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Press Release

Eneva S.A.'s Ratings Affirmed at 'brAAA', Off Watch, Despite More Leveraged Credit Metrics; Outlook Negative

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Rating Action Overview

- Eneva's acquisitions concluded during 2022, combined with the contracted investments of approximately R$ 5.8 billion for the construction of the Azulão Complex – a natural gas-fired thermoelectric complex –, which will be disbursed over the next four years, should pressure the company's financial indicators. We expect net debt to EBITDA of 5.5x-6.0x and funds from operations (FFO) to net debt of 7%-10% in 2023, in addition to a slow deleveraging trend in the coming years.
- However, the company has been considering selling assets or establishing strategic partnerships on its renewable assets platform, which could accelerate its deleveraging.
- In this context, on April 28, 2023, S&P Global Ratings removed its national scale 'brAAA' ratings assigned to Eneva and its senior unsecured debentures from CreditWatch listing with negative implications, in which they were placed on June 3, 2022. We also affirmed all ratings. The recovery ratings '3' on the company's debt remain unchanged.
- The outlook on the issuer credit rating is now negative, reflecting a potential downgrade by at least one notch by the end of 2023 if Eneva fails to execute the planned asset sales and/or to establish strategic partnerships, or if the group, contrary to this trend, makes new acquisitions, which would lead to a deterioration in its credit metrics.

Rating Action Rationale

The rating affirmation is based on our expectation that Eneva could reduce leverage in the near term. Despite the expected higher leverage due to the company's recent acquisitions and the robust investment plan in the coming years, especially for construction of the Azulão Complex, the company announced publicly its intention to sell assets or find a strategic partner for its renewable assets platform. Although we do not include divestments in our base case, as it depends on market conditions and negotiations with stakeholders, we view the company's top management message as positive and a commitment to reducing the group's debt.

Throughout 2022, Eneva completed the following acquisitions, which contributed to increase its reported gross debt from R$7.7 billion in 2021 to R$18.6 billion in 2022:

- Centrais Elétricas do Sergipe Participações S.A. (CELSEPAR) and CEBARRA – Centrais Elétricas Barra dos Coqueiros thermoelectric power plants in October 2022, for R$6.7 billion, which also added approximately R$4.1 billion in net debt and R$3.3 billion in lease obligations relating to floating storage and regasification units (FSRU), which we adjusted to the group's debt;
- CGTF - Central Geradora Termoelétrica Fortaleza S.A. thermoelectric power plant (Termofortaleza), in August 2022, for an enterprise value (EV) of R$431.6 million; and
- The Futura 1 Solar Complex, with installed capacity of 671 MW, in March 2022, for R$731 million, which required the disbursement of total investments of R$2 billion by Eneva.

In addition, Eneva won two Capacity Reserve auctions, in December 2021 and in September 2022, promoted by ANEEL, to build and operate the Azulão Complex. The latter has installed capacity of 950 MW and will require investments of around R$5.8 billion. These projects will only generate cash from 2026 onwards – and more consistently in 2027 – adding fixed revenues of approximately R$2.4 billion, to be adjusted to the IPCA inflation rate. In this context, and despite the follow-on offering of R$4.2 billion concluded in June 2022 to finance Eneva's growth plan, we expect adjusted net debt to EBITDA of 5.0x-6.0x and FFO to debt of 7%-10% in the next three years, in the absence of asset sales. Considering the asset sale or a potential new partner in its renewable assets platform, those metrics can reach up to 4.0x-5.0x and 9%-14%, respectively.

In our view, Eneva's greater scale and cash generation diversification due to its recent acquisitions, and the fact that around 65%-70% of its revenues are fixed upon availability, result in greater leverage for the group temporarily. However, we will monitor the execution of the divestment strategy and the allocation of such resources, as well as the group's growth strategy in the coming years.

Greater scale and cash generation diversification are positive for Eneva's business. The acquisitions concluded in 2022 almost doubled the company's revenue base compared to 2021, when it reported net revenue of R$5.1 billion and EBITDA of approximately R$2 billion (versus our projections of revenue of BRL 9.0 billion–R$9.5 billion and EBITDA of R$3.7 billion–R$4.0 billion in 2023). In our view, these recent acquisitions, as well as the new investments, help to diversify the group's cash generation, reducing its dependence on the Parnaíba Complex, which will now represent around 35%-40% of the group's gross profit (versus approximately 80%-85% by 2021), while CELSE is expected to represent 25%-30% and coal assets around 15%.

In addition, we view such diversification as positive because the Parnaíba Complex operations do not have redundancy to gas transportation pipelines, but it is self-sufficient in terms of gas reserves, while CELSE has a long-term gas supply contract through an FSRU and, from 2024 on, could have gas access via the pipelines of Transportadora Associada de Gás S.A. (TAG, not rated), which would mitigate the risk of raw material shortages. Therefore, as a result of the gains in scale and diversification, we have revised our assessment of Eneva's business position to satisfactory from fair.

Our assessment of the company's business position also incorporates the strength of its power purchase agreements (PPAs) based on availability in the regulated market, with an average term of 14 years, which contributes to stable and predictable cash flows. We estimate that Eneva will benefit from approximately R$7.0 billion in fixed gross revenues in 2023 and approximately R$5.8 billion in 2024 (related to fixed revenues from thermoelectric power plant contracts), due to the expiration of Termofortaleza's PPA. Our assessment of its business position also reflects the adequate availability of the plants and the low marginal operational cost when compared to other thermal power plants, given that Eneva has its own gas reserves.

Outlook

The negative outlook reflects a potential downgrade by at least one notch by the end of 2023 if Eneva fails to execute the planned asset sales and/or to establish strategic partnerships, or if the group interrupts its deleveraging strategy and acquires new assets, which would result in deterioration of its credit metrics.

Downside scenario

We could downgrade the company if its adjusted net debt to EBITDA and FFO to net debt remain above 5.0x and below 12%, respectively. This could result from a reversal of the divestment strategy or if the company announces new investments or acquisitions that increase its indebtedness, keeping its leverage at current levels for a longer time.

Upside scenario

We could revise the outlook to stable if the company's divestment strategy materializes and it uses the proceeds to prepay existing debt or to decrease its funding needs related to the construction of the Azulão Complex.

Company Description

Eneva has an integrated business model, operating in the generation of electricity and in the exploration and production of natural gas. Its current operational installed capacity is 5,271 megawatts (MW), of which 3,875 MW come from 8 natural gas-fired thermal plants, two coal-fired thermal plants with installed capacity of 725 MW and a solar complex (Futura 1), with capacity of 671 MW. The table below describes each of the group's assets. Eneva is building the Parnaíba VI plant, which will close the Parnaíba III cycle, adding 92 MW of installed capacity to the group's portfolio, and has announced the construction of the Azulão Complex, in the Amazon basin, which will add 950 MW of capacity.

In addition, the company is self-sufficient in natural gas to supply the Parnaíba and Azulão-Jaguatirica complexes, relying on proven reserves (1P), which total 28.158 billion cubic meters (bcm) in the Parnaíba basin and 10,450 bcm in the Amazon Basin.

Eneva's asset portfolio

Asset	Location	Source	Installed capacity (MW)	Status	Annual fixed revenue (BRL million)[1]	Contract term
Parnaiba I	Maranhão	Gas	676	Operational	756.0	Jan/2013 - Dec/2027
Parnaiba II	Maranhão	Gas	519	Operational	613.0	Jul/2016 - Apr/2036
Parnaiba III	Maranhão	Gas	178	Operational	168.0	Jan/2013 - Dec/2027
Parnaiba IV	Maranhão	Gas	56	Operational	33.0	Jul/2026 - Jun/2041
Parnaíba V	Maranhão	Gas	385	Operational	353.0	Jan/2024 - Dec/2048
Parnaíba VI	Maranhão	Gas	92	Under construction	105.0	Jan/2025 - Dec/2049
Jaguatirica II	Roraima	Gas	141	Operational	540.0	Jan/2022 - Jan/2037
Azulão I	Amazon	Gas	360	Under construction	239.0	Jul/2026 - Jun/2041
Azulão II	Amazon	Gas	590	Under construction	1922.0	Dec/2026 - Dec/2041
Termofortaleza	Fortaleza	Gas	327	Operational	1715.0	Dec/2003 - Dec/2023
CELSE	Sergipe	Gas	1.593	Operational	1988.0	Mar/2020 - Dec/2044
Pecém II	Ceará	Coal	365	Operational	483.0	Jan/2013 - Dec/2027
Itaqui	Maranhão	Coal	360	Operational	538.0	Jan/2012 - Dec/2026
Futura 1	Bahia	Solar	671	Pre-operational	N/A[2]	79% contracted between 2023 and 2042

[1] Figures from Eneva's corporate presentation dated March 2023. The base date of revenues is November 2022; [2] N/A: Not applicable.

Our Base Case Scenario

Assumptions

- Average inflation – which indexes most Eneva contracts and part of its costs – of 4.8% in 2023, 4.5% in 2024 and 3.6% in 2025, in line with the assumptions published in our article "Economic Outlook Emerging Markets Q2 2023: Global Crosscurrents Make For A Bumpy Deceleration", as of March 27, 2023;
- Henry Hub price, which indexes part of the tariffs of the Parnaíba I contracts, of US$3.50 per million btu (British thermal unit) in 2023, US$4.00/btu in 2024 and US$2.75/btu from 2025 on;
- Coal prices, which impact energy production costs at coal plants – Itaqui and Pecém II – of around US$260/ton (t) in 2023, US$175/t in 2024 and around US$130/t in 2025;
- Average exchange rate of the real against the US dollar of R$5.20 in 2023 and 2024 and R$5.30 as of 2025;
- Base interest rate at the end of fiscal year of 12.5% in 2023, 9.0% in 2024 and 8.5% in 2025, impacting Eneva's interest expenses;
- Average availability of thermoelectric power plants of 85%-90%. This level should guarantee a fixed remuneration of approximately R$7.0 billion in 2023, reducing to approximately R$5.7 billion-R$5.8 billion in 2024, due to the end of the Termofortaleza contracts, and increasing to R$6.0 billion-R$6.1 billion in 2025, with the operational start-up of the Parnaíba VI plant;
- Average dispatch of around 20% in 2023, due to the high reservoirs' volumes in Brazil and the low thermal power dispatch due to favorable hydrology, increasing to around 35%-

40% from 2024, considering an average dispatch slightly below historic figures of around 45%;

- Energy sales to Argentina in 2023, in line with the results reported in 2022, contributing with approximately R$300 million–R$400 million in EBITDA;
- Gross margin from Futura 1 of R$310 million–R$340 million annually;
- Settlement Price of Differences (PLD) at an average of R$70/MWh in 2023 and R$120/MWh from 2024;
- Investments of R$3.7 billion in 2023, R$2.7 billion in 2024 and R$1.3 billion in 2025, related mainly to the construction of the Parnaíba VI plant – expected to be completed in 2024 – and the Azulão Complex, over the next 3 years, as well as to the maintenance of existing plants and exploration and development of gas reserves;
- Our base case does not incorporate the acquisition of Polo Bahia Terra in partnership with PetroRecôncavo, since negotiations are at a preliminary stage and depend on Petrobras' divestment strategy;
- Due to the number of losses accumulated in previous years, we consider distribution of dividends only from 2024 onwards, in the amount of 25% of net income for the previous fiscal year. This should result in payment of around R$300 million–R$500 million annually.
- Net adjusted debt of R$22 billion–R$23 billion over the next three years, including leases (mainly CELSE's FSRU) of around BRL 3.6 billion.

Key metrics

- EBITDA margins of 40%-45% in 2023 (versus 29.3% in 2022), due to CELSE's total cash generation contribution as of 2023 and from Termofortaleza in 2023;
- Adjusted debt to EBITDA of 5.0x -6.0x over the next 3 years, in case the divestment plan does not materialize. Considering the potential sale of its renewable assets platform, indicators would improve to 4.0x-5.0x over the next 3 years;
- FFO to adjusted net debt of 7%-10% over the next 4 years, also in the absence of asset sales. If the sale takes place, we estimate this metric would come to 9%-14%;
- Negative cash generation of around R$2 billion in 2023 and R$500 million in 2024, and positive cash generation from 2025 onwards, as the group's investment requirements decrease;
- FFO interest coverage gradually improving and remaining at 1.7x-2.5x over the next 3 years.

Liquidity

We assess Eneva's liquidity as adequate. We expect sources over uses above 1.2x in the next 12 months and that liquidity sources will continue to exceed uses even if its EBITDA declines 15% compared to our base case projection. In addition, our analysis incorporates the company's ability to absorb low-probability, high-impact events over the next two years without the need for refinancing, given its extended maturity schedule, with average maturity of five and a half years as of December 31, 2022. Despite Eneva's robust cash position of approximately R$2 billion in the same period, as well as its predictable annual cash flows, given that a large part of its revenues are fixed and based on availability, we expect the group to raise new debt to finance its investment plan, which will require significant capex in the coming years. On the other hand, although we consider that leverage would remain high in the absence of asset sales, we understand that Eneva has adequate access to local capital markets and a good relationship with banks, which would enable it to raise new funds.

Principal liquidity sources

- Cash and cash equivalents of approximately R$2.0 billion as of December 31, 2022;
- Operating cash generation after payment of interest and taxes of R$1.9 billion-R$2.0 billion in 2023;
- Issuance of commercial notes in the amount of R$ 1 billion concluded in April 2023.

Principal liquidity uses

- Short-term debt maturities of approximately R$856 million as of December 31, 2022;
- Contracted and maintenance investments of approximately R$2.8 billion in 2023;
- Intra-year working capital needs of R$200 million–R$300 million;
- We do not assume dividend payments in the next 12 months.

Covenants

Eneva's debt contracts, especially its debentures, establish financial covenants that may result in non-automatic acceleration of these debts if the company's leverage exceeds certain levels. After the covenants renegotiation in 2022, the thresholds of the net debt over EBITDA metric that Eneva must comply with are the following:

- Below 6.5x by June 2023;
- Below 5.5x between September 2023 and December 2023;
- Below 5.0x between March 2024 and June 2024; and
- Below 4.5x as of September 2024.

In addition, the new covenants' calculation methodology incorporates cash generation over the last 12 months from future acquisitions and pro forma cash generation from new projects into the EBITDA. At the same time, the calculation methodology does not consider leases, which S&P Global Ratings considers in its adjusted metrics. Accordingly, the credit metrics mentioned in this report are not related to our expectation of compliance with the covenants.

In this sense, even with higher leverage and if the divestment plan and/or establishment of partnerships fails to materialize, we expect Eneva to comply with the covenants with a 15% cushion in 2023, reducing to around 5%-10% in 2024 and 2025 due to the expiration of Termofortaleza's contract.

Environmental, Social, And Governance (ESG)

ESG credit indicators:

E-1	E-2	E-3	**E-4**	E-5	S-1	**S-2**	S-3	S-4	S-5	G-1	**G-2**	G-3	G-4	G-5

– Climate transition risks	– Not applicable	– Not applicable

ESG credit metrics provide additional disclosure and transparency at the entity level and reflect S&P Global Ratings' opinion on the influence that environmental, social and governance factors have on our ratings analysis. They are not a sustainability rating or an ESG assessment by S&P Global Ratings. The extent of influence of these factors is reflected on an alphanumeric scale of 1-5 where 1 = positive, 2 = neutral, 3 = moderately negative, 4 = negative, and 5 = very negative. For more information, see our commentary "Definitions and Application of ESG Credit Metrics", published October 13, 2021.

Environmental factors have a negative influence on our credit analysis of Eneva, as around 73% of the company's operational installed capacity is provided by thermoelectric power plants fueled by gas from its own reserves. In addition, around 14% of the group's installed capacity comes from coal-fired thermoelectric power plants (Pecém II and Itaqui) and only 13% from renewable sources, with the Futura 1 solar complex. However, the company announced its interest in finding a strategic partner in its renewable assets platform, which could imply the sale of part of it.

On the other hand, compared to other types of fossil fuels, gas thermoelectric plants are cleaner and benefit from priority in the dispatch order due to their lower cost, especially in the case of Eneva, which has its own gas reserves. In addition, we understand that most of Eneva's installed capacity acts as reserve energy to meet energy demand in times of weaker hydrology, as observed in 2021, when the company recorded an average dispatch rate of 72% in the year.

Issue Ratings - Recovery Analysis

issue ratings

	Principal amount on December 31, 2022	Maturity	Issue rating	Recovery rating
Eneva SA				
2nd issue of debentures, 1st series	R$ 750,0 million	May 15, 2024	brAAA	3
2nd issue of debentures, 2nd series	R$ 750,0 million	May 15, 2027	brAAA	3
2nd issue of debentures, 3rd series	R$ 618,7 million	May 15, 2029	brAAA	3
3rd issue of debentures	R$ 795,0 million	December 15, 2027	brAAA	3
5th issue of debentures	R$ 788,1 million	June 15, 2030	brAAA	3
6th issue of debentures, 1st series	R$ 448,7 million	September 15, 2030	brAAA	3
6th issue of debentures, 2nd series	R$ 688,7 million	September 15, 2035	brAAA	3
7th issue of debentures	R$ 1.500,0 million	May 24, 2025	brAAA	3
8th issue of debentures, 1st series	R$ 718,5 million	July 15, 2032	brAAA	3
8th issue of debentures, 2nd series	R$ 471,5 million	July 15, 2037	brAAA	3
8th issue of debentures, 3rd series	R$ 500,0 million	July 15, 2029	brAAA	3
8th issue of debentures, 4th series	R$ 350,0 million	July 15, 2032	brAAA	3

Key analytical factors

The recovery ratings '3' on Eneva's senior unsecured debentures reflect our expectation of an approximate recovery of 55% for its creditors in a hypothetical default scenario. As a result, we equal the issue ratings to Eneva's corporate rating.

Our analysis considers a hypothetical scenario in which default would occur due to operational issues, resulting in difficulties in refinancing Eneva's debts and leading to potential payment delays. In this scenario, we believe that there would be incentives for a restructuring, instead of a liquidation, considering its status as a strategic energy generator for the subsystems in which it operates (North and Northeast), as well as its vertical integration and energy sales contracts. Thus, we believe that creditors would receive higher recovery amounts in a restructuring scenario than in a company liquidation.

In our simulated scenario, a default would occur in 2027, in line with the assumption used for Eneva's rating category. Our projected emergency EBITDA in the year of default is R$1.5 billion, which, combined with the 5.5x multiple – which we apply for power generation companies – results in a total gross enterprise value of around R$13.0 billion.

Simulated default assumptions

– Year of simulated default: 2027
– Approximate emergency EBITDA: R$2.4 billion
– EBITDA multiple: 5.5x
– Jurisdiction: Brazil

Payment priority structure (waterfall)

– EV after deducting 5% for administrative expenses: R$12.4 billion
– Debt at operating subsidiaries: R$6.0 billion
– Total amount available for unsecured debt at the holding level: R$6.4 billion
– Unsecured debt at the holding level: R$11.1 billion
– Expected recovery of senior unsecured debt: 55%

*All debt amounts include six months of pre-petition interest.

Rating Score Snapshot	
Issuer Credit Ratings	
Brazil National Scale	brAAA/Negative/--
Business risk	Satisfactory
Country risk	Moderately high
Industry risk	Moderately high
Competitive position	Satisfactory
Financial risk	Aggressive
Cash flow/Leverage	Aggressive
Modifiers	
Diversification/Portfolio Effect	Neutral
Capital structure	Neutral
Liquidity	Adequate
financial policy	Neutral
Administration and governance	Fair
Comparable ratings analysis	Neutral

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.

Related Criteria and Research

Criteria

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