FitchRatings

RATING ACTION COMMENTARY

Fitch Downgrades Light's IDRs to 'CC'

Thu 30 Mar, 2023 - 5:54 PM ET

Fitch Ratings - São Paulo - 30 Mar 2023: Fitch Ratings has downgraded the Local Currency and Foreign Currency Long-Term Issuer Default Ratings (IDRs) of Light S.A. (Light) and its wholly owned subsidiaries Light Servicos de Eletricidade S.A. (Light Sesa) and Light Energia S.A.'s (Light Energia) to 'CC' from 'CCC+'. Fitch has also downgraded the Long-Term National Scale Ratings of these entities to 'CC(bra)' from 'CCC(bra)'. The ratings of foreign currency and local currency debt instruments were downgraded to 'CC'/'RR4' from 'CCC+'/'RR4' and to 'CC(bra)' from 'CCC(bra)', respectively.

The downgrade reflects Fitch's view that there is a high probability that Light group will enter into a debt restructuring process, following the statements made by management during its 4Q22 earnings call. Light's management publicly stated its intention to start discussions with creditors, in an effort to improve its capital structure and preserve its cash balance while executing its capex program. Fitch expects the restructuring process will fall within its definition of a default-like process, which would result in a downgrade to 'C'.

Light's financial flexibility has weakened due to a confluence of concession renewal uncertainty and operating cash flow pressure, as a result of high energy losses, elevated interest expenses, and tax credits reimbursement to customers. These factors along with high leverage metrics have led to the company to hire a financial advisor that specializes in restructuring. Fitch believes the company's access to financing is limited and/or too expensive given the current markets conditions coupled with the credit profile of the company. Therefore, Fitch does not expect the company to be able to raise the necessary financing to support its expected negative FCF and debt amortization in 2023, estimated to be at BRL1.5 billion-BRL2.0 billion.

KEY RATING DRIVERS

Probable Debt Restructuring: Fitch expects Light to launch a debt restructuring process in 2023 that would fall within Fitch's definition of a default-like process. Light Sesa, Light's main subsidiary, has sizeable cash outflows of BRL 2.8 billion in 2023, comprising of BRL1.0 billion in debt amortization, approximately BRL800 million of capex, and BRL1.0 billion in deferred tax expenses. The company's cash position at its power distribution segment was BRL633 million, as of 4Q22, had reduced to BRL457 million; on a pro forma basis, after the anticipated payment of the third and the ninth debenture issuance on March 29, 2023, which is not enough to support those disbursements.

High Refinancing Needs: Fitch believes the company is unlikely to access competitive financing to secure its funding needs. Fitch estimates that the group needs up to BRL1.8 billion of financing in 2023, and at least BRL1.5 billion in 2024. In case of non-renewal of the Light Sesa concession, the company should receive an indemnity for unamortized assets equal to its asset base, currently valued at BRL10.1 billion, which unfavorably compares with on-balance-sheet consolidated debt of BRL11.1 billion and BRL8.7 billion at Light Sesa's level. The company had a cash position of BRL2.1 billion in December of 2022. The indemnification would partially support the recovery prospect of debt holders, if needed.

High Leverage; Weak Coverage Ratios: Light's consolidated adjusted leverage should remain high. The rating case estimates a consolidated net adjusted debt/EBITDA above 5.0x in 2023 and 2024, including guarantees provided to Norte Energia S.A. as off-balance sheet debt (BRL730 million in December 2022). As of December 2022, group's consolidated adjusted net leverage reached 5.6x, with 9.2x at Light Sesa's level. EBITDA to interest expense for the company is estimated to be 1.3x in 2023, which leaves small room for capex and debt amortization.

Recovery Analysis: Fitch applies a bespoke approach to recovery for issuers rated 'B+' and lower, using the higher of going-concern and liquidation estimates to enterprise valuation. In the case of Light, Fitch estimates recovery rates to be 'RR1' for its secured debts and 'RR3' for unsecured debts, which could potentially lead to uplift on the bonds' rating from Light's FC IDR.

However, Fitch's "Country-Specific Treatment of Recovery Ratings Criteria" caps at 'RR4' the recovery for debt instruments in Brazil, resulting in an instrument rating equal to Light's FC IDR. These caps reflect Fitch's concerns over the enforceability of creditor rights in certain jurisdictions, where average recoveries tend to be lower.

DERIVATION SUMMARY

Light's ratings reflect its probable debt restructuring, worse than of Azul S.A. (Azul; Long-Term Foreign and Local Currency IDRs CCC-) and InterCement Brasil S.A. (InterCement; FC and LC IDRs CCC), where the risk of default is more a possibility. The power company has publicly announced its intention to start discussions with the creditors. For the three companies, high financial leverage coupled with high interest rates weakens their financial flexibility.

RATING SENSITIVITIES

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

--Light maintains its ability to receive funding from banks or the capital market;

--The group sells assets or raises equity in a follow-on issuance;

--Renewal of Light Sesa's concession on more favorable terms.

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

--A downgrade may occur if, in Fitch's judgment, a default or default-like process has begun, which would be represented by a ''C' rating.

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

Heightened Refinancing Risk: Light's ability to secure funding in the short term is uncertain. During the 4Q22, Light's cash position reduced by BRL1.9 billion (or 48%), and the cash and equivalent position as of December 2022, BRL2.1 billion, should not cover the expected debt amortizations (BRL1.0 billion) and expected negative FCF through 2023. Adjusted consolidated debt was BRL11.8 billion and comprises debentures (BRL6.9 billion) and Eurobonds (BRL3.5 billion), with off-balance sheet debt of BRL730 million related to guarantees provided to Norte Energia S.A. There is no debt at the holding level.

ISSUER PROFILE

Light Sesa is the fourth largest power concession in Brazil, serving more than 70% of Rio de Janeiro's consumption, and accounts for about 60% of the group's EBITDA. Light Energia has 511 MW of assured energy, on a consolidated basis. Light S.A. is listed on B3 and has a pulverized share ownership.

SUMMARY OF FINANCIAL ADJUSTMENTS

Construction revenues and costs excluded from EBITDA

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 ⬍	RECOVERY ⬍	PRIOR ⬍

Light Servicos de Eletricidade S.A.	LT IDR	CC	Downgrade		CCC+
	LC LT IDR	CC	Downgrade		CCC+
	Natl LT	CC(bra)	Downgrade		CCC(bra)
senior unsecured	LT	CC	Downgrade	RR4	CCC+
senior unsecured	Natl LT	CC(bra)	Downgrade		CCC(bra)
Light Energia S.A.	LT IDR	CC	Downgrade		CCC+
	LC LT IDR	CC	Downgrade		CCC+
	Natl LT	CC(bra)	Downgrade		CCC(bra)
senior unsecured	LT	CC	Downgrade	RR4	CCC+
senior unsecured	Natl LT	CC(bra)	Downgrade		CCC(bra)

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

National Scale Rating Criteria (pub. 22 Dec 2020)

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

Corporate Rating Criteria (pub. 28 Oct 2022) (including rating assumption sensitivity)

Country-Specific Treatment of Recovery Ratings Criteria (pub. 03 Mar 2023)

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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