for electric power transmission. These activities are regulated by the Brazilian Electric Power Regulatory Agency (ANEEL).

The Company is headquartered at Avenida Rio Branco, nº 1 - 12º andar, city and state of Rio de Janeiro, and is controlled by Sterlite Brazil Participações S.A. ("Parent Company" or "Sterlite Group"), which is a subsidiary of Sterlite Power Grid Ventures Limited ("SPGVL"), located in New Delhi, Republic of India.

1.1. Concession

The Company has the right to explore the following Electric Power Transmission Utility contract:

			Periodic Tariff Review			Annual Revenue Allowed (RAP)	
Agreement	**Period (years)**	**Effective until**	**Term**	**Next**	**Adjusted at**	**R$**	**Base month**
35/2017	30 years	08/10/2047	5 years	2022	IPCA	24,600,000	10/2016

On April 24, 2017, Sterlite Group won ANEEL Auction No. 005/2016 with annual revenue allowed (RAP) amounting to R$24,600,000 and discount of 25.87% on maximum RAP presented by ANEEL, of R$33,185,580. The concession contract was signed on August 11, 2017. The Company will enter into operation until August 11, 2021.

The Company plans to implement and explore the venture that comprises the following electric power transmission facilities in the state of Pernambuco:

(i) Transmission line, alternated current, 230kV, between substations Caetés II and Arcoverde II, in single circuit, with approximate length of 50 km;

(ii) Transmission line, alternated current, 230kV, between substations Garanhuns II and Arcoverde II, in single circuit, with approximate length of 89 km;

(iii) Substation Arcoverde II, in the state of Pernambuco, with patio of 230 kV to receive the conversion station and its equipment and patio in 230/69 - 13.8 kV, connected by a bench of two monophasic transformers of 100 MVA;

(iv) New patio in Substation Garanhuns II, in the state of Ceará, to receive the conversion station and its equipment and patio in 230/69 - 13.8 kV, connected by a bench of two monophasic transformers of 100 MVA; and

(v) Transformation unit connections, line inputs, bar interconnections, bars, linked and other facilities required for measurement, supervision, protection, command, control, telecommunication, management and support of operations.

2. Presentation of financial statements

2.1. Statement of compliance

The Company's financial statements were prepared in accordance with accounting practices adopted in Brazil, which include provisions contained in the Brazilian Corporation Law and accounting standards and procedures issued by the Brazilian Financial Accounting Standards Board (CPC).

2.2. Basis of preparation

The financial statements were prepared and are presented in accordance with the accounting practices adopted in Brazil, which include the Brazilian Corporation Law provisions, and pronouncements, interpretations and guidance issued by the Brazilian Financial Accounting Standards Board (CPC), approved by Brazil's National Association of State Boards of Accountancy (CFC), and provide all significant information specific to the financial statements, and only such information, which is consistent with that used by management.

The Company recorded no other comprehensive income; as such, net income for the period is the only item in total comprehensive income.

The financial statements were prepared based on the historical cost, unless otherwise stated, as described in the accounting practices below. Historical cost is based on the consideration paid in exchange for assets.

The financial statements were approved by management on April 29, 2019.

2.3. Estimates and assumptions

The financial statements were prepared following various measurement bases used in the accounting estimates. The accounting estimates involved in the preparation of these financial statements were based on management's judgment to determine the adequate amounts to be recorded in the financial statements. Significant items subject to these estimates and assumptions include the valuation of concession-related contractual assets under the present value adjustment method, analysis of credit risk to determine allowance for doubtful accounts as well as other risk analyses to determine other provisions, including provision for contingencies. The Company reviews its estimates at least on an annual basis.

Accounting for concession contracts

In accounting for concession contracts, the Company conducts analysis that involve judgment by management concerning applicability of the interpretation of concession contracts, determination and classification of infrastructure implementation expenses as contractual assets.

Timing for recognition of contractual assets

Company management assesses the timing for recognition of concession-related assets based on the economic characteristics of each concession contract. The contractual asset originates to the extent that the concession operator satisfies the obligation to build and implement the transmission infrastructure. Revenue is recognized over project time. The contractual asset is matched against infrastructure implementation revenue, which is recognized based on expenses incurred.

Determination of the discount rate for contractual assets

The rate applied to the contractual asset is the discount rate that would be reflected in a separate financing transaction between the entity and its customer at agreement inception. This rate would reflect the credit characteristics of the party receiving financing under the contract, as well as any guarantee or guarantee provided by the customer or entity, including the assets transferred in the contract. The rate to price the financial component of the contractual asset is established at inception date of each concession contract. When the Granting Authority reviews or restates revenue that the Company is entitled to receive, the contractual asset amount is adjusted to reflect the reviewed flows, and this adjustment is recorded as income or expenses in P&L.

Determination of infrastructure implementation revenues

When the concession operator provides infrastructure implementation services, revenue from infrastructure implementation is recognized at fair value plus respective costs relating to infrastructure implementation services provided, resulting in a profit margin relating to infrastructure implementation when crosschecked against the fair value of the service consideration via Annual Revenue Allowed (RAP). Positive or negative variations relating to the estimated margin are posted to P&L when incurred.

Determination of revenue from operation and maintenance

After commencement of operations, when the concession operator provides operation and maintenance services, revenue is recognized at fair value. One of the parameters used are the amounts estimated by the Granting Authority and respective costs, as per service consideration amounts.

2.4. Foreign currency translation

The Company's functional currency is the Brazilian real, which is also its reporting currency.

2.5. Classification into current and noncurrent

Assets and liabilities are presented in the statement of financial position and classified into current or noncurrent. An asset is classified as current when: it is expected to be realized or intended to be sold or consumed in the normal operating cycle, it is held mainly for trading, it is expected to be realized within twelve months after the reporting period or it refers to cash or cash equivalents.

A liability is classified as current when it is expected to be settled in the normal operating cycle, held mainly for trading, expected to be realized within twelve months after the reporting period or there is no unconditional right to defer settlement of the liability for at least twelve months. Other assets and liabilities are classified as noncurrent.

2.6. Regulatory financial statements

In line with the Electric Power Sector Accounting Manual (MCSE), the Company is required to disclose the Regulatory Financial Statements (DCR) in which the complete set of financial statements are disclosed for regulatory purposes, to be presented independently of these corporate financial statements. The DCRs and the financial statements for corporate purposes will be audited by the same firm and, as determined in the MCSE and ANEEL Decision No. 4356, of December 22, 2017, will be made available on the Agency's and the Company's websites by April 30, 2019.

3. Summary of significant accounting practices

3.1. Cash and cash equivalents

Cash and cash equivalents are held so as to meet short-term cash commitments, rather than for investment or other purposes. The Company considers cash equivalents short-term investments readily convertible into a known cash amounts subject to a low risk of change in value. As such, investments are usually classified as cash equivalents when redeemable in the short term, that is, within three months as from inception date.

3.2 Concession infrastructure – contractual assets

The concession operator acts as a service provider, as set forth in the concession contract. The concession operator implements, expands, reinforces, or improves the infrastructure (infrastructure implementation services) used to provide a public service, in addition to operating and maintaining such infrastructure (operation and maintenances services) over a given period. The power transmission company receives compensation for making the infrastructure available over the concession term.

The concession contract does not transfer the right to control the use of the utility infrastructure to the concession operator. The transfer of ownership of such items only occurs for performance of the utility services, to be reversed to the Granting Authority after termination of the contract. The concession operator has the right to operate the infrastructure to provide the utility services on behalf of the Granting Authority, under the conditions established in the concession contract.

The concession operator should record and measure revenue from the services provided in accordance with Accounting Pronouncements CPC 47 – Revenue from Contracts with Customers and CPC 48 – Financial Instruments, and ICPC 01 (R1) – Service Concession Arrangements. Should the concession operator perform more than one service under a single contract, the compensation received or receivable should be allocated to each performance obligation based on the amounts related to the services rendered, if the amounts are separately identifiable.

The concession asset records receivables referring to implementation of the infrastructure and revenue from compensation of the concession-related assets.

Contractual assets

The Company's concession was classified within the contractual asset model, as of January 1, 2018, according to adoption of CPC 47 – Revenue from Contracts with Customers. The contractual asset originates as the concession operator satisfies the obligation to construct and implement the transmission infrastructure, and revenue is recognized over the project term. Receipt of the cash flow is conditional upon satisfaction of the performance obligation related to operation and maintenance. Monthly, as the Company operates and maintains the infrastructure, the portion of the contractual asset equivalent to the consideration for that month for satisfaction of the performance obligation to build becomes a financial asset, given that the receipt of the amount relies only on the lapse of time. The benefits from such asset are future cash flows.

The value of the contractual assets of the power transmission concession operators is calculated by means of the present value of future cash flows. The future cash flow is estimated at the commencement of the concession, or upon its extension, and the measurement assumptions are reviewed on occasion of the Periodic Tariff Review (RTP).

Cash flows are defined based on the Allowed Annual Revenue (RAP), which is the consideration that the concession operators receive for the provision of the transmission utility service to users.

These receipts amortize investments in this transmission infrastructure and any unamortized investments (reversible assets) generate the entitlement to indemnity from the Granting Authority at the end of the concession contract. This flow of receipts is (i) remunerated at the rate representing the financial component of the business, established at the beginning of each project, (ii) restated by the Extended Consumer Price Index (IPCA).

Implementation of the infrastructure, activity performed during the work phase, is entitled to consideration based on the performance of completion of the work and the performance obligations to operate and maintain, and not only the lapse of time. Revenue recognition and cost of the works are related to the formation of this asset, through expenses incurred.

Thus, the matching entry for the infrastructure implementation services in concession-related assets as from January 1, 2018 is now recognized under as "Infrastructure implementation", classified as a contractual asset, as the right to consideration is still conditional upon the satisfaction of another performance obligation.

Revenue from implementation of infrastructure and from remuneration of concession-related assets are subject to the deferral of cumulative Contribution Tax on Gross Revenue for Social Integration Program (PIS) and for Social Security Financing (COFINS), recognized as Deferred taxes in noncurrent liabilities.

3.3 Property and equipment

These are stated at acquisition or build-up cost, less taxes to be offset, when applicable, and accumulated depreciation.

3.4 Intangible assets

Intangible assets with defined useful life are measured at cost, less accumulated amortization and accumulated impairment loss.

3.5 Provision for impairment

Management annually tests the net book value of the assets in order to determine whether there are any events or changes in economic, operating or technological circumstances that may indicate impairment. When such evidence is found and the net book value exceeds the recoverable amount, a provision for impairment is recorded so as to adjust the net book value to the recoverable amount. These provisions are presented in the notes to the financial statements.

The recoverable amount of an asset item or of a cash-generating unit is defined as the higher of value in use and net sales.

In estimating value in use of an asset item, estimated future cash flows are discounted to present value at a pretax discount rate reflecting the weighted average capital cost (WACC) for the industry in which the cash-generating unit operates.

3.6 Income and social contribution taxes

Current

Income tax is calculated at a rate of 15%, plus 10% surtax on taxable profit exceeding R$240,000 over 12 months, whereas social contribution tax is computed at a rate of 9% on taxable profit, both recognized on an accrual basis. Therefore, additions to book income of temporarily nondeductible expenses or exclusions of temporarily non-taxable revenue upon determination of current taxable profit generate deferred tax assets or liabilities.

Deferred

Deferred taxes arise from temporary taxable differences between the tax bases of assets and liabilities and their carrying amounts.

3.7 Provisions for contingencies

The Company recognizes provision for tax, civil and labor contingencies. Assessment of the likelihood of loss includes analysis of available evidence, the hierarchy of laws, available case law, the most recent court decisions and their relevance in the legal system, as well as the opinion of external legal advisors. Provisions are reviewed and adjusted considering changes in existing circumstances, such as the applicable statutes of limitation, tax audit conclusions, or additional exposures identified based on new matters or court decisions. At December 31, 2018, based on individual analysis of the legal claims, supported by the opinion of its legal advisors, management determined that no claims filed against the Company are expected to be rated as “probable” loss, thus requiring the recognition of provision for labor, civil and tax contingencies.

3.8 Present value adjustment of assets and liabilities

Noncurrent monetary assets and liabilities are adjusted to their present value.

The present value adjustment of current monetary assets and liabilities is calculated and only recorded when the effect is considered significant in relation to the overall financial statements. For purposes of reporting and determination of significance, the present value adjustment is calculated using contractual cash flows and implicit interest rates of the respective assets and liabilities. See item 2.3 for aspects involving determination of the discount rate of the contractual asset.

3.9 Other assets and liabilities

An asset is recognized in the statement of financial position when its future economic benefits are generated and its cost or value can be reliably measured.

A liability is recognized in the statement of financial position when the Company has a legal or constructive obligation arising from a past event, the settlement of which is expected to result in an outflow of economic benefits. Provisions are recorded reflecting the best estimates of the risk involved.

3.10 Determination of profit or loss

Profit or loss from operations is recorded on an accrual basis.

3.11 Operating revenue

Revenues are classified into the following groups:

a) Infrastructure implementation revenue – Services for infrastructure implementation, and expansion, reinforcement and improvement of electric power transmission facilities. Infrastructure revenue is recognized as expenses are incurred, and calculated with addition of PIS and COFINS rates to the investment value. Positive or negative variations in relation to the estimated margin are allocated to P&L as incurred.

All infrastructure implementation revenue is received during the construction work, and positive or negative variations are immediately allocated to P&L as incurred. To estimate the infrastructure implementation revenue, the Company used a model that calculates the cost of financing the customer (in this case the Granting Authority). The rate defined for the net present value of the infrastructure implementation (and operation) margin is defined at the project commencement and does not undergo subsequent changes, calculated according to the customer's credit risk and financing term.

b) Remuneration of the concession-related contractual assets - Interest recognized by the straight-line method based on the discount rate that best represents the financial component of cash flows that remunerate the transmission infrastructure investments, as the specific risks and rewards of the business are considered. The rate seeks pricing of the financial component of the contractual asset, established on the date of commencement of each concession contract. The rate of return is applied to the amount receivable from the future cash receipt flow.

3.12 Financial instruments

The Company applied the requirements of CPC 48 – Financial instruments as from January 1, 2018, regarding the classification and measurement of financial assets and liabilities and the measurement and recognition of impairment losses.

a) Financial assets

Classification and measurement - With adoption of the CPC 48, financial instruments are now classified into three categories: measured at amortized cost, at fair value through other comprehensive income (FVTOCI), and at fair value through profit or loss (FVTPL). The standard also eliminates existing held-to-maturity, loans and receivables, and available-for-sale categories of CPC 38. Classification of financial assets upon initial recognition depends on the characteristics of the contractual cash flows and the business model for management of such financial assets. As from January 1, 2018, the Company discloses financial instruments as follows:

• Financial assets at fair value through profit of loss - Financial assets at fair value through profit or loss comprise financial assets held for trading, financial assets designated upon initial recognition at fair value through profit or loss, or financial assets to be necessarily measured at fair value. Financial assets with cash flows that are not exclusively payments of principal and interest are classified and measured at fair value through profit or loss. Net fair value changes are recognized in P&L.

• Amortized cost - A financial asset is classified and measured at amortized cost when its purpose it to receive contractual cash flows and generate cash flows that are "solely principal and interest payments" on the value of the outstanding principal. Such assessment is conducted at the instrument level. Assets measured at amortized cost use the effective interest rate method, less any impairment loss. Interest income is recognized by applying the effective interest rate, except for short-term receivables, when recognition of interest would be immaterial.

(i) Impairment of financial assets - CPC 48 replaced the “incurred loss” model of CPC 38 by a prospective “expected credit loss” model. The new expected loss model is applicable to financial assets measured at amortized cost or at fair value through other comprehensive income, with the exception of investments in equity instruments. The Company did not identify impairment losses to be recognized in the years presented.

(ii) Write-off of financial assets – The write-off (derecognition) of a financial asset occurs when the contractual rights to cash flows of the asset expire, or when the rights to receive the contractual cash flows on a financial asset are transferred to a third party in a transaction in which substantially all the risks and rewards of the ownership of the financial asset are transferred. Any interest that is created or retained by the Company in such transferred financial assets is recognized as a separate asset or liability.

b) Financial liabilities

Financial liabilities are classified as at fair value through profit or loss when held for trading or designated at fair value through profit or loss. Other financial liabilities (including loans) are measured at amortized cost using the effective interest rate method.

3.13 Cash flow

The statement of cash flows was prepared under the indirect method and is presented in accordance with Accounting Pronouncement CPC 03 (R2) – Statement of Cash Flows.

3.14 Transactions with related parties

Transactions with related parties were, as a general rule, conducted under conditions and terms similar to those observable in the market. Certain transactions that have unique and/or specific characteristics and conditions, and are therefore not comparable, were established on fair terms between the parties in order to adequately remunerate their respective investments and operating costs.

4 Key changes in accounting practices

4.1. Accounting Pronouncement CPC 47 – Revenue from contracts with customers

The Company adopted CPC 47 using the cumulative effect method, with first-time adoption of the standard on January 1, 2018. As a result, the company will not apply the requirements of this CPC to the comparative year presented. The standard also determines that the Company may only account for the effects of a contract with a customer when it is likely that it will receive the consideration to which it will be entitled in exchange for the goods or services that will be transferred.

The Company evaluated its operations in the light of the new accounting standards, and as described in item 3.2, concluded that the infrastructure implementation activity is affected by the new CPC, since the right to the consideration for goods and services is conditional upon compliance with another performance obligation. As a consequence of adoption of CPC 47, the infrastructure implementation concession asset, until then classified as financial asset totaling R$4,617,928 on January 1, 2018, is now classified as a contractual asset, in the amount of R$6,478,946. The difference in the measurement criteria of R$1,861,018 was recorded as retained earnings, net of tax effects.

4.2. Accounting Pronouncement CPC 48 – Financial instruments

CPC 48 combines the three aspects of accounting for financial instruments: classification and measurement, impairment, and hedge accounting.

The Company adopted the new standard and took advantage of the exemption regarding non-presentation of comparative information from prior periods set forth by the simplified initial adoption provision.

Years ended December 31, 2018 and 2017 (In reais)

The table below summarizes the impact from adoption of CPC 47 on retained earnings, net of taxes, on January 1, 2018.

Adoption of CPC 47 and 48 impacted the statements of financial position and of profit or loss on January 1, 2018, as follows:

	Impacts from adoption of CPC 47 and 48 at 01.01.2018
Retained earnings	
Concession infrastructure – contractual assets	1,861,018
Related deferred taxes	(742,317)
Impact on January 1, 2016	**1,118,701**

5 Standards and interpretations issued but not yet in force

Accounting pronouncements, guidance and interpretations, whether new and/or revised by the CPC, effective in the year beginning on or after January 1, 2019, are described below:

CPC 06 (R2) - Leases, issued by the CPC, is equivalent to IFRS 16 - Leases, issued in January 2016 in replacement of the previous version of said standard (CPC 06 (R1), equivalent to IAS 17). CPC 06 (R2) establishes the principles for recognition, measurement, presentation and disclosure of leases and requires lessees to account for all leases according to a single statement of financial position model, similar to accounting for finance leases in accordance with CPC 06 (R1). The standard includes two exemptions from recognition for lessees - leases of "low-value" assets (e.g., personal computers) and short-term leases (i.e., maturing within 12 months). At the commencement date of a lease, the lessee recognizes a liability to make the payments (a lease liability) and an asset representing the right to use the leased asset over the lease term (right-of-use asset). Lessees are required to separately recognize the interest expense on the lease liability and the depreciation expense on the right-to-use asset. Lessees will also have to reassess the lease liability when certain events occur (for example, a change in the lease term, a change in future lease payments as a result of a change to an index or rate used to determine such payments). In general, the lessee will recognize the revalued lease liability as an adjustment of the right-to-use asset. There is no substantial change in lessor accounting based on CPC 06 (R2) in relation to the current accounting in accordance with CPC 06 (R1). Lessors will continue to classify all leases in accordance with the same CPC 06 (R1) classification principle, distinguishing between two types: operating and finance. CPC 06 (R2), which is effective for annual periods beginning on or after January 1, 2019, requires lessees and lessors to make more extensive disclosures than under CPC 06 (R1).

The Company plans to adopt CPC 06 (R2) using the modified retrospective approach and will opt to adopt the standard for contracts that were previously identified as leases, which use CPC 06 (R1) and ICPC 03 - Supplementary aspects of leases. Therefore, the Company will not apply the standard to contracts that have not been previously identified as contracts containing a lease under CPC 06 (R1) and ICPC 03, and will opt to use the exemptions proposed by the standard for lease agreements with a 12-month term from the initial adoption date, and lease agreements whose underlying asset is of low value.

The Company has a small number of lease agreements and the related amounts are not representative. No significant impacts are expected from adoption of CPC 06 (R2).

Annual improvements – 2015-2917 cycle - CPC 32 – Income taxes: The amendments clarify that the consequences of income tax on dividends are related more directly to past transactions or events that generated distributable profits than to distributions to owners. Therefore, the entity recognizes the consequences of income tax on dividends in profit or loss, other comprehensive income, or equity, according to where the entity originally recognized these transactions or past events.

Years ended December 31, 2018 and 2017 (In reais)

Although the CPC has been updated by revision No. 13, this improvement is not applicable to the Company under the Brazilian tax legislation.

Interpretation IFRIC 23 – Uncertainty over income tax treatments - The Interpretation (without a corresponding CPC standard in Brazil, but that will issued as ICPC 22) addresses accounting for income taxes in cases where tax treatment involves uncertainty that affects the application of IAS 12 (CPC 32), and does not apply to taxes outside the scope of IAS 12, nor does it specifically include the requirements regarding interest and fines associated with uncertain tax treatment. The interpretation specifically addresses the following: (i) whether the entity considers uncertain tax treatments separately; (ii) the assumptions that the entity makes regarding the examination of tax treatments by tax authorities; (iii) how the entity determines taxable profit (tax loss), tax bases, unused tax losses, previously unused tax credits and tax rates; and (iv) how the entity considers changes in facts and circumstances.

The entity should determine whether it considers each tax treatment to be uncertain separately or together with one or more uncertain tax treatments. The best approach to solving uncertainty should be followed. The Interpretation is effective for annual periods beginning on or after January 1, 2019, but some transition exemptions are made available. The Company will adopt the interpretation from the date it becomes effective.

6 Cash and cash equivalents

	2018	2017
Cash and bank deposits	-	1,607,766
Short-term investments	15,423,990	-
	15,423,990	1,607,766

Short-term investments, classified as financial assets at fair value through profit or loss, are Bank Deposit Certificates (CDB), remunerated by reference to Interbank Deposit Certificates (CDI).

Years ended December 31, 2018 and 2017 (In reais)

7 Prepaid expenses

	2018	2017
Insurance premium paid in advance	475,240	427,776
Other	-	17,186
	475,240	444,962
Current	231,352	115,510
Noncurrent	243,888	329,452

This refers basically to the guarantee insurance taken out mainly with insurance companies Travellers e AXA, amortized according to the policy conditions, with maturities on April 06, 2019 and May 08, 2022, respectively (Note 21).

8 Advances to suppliers and employees

This refers mostly to funds granted to suppliers related to the construction work and subcontractors, according to the agreed contractual payment conditions, amounting to R$13,433,990, classified as current, at December 31, 2018 (R$6,765.959 at December 31, 2017), and R$5,483,654 as noncurrent, at December 31, 2018 (NIHIL at December 31, 2017). These advances will be written off upon delivery of the goods or according to the subsequent invoices provided by the supplier. Such advances are guaranteed by collaterals received by the respective suppliers.

9 Concession infrastructure – contractual assets

	2018	2017
Opening balance	4,617,928	-
Infrastructure implementation revenue	159,052,040	4,585,039
Infrastructure implementation margin	64,121,458	-
Remuneration of concession assets	6,874,275	32,889
Adoption of CPC 47, effective as from January 1, 2018	1,861,018	-
Closing balance	236,526,719	4,617,928

The Company recognized a service concession receivable according to the current value of the guaranteed annual minimum payments to be received from the Granting Authority, discounted to present value. The rate applied by the Company to discount the contractual asset is the discount rate that would be reflected in a separate financing transaction between the entity and its customer at the beginning of the contract. This rate would reflect the credit characteristics of the party receiving financing under the contract, as well as any guarantee or guarantee provided by the customer or entity, including the assets transferred in the contract.

The power transmission line concessions of the Company are remunerated based on availability of the transmission facilities, which are part of the Basic Grid and of other transmission facilities, not linked to the electric power load transmitted, but to the amount approved by ANEEL when granting the concession agreement.

Years ended December 31, 2018 and 2017 (In reais)

10 Trade accounts payable

	2018	2017
Trade accounts payable related to infrastructure implementation	47,554,132	-
Service providers	1,950,387	12,451
Other	349,938	-
Closing balance	49,854,457	12,451

11 Income and social contribution taxes

	2018	2017
Deferred social contribution tax	20,531	51,187
Withholding income tax (IRRF)	23,166	58,803
Service Tax (ISS)	785,616	-
Unemployment Compensation Fund (FGTS)	81,687	14,867
Social Security Tax (INSS)	1,507,251	52,873
PIS	1,038	-
COFINS	6,386	-
Other	248,336	-
	2,674,011	**177,730**

12 Loans and financing

a) Breakdown of loans and financing is as follows:

Creditor	Charges	2018	2017
Sterlite Power Grid Ventures Limited	-	-	3,436,837
Sterlite Power Grid Ventures Limited	9%		8,899,162
1st issue of debentures	CDI + 2.85%	68,899,700	-
		68,899,700	**12,335,999**

Years ended December 31, 2018 and 2017 (In reais)

Changes in loans and financing

	2018	2017
Opening balance	12,335,999	-
Issue of debentures	70,000,000	-
Intercompany loan	13,418,144	12,316,294
Accrued interest	488,115	19,705
Payment of principal and interest (related parties)	(27,342,558)	-
	68,899,700	**12,335,999**

The Company conducted the first issue of unsecured debentures, on November 14, 2018, comprised of principal and interest, not convertible into shares, maturing and to be settled on May 14, 2020, and remunerated at DI rate + 2.85%.

13 Deferred tax liabilities

	2018	2017
Deferred COFINS	17,976,031	75,867
Deferred PIS	3,902,691	349,778
Deferred income tax	16,476,712	2,632
Deferred social contribution tax	5,953,261	948
	44,308,695	**429,225**

These balances refer to: (i) accounting records of changes relating to CPC 47 – Revenue from Contracts with Customers – which will be performed in proportion to the operations, considering revenue and operating expenses realized and depreciation of concession-related property and equipment; and (ii) PIS and COFINS on revenue from implementation of infrastructure (recognized in accordance with CPC 47 – Revenue from Contracts with Customers), which will be realized based on receipt of revenue from referred to works (concession-related property and equipment).

14 Equity

a) Capital

The Company was associated on May 26, 2017 with authorized capital amounting to R$ 1,000, represented by 1,000 registered common shares with par value of R$ 1.00.

On July 31, 2019, capital was increased by R$8,500,000, through issue of 8,500,000 fully subscribed and paid up registered common shares, at par value of R$1 each, as per Minutes of the Special General Meeting (AGE) held on referred to date.

On October 31, 2019, capital was increased by R$40,960,000, through issue of 40,960,000 fully subscribed and paid up registered common shares, at par value of R$1 each, as per Minutes of the Special General Meeting (AGE) held on referred to date.

Years ended December 31, 2018 and 2017 (In reais)

On November 13, 2019, capital was increased by R$15,539,000, through issue of 15,539,000 fully subscribed and paid up registered common shares, at par value of R$1 each, as per Minutes of the Special General Meeting (AGE) held on referred to date.

As at December 31, 2018, Company subscribed and paid-up capital amounts to R$65,000,000 (R$1,000 at December 31, 2017), represented by 65,000,000 (1,000 at December 31, 2017) subscribed and paid-up registered common shares, at par value of R$1 each. Breakdown of subscribed capital is as follows:

Sterlite Brazil Participações S.A.	100%
	100%

b) Income reserves

Legal reserve (i)	1,964,611
Retained profit reserve	37,323,878
Retained earnings at December 31, 2018	**39,288,489**

(i) Legal reserve is limited at 5% of net income for the year, capped at 20% of capital before allocation.

15 Net operating revenue

	2018	2017
Gross operating revenue		
Infrastructure implementation revenue (a)	159,052,040	4,585,039
Infrastructure implementation margin (a)	64,121,458	
Remuneration of concession-related assets (b)	6,874,275	32,889
Gross profit	230,047,773	4,617,928
Deductions from operating revenue		
Deferred PIS on infrastructure implementation revenue	(2,624,358)	(75,327)
Deferred PIS on infrastructure implementation margin	(1,058,004)	-
Deferred PIS on remuneration of concession-related assets	(113,426)	(540)
Deferred Cofins on infrastructure implementation revenue	(12,087,955)	(347,287)
Deferred COFINS on infrastructure implementation margin	(4,873,231)	-
Deferred Cofins on remuneration of concession-related assets	(522,445)	(2,491)
	(21,279,419)	(425,645)
Net operating revenue	**208,768,354**	**4,192,283**

a) **Infrastructure implementation revenue and margin** - revenue relating to implementation of infrastructure for provision of electric power transmission services under the service concession agreement is recognized based on infrastructure implementation progress. Operation and maintenance service revenues are recognized in the period when the services are provided by the Company, as well as the adjustment portion. When the Company provides more than one service under a service concession agreement, remuneration received is allocated by reference to the fair value of the services delivered.

Years ended December 31, 2018 and 2017 (In reais)

b) **Remuneration of concession-related assets –** this amount is recorded on a straight-line basis at the rate that best represents the financial component of the transmission investments, established at project beginning.

16 Cost of operation

	2018	2017
Infrastructure implementation cost	(144,339,727)	(4,160,923)
Total cost of operation	**(144,339,727)**	**(4,160,923)**

17 General and administrative expenses

	2018	2017
Personnel and charges	(612,275)	-
Third-party services	(159,757)	-
Material	(329,792)	-
Rentals	(45,571)	-
Taxes	(323,134)	-
Insurance	(349,911)	-
Other	(210,513)	-
Total general and administrative expenses	**(2,030,953)**	**-**

18 Finance income/(costs)

	2018	2017
Finance income		
Short-term investment yield	187,540	-
Discounts obtained	13,195	-
	200,735	-
Finance costs		
Interest on loans	(2,176,037)	(19,705)
Commissions and charges	(269,272)	-
Tax on Financial Transactions (IOF)	(124,401)	-
Other	(1,445)	(1,125)
	(2,571,155)	(20,830)
Finance income/(costs)	**(2,370,420)**	**(20,830)**

Years ended December 31, 2018 and 2017 (In reais)

19 Income and social contribution taxes

	2018	2017
Income before income and social contribution taxes	60,027,254	10,530
Statutory rate	34%	34%
Expected income and social contribution taxes	(20,409,266)	(3,580)
Temporary differences	(1,448,467)	-
Effective income and social contribution taxes	**(21,857,733)**	**(3,580)**
Income and social contribution taxes		
Current	-	-
Deferred	(21,857,733)	(3,580)
	(21,857,733)	**(3,580)**

a) Deferred income and social contribution taxes

	2018	2017
Deferred taxes		
Remuneration of concession-related assets and infrastructure implementation margin, net of deferred PIS and COFINS	66,023,450	29,858
Statutory rate (34%)	22,429,973	7,166
Temporary differences	-	(3,586)
Total deferred taxes	**22,429,973**	**3,580**

The balance of R$22,429,973 (R$3,580 in 2017) in noncurrent liabilities refers to income and social contribution taxes on income from infrastructure implementation margin for provision of electric power transmission services and concession assets remuneration (CPC 47), and relating to IRS Revenue Procedure No. 1753/17, recorded on an accrual basis, which are subject to taxation as the amounts are effectively received.

20 Environment

Ruling No. 421/2011 establishes procedures for licensing and compliance with environmental rules in the federal sphere for electric power transmission systems. Worth mentioning, preparation of the Environment Impact Study and Environment Impact Report (EIA/RIMA) based on the Term of Reference issued by the relevant environmental authority.

Environment-related expenses incurred in the year are directly related to preparation of environmental studies, among other licensing phases relating to obtainment of the installation license, as established by the environment regulating authority.

Years ended December 31, 2018 and 2017 (In reais)

21 Insurance

The Company has an insurance agreement that guarantees indemnification up to the amount established in the policy, for damages deriving from nonfulfillment of the obligations assumed by the Company in the master agreement, in connection with the Invitation to Bid of ANEEL Auction No. 005/2016, as well as fines and indemnification due to the public administration.

Indemnification guarantees for construction, supply or provision of services total up to the amount insured of R$224,674,000 effective until May 8, 2022.

22 Transactions with related parties

Transactions with related parties are summarized as follows:

Related parties		Transaction nature	2018	2017
Current liabilities				
Loans and financing				
Sterlite Power Grid Ventures Limited	(a)	Loan	-	3,436,837
Sterlite Power Grid Ventures Limited	(a)	Loan	-	8,879,457
Sterlite Power Grid Ventures Limited	(a)	Interest	-	19,705
			-	12,335,999
P&L				
Loans and financing				
Sterlite Power Grid Ventures Limited	(a)	Interest	1,350,596	-
			1,350,596	-

(a) These refer to the intercompany loan taken out with Sterlite Power Grid Ventures Limited, settled in November 2018.

23 Financial instruments

Company financial instruments are managed through operational strategies and internal controls intended to ensure safety, profitability and liquidity. The Company's control policy is previously approved by the Executive Board.

The fair value of receivables does not differ from book balance, since these amounts are monetarily restated consistently with market rates and/or are adjusted by provision for impairment. As such, we do not present a comparative table between book balances and fair value of financial instruments.

Company financial instruments included in the statement of financial position are hierarchically classified into level 2 and stated at contract value, which approximates market value.

Years ended December 31, 2018 and 2017 (In reais)

23,1 Classification of financial instruments by category

Assets measured at amortized cost	Note	2018	2017
Cash and cash equivalents	**6**	15,423,990	1,607,766

Liabilities measured at amortized cost	Note	2018	2017
Trade accounts payable	**10**	49,854,457	12,451
Loans and financing	**11**	68,899,700	12,335,999

23,2 Risk management

Company financial transactions are performed by the finance area using conservative strategies aimed at safety, profitability and liquidity, which are previously approved by the Group's Executive Board. Significant market risk factors that could affect Company business are as follows:

a) Interest rate risk

This relates to the possibility of changes in fair value of loans and financing indexed to fixed interest rates, in case such rates do not reflect current market conditions. While the Company is constantly monitoring these indexes, it has so far not identified the need to contract hedging financial instruments against interest rate risk.

b) Currency risk

The Company periodically monitors its currency exposure and has so far not identified the need to contract hedging financial instruments against currency risk.

c) Liquidity risk

The Company monitors the risk of cash shortage using a recurring liquidity planning tool. Company objective is to maintain the balance between continuity of funds and flexibility through secured accounts and bank loans. The policy adopted sets out that amortization should be distributed over time in a balanced manner.

Cash flow forecast is performed in a centralized manner by Company management through monthly reviews. The purpose is to ensure that the cash generated is sufficient to meet Company operating, costing and investment needs.

24 Capital management

The Company uses own and third-party capital to fund its activities. Use of third-party capital seeks to optimize Company capital structure. Additionally, the Company monitors its capital structure and adjusts such structure taking into consideration the changes in economic conditions. Management's main purpose is to ensure sufficient funds for construction to continue.

As at December 31, 2018 and 2017, the Company objectives, policies or processes did not change.

25 Events after the reporting period

On January 14, 2019, the Company received the second disbursement relating to the financing agreement amounting to R$ 30,000,000.00 (thirty million reais) taken out from Banco do Nordeste.

On March 14, 2019, the Company received the third disbursement relating to the financing agreement amounting to R$ 30,000,000.00 (thirty million reais) taken out from Banco do Nordeste.

On April 16, 2019, the Company commenced operation testing phase.