RATING ACTION COMMENTARY

Fitch Revises Light's Outlook to Negative; Affirms Ratings

Fri 24 Apr, 2020 - 16:48 ET

Fitch Ratings - Rio de Janeiro - 24 Apr 2020: Fitch Ratings has affirmed the ratings for Light S.A. and its wholly owned subsidiaries Light Servicos de Eletricidade S.A. (Light Sesa) and Light Energia S.A. (Light Energia), including the companies' Long-Term Foreign Currency (FC) and Local Currency (LC) Issuer Default Ratings (IDRs) at 'BB-' and National Scale Ratings at 'A+(bra)'. The Rating Outlook for the corporate ratings was revised to Negative from Stable.

The Negative Outlook reflects Light group's challenging scenario to improve its operational performance and present its consolidated credit metrics in line with the current 'BB-' IDRs. Light group has tight rating headroom in terms of leverage triggers. Fitch believes the current high adjusted gross and net leverage ratios will remain above 4.5x and 4.0x until 2022, respectively, even considering some financial support from the Brazilian government to Light Sesa and other distribution companies (DisCos) in order to mitigate liquidity and cash flow pressures of the distressed scenario caused by the coronavirus outbreak. A higher than expected rhythm of recovery in terms of energy demand in the distribution segment, which is the most important for Light group, after the end of the quarantine, and the ability to control manageable costs will be crucial to sustain the current IDRs.

Light group's IDRs reflect its low to moderate business risk profile resulting from its exclusive electricity distribution rights in the energy distribution segment, combined with assets on the power generation segment at Light Energia adding to risk dilution and cash flow predictability during favorable hydrological conditions. Fitch's analysis considered the group's sound cash position and high financial flexibility to manage its debt maturities despite of the tighter credit market and the forecast negative FCF. The IDRs reflect a consolidated view of Light group's credit profile, due to the existence of cross-default clauses in some debts. Fitch's analysis considered the Brazilian energy sector's moderate regulatory risk and that hydrological risk exposure, inherent to the sector, is above the historical average and currently pressures the group's consolidated cash flow and financial profile.

KEY RATING DRIVERS

High Leverage Metrics: The expected weaker operating performance in 2020 increases Light's challenge to bring its consolidated financial leverage metrics to levels more consistent with its current IDRs. According to Fitch's calculations, the group's adjusted total debt/EBITDA should remain above 5.0x in the next couple of years, being 6.2x in 2020 and 5.0x in 2021, with adjusted net leverage at 5.5x in 2020 and reducing to 4.6x in 2021. As of Dec. 31, 2019, adjusted net debt/EBITDA was 4.6x, while adjusted total debt/EBITDA was 5.6x. The leverage metrics incorporate BRL740 million in off-balance-sheet debt guarantees provided to non-consolidated entities.

Weak Performance in Distribution: Fitch expects an annual demand reduction of 3.5% in 2020 for Light Sesa, with a 10% decline in 2Q20, to impact its performance. Some recovery of 1.25% is forecast in 2021, but not enough to return to previous levels. We also anticipate a 15% increase in the company delinquency levels. Positively, the base case scenario considers that the company will be compensated on the entire cost associated with energy purchases, even if above the regulatory cap of 105% of demand. Light Sesa needs to reach greater operational efficiency in order to approach regulatory parameters. The BRL1.0 billion EBITDA in 2019 and forecast to 2020 is significantly below the regulatory benchmark of BRL1.6 billion. Energy losses and delinquency remain important challenges, and Fitch does not believe the company will achieve significant improvement in the near future. Energy losses of 26.04% of total energy purchased in 2019 represented 640bps higher than the regulatory target of 19.62% and a negative impact on EBITDA at around BRL600 million.

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Generation Benefits Credit Profile: Light group's operating cash flow generation and business profile benefit from the energy generation segment, which represented approximately 10% and 30% of the group's consolidated revenue and EBITDA in 2019, respectively. Light Energia's results have higher predictability than the energy distribution segment under normal hydrological scenarios as the assured energy of its hydroelectric plants is largely commercialized with large industrial clients, typically through medium-term contracts.

Fitch forecasts a 10% reduction in energy sales in 2020, returning to the normal levels in 2021. The company will have to manage the volume of its energy available for sale to avoid significant exposure coming from unfavorable hydrological conditions in the country, with the annual Generation Scaling Factor (GSF) at 0.84 in

2020, according to Fitch's projections. The company has about 25% of its energy uncontracted in 2020 and 35% in 2021, which mitigates this exposure.

Pressured FCF in 2020 and 2021: Fitch believes the group will generate negative FCF over the next four years, with BRL403 million in 2020, mainly impacted by the weak performance of Light Sesa, and BRL734 million in 2021, the latest being pressured by the dividend payments related to 2019 and 2020 net income. Light's decision to postpone the dividend payment of BRL315 million related to 2019 net income, due in 2020, is positive in a liquidity perspective. The agency also incorporates Light Energia's payment in 2021 of 50% of the BRL657 million amount due of a net liability related to contractual obligations for energy delivery, with the remaining 50% paid in 2022.

Average annual investments should be around BRL1.0 billion. Cash flow from operations (CFFO) is expected to benefit from the return through tariff of a significant balance of non-manageable costs at Light Sesa. The base case scenario incorporates the reimbursement of BRL662 million in net regulatory assets reported in December 2019 over the 2021-2022 period. The group's consolidated EBITDA is expected to reduce 12% in 2020 to BRL1.4 billion and to increase to BRL1.8 billion - BRL2.0 billion during 2021-2022.

Balanced Business Profile: The group's credit profile benefits from its significant position and asset base in the Brazilian electric energy sector. Light Sesa serves 4.4 million customers and is the country's seventh largest electricity DisCo, a segment characterized by a high regulation and low competition. This segment accounted for approximately 80% and 65% of the group's consolidated net revenues and EBITDA, respectively, in 2019. With 1.2 GW of installed capacity, a medium size among the country's main private competitors, the generation segment contributes to greater diversification of operating cash generation and to the dilution of operating risks, which are more present in the distribution segment.

DERIVATION SUMMARY

Light's IDRs are lower than other electric energy groups in Latin America such as Enel Americas S.A. (A-/Stable), Empresas Publicas de Medellin S.A E.S:P. (BBB/Rating Watch Negative), Grupo Energia Bogota S.A. E.S.P. (BBB/Stable) and AES Gener S.A. (BBB-/Stable). Light's business risk is higher, reflecting its operating environment in Brazil (BB-/Stable), while its peers are more exposed to investment grade countries,

mainly Chile (A/Negative) and Colombia (BBB-/Negative). Light's business profile is more concentrated in energy distribution than those companies, and presents higher leverage.

Compared to a Brazilian electricity group with operations predominantly in the distribution segment, Light's less diversified asset base, lower operational performance and more aggressive financial profile explain the difference from Energisa group's IDRs (Local Currency IDR 'BB+' and Foreign Currency IDR 'BB'; both Stable Outlooks).

KEY ASSUMPTIONS

The Main Assumptions of Fitch's Base Scenario for the Issuer Include:

-- Light Sesa's demand decline of 3.5% in 2020 and increase of 1.25% on average in the following three years;

-- Light Energia's disbursement of BRL657 million in two installments in 2021-2022 to liquidate its debt at Camara de Comercializacao de Energia Eletrica (CCEE);

-- Average annual consolidated capex of BRL1.1 billion during 2020-2023;

-- Light Sesa's recovery of BRL662 million in non-manageable costs in 2021-2022;

-- Dividend payout of 25%, with the payment related to 2019 net income postponed to 2021;

-- No asset sale.

RATING SENSITIVITIES

Factors That Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade:

--Improvements in the distribution segment operating performance;

--Adjusted net leverage consistently equal or less than 3.0x;

--Adjusted total leverage consistently equal or less than 4.0x;

-- Fitch will revise the Outlook to Stable if the company presents better operating performance in 2020-2021, with expectation of maintenance of adjusted gross and net leverage ratios below 5.0x and 4.0x, respectively.

Factors That Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade:

--Deterioration of the group's liquidity profile;

--Adjusted net leverage consistently above 4.0x;

--Adjusted total leverage consistently above 5.0x.

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

Strong Financial Flexibility: Light group presents high financial flexibility, with a robust liquidity position to deal with its debt maturities and expected negative FCF in the future. At YE 2019, the group had cash and equivalents of BRL1.7 billion covering its short-term debt of BRL1.4 billion by 1.2x. If the temporary BRL657 million is excluded from Light Energia's cash, the ratio would weaken to 0.7. Positively, Fitch expects this cash outflow to occur during 2021 and 2022. Proceeds

from Light Sesa's new debenture issuance of BRL400 million raised in April 2020 will be used to fulfill working capital needs and lengthen the debt profile. On December 2019, total consolidated adjusted debt of BRL8.4 billion mainly consisted of debentures issuances (BRL4.5 billion), Eurobonds (BRL1.6 billion) and securitization of receivables (FIDC) (BRL1.3 billion).

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. 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.

Additional information is available on www.fitchratings.com

RATING ACTIONS

ENTITY/DEBT	RATING		
Light Servicos de Eletricidade S.A.	LT IDR	BB-	Affirmed
	LC LT IDR	BB-	Affirmed
	Natl LT	A+(bra)	Affirmed

ENTITY/DEBT	RATING		
• senior	LT	BB-	Affirmed

VIEW ADDITIONAL RATING DETAILS

FITCH RATINGS ANALYSTS

Wellington Senter
Associate Director
Primary Rating Analyst
+55 21 4503 2606

Rafael Faro
Analyst
Secondary Rating Analyst
+55 21 3957 3616

Mauro Storino
Senior Director
Committee Chairperson
+55 21 4503 2625

MEDIA CONTACTS

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

Additional information is available on www.fitchratings.com

APPLICABLE CRITERIA

National Scale Ratings Criteria (pub. 18 Jul 2018)

Corporate Rating Criteria (pub. 27 Mar 2020) (including rating assumption sensitivity)

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
Light S.A.	EU Endorsed
Light Servicos de Eletricidade S.A.	EU Endorsed

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