FitchRatings

RATING ACTION COMMENTARY

Fitch Revises Light's Outlook to Stable; Upgrades National Scale Rating

Thu 21 Jan, 2021 - 17:02 ET

Fitch Ratings - Rio de Janeiro - 21 Jan 2021: 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' Foreign Currency (FC) and Local Currency (LC) Long-Term Issuer Default Ratings (IDRs) at 'BB-'. At the same time, Fitch has upgraded the Long-Term National Scale Rating for the three entities to 'AA-(bra)', from 'A+(bra)'. The Rating Outlook for the corporate ratings was revised to Stable from Negative.

The revision of the Outlook to Stable follows Light's successful capital increase that will improve the company's capital structure, reducing its high net leverage to 3.5x in 2021 and 3.0x in 2022. The Stable Outlook also incorporates Fitch's expectation that Light will use a considerable part of the proceeds to reduce total debt. On Jan. 19, 2021, Light priced its primary and secondary distribution of common shares, in the amount of BRL2.8 billion, that will be settled on Jan. 22, 2021. Light will receive BRL1.4 billion from the primary offering, which will bring the consolidated credit metrics in line with the current 'BB-' IDRs. The upgrade on the National Scale ratings reflects Light group's strengthening of its credit profile within the 'BB-' IDR level.

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The primary offering will also improve Light group's already satisfactory liquidity position. Light's pro forma cash position of BRL4.7 billion on Sept. 30, 2020, including the capital increase of BRL1.4 billion and BRL336 million received in December 2020 from an agreement to end an indemnity judicial claim against Furnas Centrais Elétricas S.A. (Furnas), will cover the BRL3.4 billion debt maturing up to December 2021 by 1.4x. This position includes the around BRL800 million net liability to be paid in the first half 2021 to Camara de Comercializacao de Energia Eletrica (CCEE) in the energy generation subsidiary Light Energia.

Fitch also views as positive the change in the shareholder structure resulting from the public offering. Light's main shareholder, Companhia Energetica de Minas Gerais (Cemig: Long-Term FC and LC IDRs BB-/Positive), sold all of its shares along with the primary offering, which represented 22.58% of Light's total capital. In Fitch's opinion, the exit of Cemig as a shareholder exclude the weight of the political risk inherent to the public control of the company.

Light and its subsidiaries' IDRs continue to reflect the low to moderate business risk profile resulting from Light Sesa's exclusive electricity distribution rights in its concession area, combined with assets on the power generation segment at Light Energia, adding to cash flow predictability during favorable hydrological conditions and risk dilution.

The ratings are still limited by the group's challenge to improve its operational performance and translate it into higher profitability. Light has been impacted by an unfavorable scenario in the concession area of its most significant subsidiary, the energy distribution company Light Sesa, in the Metropolitan Region of the State of Rio de Janeiro, with high energy losses and delinquency rates, as well as disappointing results on the recovery of energy demand. The company has the important challenge to improve its reported EBITDA to levels close to the regulatory EBITDA, which Fitch estimates to be about BRL650 million higher in 2021 (35% of inefficiency).

The IDRs reflect a consolidated view of Light group's credit profile, due to the existence of cross-default clauses in some debts. The regulatory risk of the Brazilian energy sector was considered moderate, 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

Positive Results of the Follow On: On Jan. 19, 2021, Light concluded its public shares offer through the sale of 137,242.528 common shares priced at BRL20.00 per share. The shares sold contemplated 68,621,264 newly issued common shares (primary offering) and

68,621,264 common shares sold by Cemig (secondary offering), in the total amount of BRL2.8 billion. With the transaction, Cemig sold its entire 22.58% participation in Light and market free float increases to 66.78% from 44.6%. Nevertheless, the main benefit in the company's credit profile came from the meaningful cash inflow from the primary offering.

Improved Capital Structure: Fitch expects Light's consolidated financial net leverage, according to the agency's criteria, to be 4.1x in 2020 and 3.5x in 2021, reducing to more conservative levels below 3.5x from 2022 on. On a pro forma basis, considering the BRL1.4 billion cash inflow from the primary offering and the company's financial statements as of Sept. 30, 2020, and the cash outflow of BRL801 million to be paid to CCEE, Light's consolidated net debt/EBITDA ratio reduces to 3.5x, from the 4.1x reported in the LTM ended Sept. 30, 2020.

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-/Negative), 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'/Negative).

Feedback

Compared to Brazilian peers on the National Scale, Lights credit profile is weaker than Companhia Paranaense de Energia (Copel: AA+(bra)/Positive) and Centrais Eletricas de Santa Catarina (Celesc: AA(bra)/Stable). In comparison with Copel, which has a better business profile, this company has greater relevance in the generation segment in the consolidated results, lower financial leverage and more robust liquidity position. The agency considers that the stronger financial profile of Celesc, benefiting from a conservative leverage ratio and less intense investment plan, justifies the higher rating, despite of its high exposure to the distribution segment.

KEY ASSUMPTIONS

--Light Sesa's demand decline of 5.7% in 2020 and increase of 1.5% on average in the following three years;

--Light Energia's disbursement of BRL801 million in one installment in 2021 to liquidate its debt at CCEE;

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

--Light Sesa's recovery of BRL1.4 billion in non-manageable costs in 2020;

--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; with the company's EBITDA closer to the Regulatory EBITDA;

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

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

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

--Deterioration of the company's liquidity profile;

--Net leverage consistently above 4.5x;

--Total leverage consistently 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

Strong Liquidity Profile: Light's liquidity and financial flexibility will improve with the BRL1.4 billion cash increase and the BRL336 million received in December 2020 from an agreement to end an indemnity judicial claim against Furnas, better positioning the company to deal with its debt maturities and expected negative FCF. Fitch expects Light group to use a considerable part of the proceeds to reduce total debt. As of Sept. 30, 2020, Light had consolidated cash and equivalents of BRL3.0 billion covering short-term debt of BRL2.3 billion by 1.3x.

In addition, a better financial profile should allow the group to refinance existing debt at more attractive conditions with lower funding cost and longer debt amortization. On Sept. 30, 2020, total consolidated adjusted debt of BRL8.7 billion mainly consisted of debentures issuances (BRL5.1 billion), Eurobonds (BRL2.2 billion), securitization of receivables (FIDC) (BRL1.1 billion) and Law 4.131 credit lines (BRL902 million). Off-balance-sheet debt was BRL750 million, related to guarantees provided to nonconsolidated companies.

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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

Light S.A.: Governance Structure: 4 . Light has exposure to board independence risk which, in combination with other factors, impacts the rating.

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 Negative
	LC LT IDR	BB- Rating Outlook Stable	Affirmed	BB- Rating Outlook Negative
	Natl LT	AA-(bra) Rating Outlook Stable	Upgrade	A+ (bra) Rating Outlook Negative
• senior unsecured	LT	BB-	Affirmed	BB-

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Parent and Subsidiary Linkage Rating Criteria (pub. 26 Aug 2020)

Corporate Rating Criteria (pub. 21 Dec 2020) (including rating assumption sensitivity)

National Scale Rating Criteria (pub. 22 Dec 2020)

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

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