FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Light's Ratings; Outlook Stable

Fri 21 Jan, 2022 - 2:18 PM ET

Fitch Ratings - São Paulo - 21 Jan 2022: Fitch Ratings has affirmed Light S.A. and its wholly owned subsidiaries Light Servicos de Eletricidade S.A. (Light Sesa) and Light Energia S.A.'s (Light Energia) Foreign Currency (FC) and Local Currency (LC) Issuer Default Ratings (IDRs) at 'BB-' and National Scale Ratings at 'AA-(bra)'. The Rating Outlook is Stable for all ratings.

The ratings reflect Light group's low to moderate business risk profile within the Brazilian electric-energy sector. Light Sesa has exclusive electricity distribution rights in its concession area and Light Energia's generation asset base adds to cash flow predictability. Light group presents a robust liquidity position and lengthened debt maturity profile, but operational inefficiencies in the distribution segment and moderate leverage ratios limit the ratings. The analysis incorporates the benefit from a stronger consolidated EBITDA due to expected favorable tariff review for Light Sesa in March 2022. Fitch rates Light group on a consolidated basis given the strong ties among the three entities.

KEY RATING DRIVERS

Balanced Business Profile: Light group's credit profile benefits from its significant position and asset base in the Brazilian electric-energy sector. Light Sesa operates in the distribution segment, serving 4.3 million customers in the State of Rio de Janeiro - a segment characterized by a monopoly position in the concession area and pass-through of non-manageable costs to tariffs. This segment should account for approximately 90% and 70% of the group's consolidated net revenue and EBITDA, respectively, in 2022. Light Sesa's concession ends in 2026 and its renewal is deemed very likely since service quality requirements have been met.

In the generation segment, Light Energia contributes to greater diversification of cash flows and the dilution of operating risks, which are more prevalent in the distribution segment. The company has 1.2 GW of hydro generation capacity and most of its concessions end in 2028, for which renewal conditions are more uncertain.

Negative Performance on Distribution: Light Sesa's EBITDA is limited by energy losses and provisions for credit losses above tariff coverage, as well as indemnities to consumers. Positively, the company should benefit from the next tariff review on March 2022, which will likely incorporate a BRL2.0 billion increment in asset base and increase regulatory limits for energy losses to at least 21.7% of total load, from 19,2%. Fitch's base case assumes energy losses of 26.5% and a modest 0.5% growth rate on energy demand as of 2022, after an expected decrease of 0.5% in 2021. EBITDA should reach BRL1.2 billion in 2022 and BRL1.3 billion in 2023, significantly below the estimated regulatory EBITDA of BRL2.3 billion

Generation Benefits Credit Profile: Light Energia adds predictability to the group's operating cash flows. Its assured energy of 672 aMW was largely sold to industrial clients through medium-term contracts. The company follows a conservative hedge strategy against hydrological risk by keeping 28% of its energy uncontracted for 2022 and 2023. This compensates for the lack of protection related to quotas or regulatory insurance. The company's EBITDA should reach BRL549 million in 2021 and BRL568 million in 2022, with underlying average GSF of 0.77 and 0.80, respectively. Light Energia's EBITDA may slightly decline as of 2024 due to falling long-term energy prices.

Manageable Negative FCFs: The base case scenario for the ratings considers Light group's EBITDA and cash flow from operations (CFFO) of BRL1.6 billion and negative BRL470 million in 2021, and BRL1.8 billion and BRL373 million in 2022, respectively. The cash impact in 2021 derives from a BRL1.3 billion payment from Light Energia, related to GSF renegotiation, and an estimated BRL1.8 billion increase (+27%) in energy cost from Light Sesa, compared to 2020, due to water scarcity in Brazil. Investments should average BRL1.4 billion annually in 2021-2023, mostly focused in the distribution business. FCF is expected to be negative in 2021 and 2022, at BRL2.0 billion and BRL1.2 billion, and moderately positive as of 2023, after dividends of 25% of net income.

Credit Metrics Under Pressure: The group's consolidated net adjusted leverage should be in the range of 4.0x-4.5x until 2023, compared with 4.1x in 2020, according to Fitch's criteria. These ratios incorporate guarantees provided to Norte Energia S.A. as off-balance sheet debt (BRL716 million on September 2021). Financial flexibility is limited, since the group has already been distributing minimum dividends and needs to maintain intensive capex. A new cash support sponsored by the government, anticipating future collections from customers, if implemented, might reduce net leverage in 0.2x. It assumes an uncertain cash inflow of around BRL400 million in 2022, not incorporated in the rating scenario. Gross leverage is estimated in 6.1x and 5.2x in 2021 and 2022.

Consolidated Approach: The ratings consider the strong legal and strategic links between Light S.A. and its main subsidiaries, Light Sesa and Light Energia. These companies should generate 30% and 70% of all dividends to be received by the parent in 2021-2024, respectively. The parent guarantees most of the debt instruments issued by the subsidiaries and there are cross-default provisions between these debts.

DERIVATION SUMMARY

Light's IDRs are lower than several electric energy groups in Latin America, such as Empresas Publicas de Medellin E.S.P. (EPM, LC IDR BBB-/Rating Watch Negative), Grupo Energia Bogota S.A. E.S.P. (GEB, LC IDR BBB/Stable) and Enel Americas S.A. (LC IDR A-/Stable). Light operates in Brazil (BB-/Negative), while its peers are more exposed to higher rated countries, like Chile (A-/Stable) and Colombia (BB+/Stable). Light's business profile is also worse than these peers because it is more concentrated in energy distribution, wherein operating cash flows tend to be more volatile.

Compared to the Brazilian Companhia Energetica de Minas Gerais (Cemig, LC IDR BB/Stable), Light has somewhat weaker business profile, with less diversified asset base and the generation business accounting for around 30% of its consolidated EBITDA, lower than Cemig`s ratio of 45%. In the distribution segment, Light faces weaker operating performance and poor growth prospects. Light's financial profile is also weaker. Average net leverage in 2021-2022 is estimated at 4.5x for Light and 2.3x for Cemig.

KEY ASSUMPTIONS

Fitch's Key Assumptions Within Our Rating Case for the Issuer

-- GSF: 0.77, 0.80, 0.85 and 0.94, from 2021 to 2024, on average;

-- Energy short-term prices (BRL/MWh): 274, 190, 82 and 62, from 2021 to 2024, on average.

Light Sesa

-- Energy demand: 0.5% decline in 2021 and 0.5% growth as of 2022;

-- Gross profit (after non-manageable costs): BRL2.9 billion in 2021 and BRL3.1 billion in 2022;

-- Energy losses: 26.5% of total load (total market + losses);

-- Provision for credit losses: 5.8% of energy supply revenues (sales + network usage).

Light Energia

-- Annual average values for 2021-2024;

-- Existing sales contracts: 366 aMW at BRL220/MWh;

-- New sales contracts: 77 aMW at BRL199/MWh;

-- Existing purchase contracts: 54 aMW at BRL221/MWh;

Light S.A. (consolidated)

-- Average annual investments of BRL1.3 billion in 2021-2024;

-- Dividend distribution equivalent to 25% of net income;

-- Cash inflow of BRL179 million in 2022 for the sale of assets (equity stakes in Lightger and Guanhaes).

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--Improvements in distribution segment operating performance, with the company's EBITDA closer to the regulatory EBITDA;

--Net leverage consistently less than or equal to 3.5x;

--Total leverage consistently less than or equal to 4.5x.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--Deterioration of the company's liquidity profile;

--Net leverage consistently at or above 4.5x;

--Total leverage consistently at or above 5.5x.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Non-Financial Corporate issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

LIQUIDITY AND DEBT STRUCTURE

Sound Liquidity Profile: Light's liquidity profile improved after the BRL1.4 billion follow-on and successful liability management transactions, despite the strong negative FCF in 2021. The group has been able to refinance existing debt with lower funding costs and a longer debt-amortization profile. Light's consolidated cash and equivalents were BRL3.5 billion at the end of September 2021. This amount covered more than three years of debt amortization, but Fitch estimates refinancing needs in 2022 - even considering a BRL179 million receipt from the sale of generation assets. Short-term debt was BRL924 million at the end of September 2021. Total adjusted consolidated debt of BRL11.3 billion mainly consisted of debentures issuances (BRL6.2 billion) and Eurobonds issued in June 2021 (BRL3.3 billion), and included off-balance sheet debt of BRL716 million related to guarantees provided to Norte Energia S.A.. There is no debt at the holding level.

ISSUER PROFILE

Light S.A. is a corporation listed at B3 and a non-operational holding of a mid-size Brazilian energy group. The two main subsidiaries, Light Sesa and Light Energia, hold a 4.0 aGW power distribution concession and a 1.2 GW portfolio of hydro plants.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

ENTITY / DEBT	RATING			PRIOR
Light Servicos de Eletricidade S.A.	LT IDR	BB- Rating Outlook Stable	Affirmed	BB- Rating Outlook Stable
	LC LT IDR	BB- Rating Outlook Stable	Affirmed	BB- Rating Outlook Stable
	Natl LT	AA-(bra) Rating Outlook Stable	Affirmed	AA-(bra) Rating Outlook Stable
senior unsecured	LT	BB-	Affirmed	BB-
senior unsecured	Natl LT	AA-(bra)	Affirmed	AA-(bra)

Light Energia S.A.	LT IDR	BB- Rating Outlook Stable Affirmed	BB- Rating Outlook Stable
	LC LT IDR	BB- Rating Outlook Stable Affirmed	BB- Rating Outlook Stable
	Natl LT	AA-(bra) Rating Outlook Stable Affirmed	AA-(bra) Rating Outlook Stable
senior unsecured	LT	BB- Affirmed	BB-
senior unsecured	Natl LT	AA-(bra) Affirmed	AA-(bra)
Light S.A.	LT IDR	BB- Rating Outlook Stable Affirmed	BB- Rating Outlook Stable
	LC LT IDR	BB- Rating Outlook Stable Affirmed	BB- Rating Outlook Stable
	Natl LT	AA-(bra) Rating Outlook Stable Affirmed	AA-(bra) Rating Outlook Stable

VIEW ADDITIONAL RATING DETAILS

FITCH RATINGS ANALYSTS

Lucas Rios, CFA
Associate Director
Primary Rating Analyst
+55 11 4504 2205
lucas.rios@fitchratings.com
Fitch Ratings Brasil Ltda.
Alameda Santos, nº 700 – 7º andar Edifício Trianon Corporate - Cerqueira César São Paulo, SP SP Cep 01.418-100

Wellington Senter
Associate Director
Secondary Rating Analyst
+55 21 4503 2606
wellington.senter@fitchratings.com

Mauro Storino
Senior Director
Committee Chairperson
+55 21 4503 2625
mauro.storino@fitchratings.com

MEDIA CONTACTS

Elizabeth Fogerty
New York
+1 212 908 0526
elizabeth.fogerty@thefitchgroup.com

Additional information is available on www.fitchratings.com

PARTICIPATION STATUS

The rated entity (and/or its agents) or, in the case of structured finance, one or more of the transaction parties participated in the rating process except that the following issuer(s), if any, did not participate in the rating process, or provide additional information, beyond the issuer's available public disclosure.

APPLICABLE CRITERIA

National Scale Rating Criteria (pub. 22 Dec 2020)

Corporate Rating Criteria (pub. 15 Oct 2021) (including rating assumption sensitivity)

Sector Navigators - Addendum to the Corporate Rating Criteria (pub. 15 Oct 2021)

Parent and Subsidiary Linkage Rating Criteria (pub. 01 Dec 2021)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Corporate Monitoring & Forecasting Model (COMFORT Model), v7.9.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Light Energia S.A.	EU Endorsed, UK Endorsed
Light S.A.	EU Endorsed, UK Endorsed
Light Servicos de Eletricidade S.A.	EU Endorsed, UK Endorsed

DISCLAIMER

FOR WHICH THE LEAD ANALYST IS BASED IN AN ESMA- OR FCA-REGISTERED FITCH RATINGS COMPANY (OR BRANCH OF SUCH A COMPANY) OR ANCILLARY SERVICE(S) CAN BE FOUND ON THE ENTITY SUMMARY PAGE FOR THIS ISSUER ON THE FITCH RATINGS WEBSITE.

READ LESS

COPYRIGHT

authorized to issue credit ratings on behalf of the NRSRO (see https://www.fitchratings.com/site/regulatory), other credit rating subsidiaries are not listed on Form NRSRO (the "non-NRSROs") and therefore credit ratings issued by those subsidiaries are not issued on behalf of the NRSRO. However, non-NRSRO personnel may participate in determining credit ratings issued by or on behalf of the NRSRO.

READ LESS

SOLICITATION STATUS

The ratings above were solicited and assigned or maintained by Fitch at the request of the rated entity/issuer or a related third party. Any exceptions follow below.

ENDORSEMENT POLICY

Fitch's international credit ratings produced outside the EU or the UK, as the case may be, are endorsed for use by regulated entities within the EU or the UK, respectively, for regulatory purposes, pursuant to the terms of the EU CRA Regulation or the UK Credit Rating Agencies (Amendment etc.) (EU Exit) Regulations 2019, as the case may be. Fitch's approach to endorsement in the EU and the UK can be found on Fitch's Regulatory Affairs page on Fitch's website. The endorsement status of international credit ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.

Corporate Finance: Middle Markets   Corporate Finance   Utilities and Power

Corporate Finance: Leveraged Finance   Latin America   Brazil

---