S&P Global Ratings

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Ratings On 26 Brazilian Electric Utilities Affirmed Despite The Pandemic's Disruption

July 22, 2020

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- Overall, we view Brazilian power generators and transmission entities as less vulnerable than distributors to the impact of COVID-19. This is because we expect distributors will have higher working capital needs in the short term, given that they collect revenues for the entire sector, while balancing the mismatch of lower demand and energy surpluses and dealing with rising delinquency rates stemming from the economic downturn.
- To address the situation, Brazil's government recently released an extraordinary liquidity package (known as "Conta Covid") that we view as positive from a credit perspective because it will help mitigate the expected lower operating cash flows.
- In general, we believe rated electric utilities will be able to withstand the economic crisis mostly due to their relatively comfortable liquidity positions and flexibility to trim investments and dividends if needed, without compromising their credit metrics.
- As a result, on July 22, 2020, we affirmed our ratings on 26 Brazilian electric utilities.

SAO PAULO (S&P Global Ratings) July 22, 2020--S&P Global Ratings today affirmed the ratings on 26 Brazilian electric utilities. The affirmation of the ratings listed below reflects our expectation that the companies have enough financial flexibility to cope with the detrimental effects of the COVID-19 pandemic without jeopardizing their credit quality. This is in spite of the significant drop in demand and the measures announced by the regulator to provide relief to customers. We expect leverage to peak this year and for credit metrics should gradually recover in the next few years.

In this context, we affirmed the following issuers and their issue-level ratings:

- CESP-Companhia Energetica de Sao Paulo (CESP)
- CPFL Energia S.A. and its subsidiaries Companhia Paulista de Força e Luz, Companhia Piratininga de Força e Luz, and RGE Sul Distribuidora de Energia S.A (collectively CPFL)
- EDP Espirito Santo Distribuicao de Energia S.A. and EDP Sao Paulo Distribuicao de Energia S.A. (collectively EDP Brasil)
- Eletrobras-Centrais Eletricas Brasileiras S.A. (Eletrobras)
- Energisa S.A. and its subsidiaries Energisa Sergipe-Distribuidora de Energia S.A. and Energisa Paraiba-Distribuidora de Energia S.A. (Energisa)
- ENEVA S.A. (Eneva)
- Equatorial Energia S.A. and its subsidiaries Equatorial Alagoas Distribuidora de Energia S.A., Equatorial Maranhao Distribuidora de Energia S.A, Equatorial Para Distribuidora de Energia

S.A., and Integração Transmissora de Energia S.A. (Intesa) (collectively Equatorial group)

- Itaipu Binacional
- Light Servicos de Eletricidade S.A. (Light SESA)
- Neoenergia S.A. and its subsidiaries Companhia de Eletricidade do Estado da Bahia, Companhia Energetica de Pernambuco (CELPE), Companhia Energetica do Rio Grande do Norte, and Elektro Redes S.A. (collectively Neoenergia)
- Transmissora Alianca de Energia Eletrica S.A. (TAESA)
- UHE Sao Simao Energia S.A. (São Simão)

Brazil's weak economy pressures utilities. We expect economic conditions to remain subdued, with Brazil falling into a recession in 2020. We forecast its GDP to contract 7% in 2020, and then return to growth in 2021. Moreover, the National Electricity Regulatory Agency (Agência Nacional de Energia Elétrica; ANEEL) implemented a series of initiatives to alleviate the burden of utilities bills for residential clients, including exempting low-income customers and prohibiting power cuts of residential clients, which has also hampered operating performance, especially those of the distributors.

The sector has comfortable liquidity. In our view, the utilities that we rate have enough financial flexibility to deal with the current situation. They're cutting costs and expenses and adjusting investments and dividends to protect their creditworthiness. Many utilities also recently resorted to issuing bank debt to preserve cash, and have raised close to R$6 billion of new credit facilities since mid-March on an aggregate basis. We assess as adequate the liquidity of all the Brazilian electricity groups that we rate. In addition, most of these companies have stronger stand-alone credit profiles (SACPs) than the current ratings, because the Brazilian sovereign ratings cap those on the companies given the regulated nature of their business.

While in our view the "Conta Covid" should provide timely short-term liquidity to the sector, the distributors could continue facing longer-term impacts, including delinquency rates above the historical average because these were exacerbated by the prohibition to disconnect delinquent customers. The expected decrease in consolidated EBITDAs will raise the risk of covenant breaches in 2020 and 2021 as cushions get tighter, but we don't expect any risk of debt acceleration.

Regulatory framework is supportive. In this context, an economic equilibrium of the current concessions will be negotiated once the pandemic subsides, which could result in additional compensation for the distributors in the next few months. We see the Brazilian regulatory framework as having a solid record of maintaining the economic and financial sustainability of the electricity market.

Government measures giving liquidity support to help distributors. Overall, the social distancing measures to contain the virus are taking a toll on the distribution business (see "COVID-19 To Dim, But Not Darken, Brazilian Electric Utilities' Operations", May 29, 2020). To compensate for that, the Brazilian distributors are entitled to receive about R$15 billion from "Conta Covid" over the next six months. "Conta Covid" is an off-balance financing program put in place by the regulator and Brazilian government to address the liquidity squeeze among the distributors suffering from adverse effects of the pandemic, including reduced consumption and related energy surpluses, higher customer delinquency, and lower collections amid higher dollar-denominated energy costs in 2020. While some of these factors may persist after this year, the financial sustainability of the concessions will be discussed in a public hearing set for late August, which could result in extraordinary rate readjustments to distributors in the fourth quarter of 2020. In our view, this mechanism limits further downside risks.

From our rated pool of Brazilian electric utilities, we view groups like Equatorial, Energisa, and Neoenergia as more exposed, given that their distribution businesses represent the vast majority of their cash flows. Additionally, they have sizable investment programs not only in their main businesses, but also as they expand their presence into the transmission segment. Integrated conglomerates such as CPFL and EDP are more diversified, and they sell most of their generation capacity in the less risky regulated market. Finally, we view Light and Companhia Energetica de Minas Gerais (CEMIG; global scale: B/Positive/--; national scale: brA+/Positive/--) as exposed to higher customer delinquency while their generation contracts are in the free market.

Generators face higher counterparty risk. We believe the rated generators are better positioned overall than distributors, given that they usually sell energy through long-tenor, take-or-pay contracts with solid counterparties in the regulated and free markets. They also enjoy sufficient financial flexibility to face the rising counterparty risk. While we don't expect a significant impact in the regulated market because distributors will receive financial support, this isn't necessarily the case for the portion of the energy sold in the free market, given the prevailing low spot prices (currently at R$91.19 per megawatt hour [MWh]) and counterparty risk under bilateral sales agreements. Contracts in the free market usually contain flexibility clauses so that the contracted energy consumed can be adjusted (usually within a 5%-15% range).

In our rated portfolio of Brazilian generators, Eletrobras receives the bulk of its cash flows from indemnification of non-depreciated assets related to the early renewal of the transmission concessions (under Law 12,783/2013), and from the availability of its transmission lines and generation capacity (approximately 35% of it operates under an operations and maintenance regime). In the case of Itaipu, its operating model mitigates the operating risks of a hydro plant, including volume, price, and hydrology risks, because its rates are calculated to fully cover its costs, including operating and debt service costs for the next year. In this specific case, we project Itaipu's credit metrics to keep improving as the company amortizes its debt.

About 60%-70% of the revenues from both Eneva and São Simão come from the availability of their plants, which brings stability to their cash flows. Finally, although CESP sells about 60% of its capacity in the free market, it does so through long-term contracts with solid counterparties, reducing counterparty risk.

The transmission segment is least exposed. We believe that the public health crisis will have the least impact on transmission companies, including TAESA and INTESA, given their availability-based nature. Their concession contracts operate under a revenue cap model--Receita Anual Permitida (Allowed Annual Revenues). This establishes the annual revenues a transmission concession is entitled to receive, based on the availability of the lines, rather than the actual volume of power transmitted. Therefore, we do not anticipate changes in their EBITDA generation.

The overall outlook for the sector is stable. Thus far, Brazilian electric utilities' credit quality has been resilient to the economic fallout from the COVID-19 pandemic. Since March, we haven't taken any negative rating actions in our portfolio. In this context, about 90% of the electric utilities we rate in Brazil have a stable outlook. This compares with about one-third for all Brazilian corporate ratings as a whole that currently either have a negative outlook or are on CreditWatch with negative implications. The outlooks on the electric utilities reflect the sector's resilience to the COVID-19-related economic disruption. With the exceptions of CEMIG and Light SESA, the groups that we rate are either:

- Capped at the sovereign level (Brazil; global scale: BB-/Stable/B; national scale: brAAA/Stable/--), for those that have global scale ratings; or
- Already have a long-term national scale rating of 'brAAA' with a stable outlook--at the top of the rating scale.

There are downside risks for the electricity sector, especially in the next several years, including rising bad debt and lower collection amid an even harsher scenario for electricity demand. However, lowering our ratings would mostly depend on a downgrade of the sovereign, because in general the electric utilities have stronger intrinsic repayment capacity (which we refer to as SACPs), but Brazilian sovereign ratings cap those on the companies given the regulated nature of their business.

OUR BASE-CASE SCENARIO

We revised our macroeconomic assumptions for the region on June 30, 2020 (see "Economic Research: Latin American Economies Are Last In And Last Out Of The Pandemic").

- Due to the coronavirus pandemic, we revised downwards our expectations for electricity consumption, which we expect to contract 7% in 2020 and grow 3.5% in 2021, in line with our assumptions for Brazil's GDP trajectory (see table 1).
- We currently don't assume an extraordinary readjustment of the distributor's rates in 2020, although it may occur in the fourth quarter this year. For 2021 and 2022, rates to increase in line with our expectations for inflation of 3.5% and 3.8%, respectively.
- Reference interest rates at an all-time low of 2.25% in 2020 and 3.50% in 2021, which would help ease the groups' interest expenses.

Table 1

Macroeconomic Assumptions

	2020E	2021E	2022E	2023E
GDP growth (%)	(7.0)	3.5	3.3	2.9
CPI growth (%)	1.7	3.5	3.8	4.0
Year-end interest rates (%)	2.25	3.50	4.50	5.00
Average exchange rate (R$/US$)	4.94	4.97	4.92	4.90

- Revenue collections of distributors 3.0%-3.5% lower in 2020 (see table 2) following higher delinquency, given the combination of weaker economic activity and the temporary restrictions imposed on distributors from disconnecting non-paying residential and essential-services customers from networks. Distributors exposed to more challenging concession areas and lower per capita income levels will likely be more affected.

Table 2

Lower Collections/Delinquency

	Expected delinquency (% of 2020 revenues)
Cemig-D	4.5-5.0%

Table 2

Lower Collections/Delinquency (cont.)

	Expected delinquency (% of 2020 revenues)
CPFL	0.5-1.0%
EDP Brasil	2.5-3.0%
Equatorial	6.0-6.5%
Energisa	3.5-4.0%
Light	4.0-4.5%
Neoenergia	2.5-3.0%
All Brazilian distribution companies	3.0-3.5%

- A 15% haircut on the generators' free-market contracted energy in 2020, given that non-regulated contracts in general contain flexibility clauses that counterparties could trigger, so that the contracted energy consumed could be adjusted (usually within a 5%-15% range).
- We don't expect losses or delays in receiving payments for transmission companies.
- Distributors receiving cash inflows from "Conta Covid" over the next six months (see table 3). We expect 70%-80% to be received in the next few weeks (mostly related to existing regulatory assets) while the remainder will be received on a monthly basis until December, based on the cash flow impact estimated for the period.

Table 3

Expected Cash In-Flows From "Conta Covid"

	Contracted (Bil. R$)
Cemig-D	1,404
CPFL	1,382
EDP Brasil	574
Equatorial	1,296
Energisa	1,359
Light	1,326
Neoenergia	1,664
All Brazilian distribution companies	14,800

In this context, we project the following credit metrics for 2020 and 2021, and as a result, forecast the entities' financial risk profiles to be unchanged.

Table 4

Projected Credit Metrics

Average ratios

	2020 Debt/EBITDA (x)	FFO/Debt(%)	2021 Debt/EBITDA (x)	FFO/Debt (%)
Cemig	4.5-5.0x	10-15%	4.0-4.5x	10-15%
CESP	1.5-2.0x	>50%	1.0-1.5x	>50%

Table 4

Projected Credit Metrics (cont.)

Average ratios

	2020 Debt/EBITDA (x)	FFO/Debt(%)	2021 Debt/EBITDA (x)	FFO/Debt (%)
CPFL	2.5-3.0x	20-25%	2.5-3.0x	20-25%
EDP Brasil	3.0-3.5x	20-25%	2.5-3.0x	25-30%
Eletrobras	>5.5x	5-10%	> 5.5x	5-10%
Energisa	3.5-4.0x	15-20%	3.5-4.0x	15-20%
Eneva	4.5-5.0x	10-15%	3.5-4.0x	15-20%
Equatorial	4.0-4.5x	15-20%	3.5-4.0x	15-20%
Equatorial Maranhão	1.5-2.0x	50-60%	1.5-2.0x	50-60%
Equatorial Pará	1.5-2.0x	50-60%	1.5-2.0x	50-60%
Equatorial Alagoas	>5.5x	5-10%	> 5.5x	5-10%
INTESA	2.5-3.0x	25-30%	2.5-3.0x	25-30%
Itaipu Binacional*	2.0-2.5x	40-50%	1.5-2.0x	>50%
Light	4.0-4.5x	10-15%	4.0-4.5x	10-15%
Neoenergia	3.5-4.0x	15-20%	3.5-4.0x	15-20%
São Simão	3.5-4.0x	10-15%	3.5-4.0x	10-15%
TAESA	4.0-4.5x	15-20%	4.0-4.5x	15-20%

Note: We make several adjustments to our ratios, including considering pension-related liabilities and guarantees provided to non-consolidated entities as debt. *We expect Itaipu's credit metrics to gradually improve over the next few years as its debt amortizes, improving its financial risk profile.

LIQUIDITY

Following the initiatives the utilities have taken since the beginning of the pandemic to preserve cash, and considering the amounts they'll receive from the "Conta Covid" program, we assess the liquidity of all the electricity groups that we rate in Brazil as adequate (see table 5).

Despite the pandemic, our portfolio of electric utilities have, in general, financial flexibility to absorb weaker operating performance until severe social distancing measures are lifted. Electric utilities' initiatives to preserve cash include:

- Most companies issued new bank loans. Since mid-March, the rated electric utilities raised close to R$6 billion in new credit facilities. In addition, the cash position among the sector's players was already relatively robust, covering about 150% of short-term maturities on an aggregate basis.
- Reduced non-mandatory capital expenditures.
- Curtailed or postponed dividend payments.

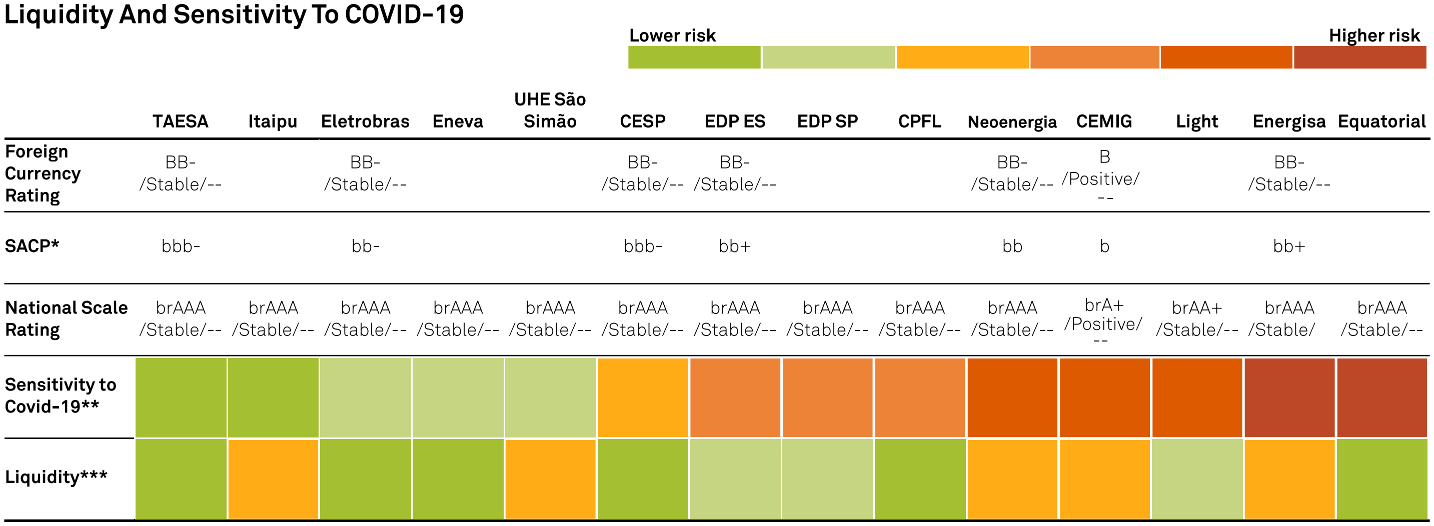
COVENANTS

Most of the distribution groups that we rate, including EDP Brasil, Equatorial, Neoenergia, and especially Energisa and Light, will have tighter covenant cushions in 2020, but we don't anticipate any risk of debt acceleration. Because the "Conta Covid" will be partially backed by existing regulatory assets in the companies' balance sheets (i.e. already recognized as EBITDA for the covenant calculation), in our view the primary impact of the additional liquidity will be to reduce net debt. Although most of the entities that we rate have their leverage covenants calculated with adjustments for net regulatory assets, we expect those to be monetized this year, resulting in tighter covenant cushions in 2020.

Nevertheless, typically debt documentations establish that covenant breaches occurs only if target ratios are not met for more than a measurement period. This, in our view, give companies some flexibility to comply with the ratios and to prevent potential debt acceleration. Although not in our base-case scenario at this point, metrics might improve once utilities implement extraordinary tariff increases in order to compensate for the longer-term effects of the pandemic.

In the case of generators, as the support package improves liquidity throughout the electricity system, risks in the regulated market will dissipate, in our view. The generators and transmission companies that we rate have comfortable credit metrics, which allow for adequate cushion over the covenant thresholds. In our view, the all-time low interest rates in Brazil should help companies to keep coverage ratio-based covenants under control.

Liquidity And Sensitivity To COVID-19



* SACP only available for ratings in the global scale
** Sensitivity to Covid-19 within the electricity sector, considering exposure to distribution, generation and transmission
*** Liquidity based on sources over uses:

- Above 1.6x
- Above 1.3x
- Above 1.1x
- Cash uses almost equal to sources
- Cash deficit
- Significant cash deficit

Source: S&P Global Ratings.

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019

- General Criteria: Methodology For National And Regional Scale Credit Ratings, June 25, 2018
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- Criteria | Corporates | General: Recovery Rating Criteria For Speculative-Grade Corporate Issuers, Dec. 7, 2016
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Guarantee Criteria, Oct. 21, 2016
- Criteria | Corporates | Industrials: Key Credit Factors For The Unregulated Power And Gas Industry, March 28, 2014
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- Criteria | Corporates | Utilities: Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Brazilian Electric Utility CEMIG And Subsidiaries Outlook Revised To Positive On Deleveraging, Ratings Affirmed, July 10, 2020
- COVID-19 To Dim, But Not Darken, Brazilian Electric Utilities' Operations, May 29, 2020

Ratings List

Ratings Affirmed	
Transmissora Alianca de Energia Eletrica S.A.	
Issuer credit rating	BB-/Stable/--
National scale	brAAA/Stable/brA-1+
Neoenergia S.A.	
Issuer credit rating	BB-/Stable/--
National scale	brAAA/Stable/brA-1+
Companhia de Eletricidade do Estado da Bahia	

Issuer credit rating	BB-/Stable/--
National scale	brAAA/Stable/--
Companhia Energetica de Pernambuco (CELPE)	
Issuer credit rating	BB-/Stable/--
National scale	brAAA/Stable/--
Companhia Energetica do Rio Grande do Norte	
Issuer credit rating	BB-/Stable/--
National scale	brAAA/Stable/--
Elektro Redes S.A.	
Issuer credit rating	
National scale	brAAA/Stable/--
Energisa S.A.	
Issuer credit rating	BB-/Stable/--
National scale	brAAA/Stable/--
Energisa Paraiba-Distribuidora de Energia S.A.	
Issuer credit rating	BB-/Stable/--
National scale	brAAA/Stable/--
Energisa Sergipe-Distribuidora de Energia S.A.	
Issuer credit rating	BB-/Stable/--
National scale	brAAA/Stable/--
EDP Espirito Santo Distribuicao de Energia S.A.	
Issuer credit rating	BB-/Stable/--
National scale	brAAA/Stable/--
EDP Sao Paulo Distribuicao de Energia S.A.	
Issuer credit rating	
National scale	brAAA/Stable/--
CPFL Energia S.A.	
Issuer credit rating	
National scale	brAAA/Stable/--
Companhia Paulista de Forca e Luz	
Issuer credit rating	
National scale	brAAA/Stable/--
Companhia Piratininga de Forca e Luz	
Issuer credit rating	
National scale	brAAA/Stable/--
RGE Sul Distribuidora de Energia S.A	
Issuer credit rating	
National scale	brAAA/Stable/--
Eletrobras-Centrais Eletricas Brasileiras S.A.	

Issuer credit rating	BB-/Stable/--
National scale	brAAA/Stable/brA-1+
Light Servicos de Eletricidade S.A.	
Issuer credit rating	
National scale	brAA+/Stable/brA-1+
Eneva S.A.	
Issuer credit rating	
National scale	brAAA/Stable/--
CESP-Companhia Energetica de Sao Paulo	
Issuer credit rating	BB-/Stable/--
National scale	brAAA/Stable/--
Itaipu Binacional	
Issuer credit rating	
National scale	brAAA/Stable/--
UHE Sao Simao Energia S.A.	
Issuer credit rating	
National scale	brAAA/Stable/--
Equatorial Energia S.A.	
Issuer credit rating	
National scale	brAAA/Stable/--
Equatorial Pará Distribuidora de Energia S.A.	
Issuer credit rating	
National scale	brAAA/Stable/--
Equatorial Maranhão Distribuidora de Energia S.A.	
Issuer credit rating	
National scale	brAAA/Stable/--
Equatorial Energia Alagoas	
Issuer credit rating	
National scale	brAA/Stable/--
Integração Transmissora de Energia S.A.	
Issuer credit rating	
National scale	brAAA/Stable/--

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.