

Research Update

# Eneva **S.A.**'s '**brAAA**' Ratings Affirmed; New Debentures Issuances Rated '**brAAA**'; Outlook Stable

Jan. 21, 2020

*This English version is provided on request and reflects the translation of the original article published only in Portuguese by S&P Global Ratings on Jan. 21, 2020. In case of any discrepancy between this English version and the original in Portuguese, the Portuguese version shall apply*

## Overview

- In our view, the Brazilian thermal power generator Eneva S.A. (Eneva) should continue to provide solid and stable cash flow generation, allowing it to undergo its expansion investment cycle without compromising its credit quality.
- On January 21, 2020, we affirmed Eneva's 'brAAA' national scale corporate credit rating. This reflects our expectation that the company will reach a leverage peak in 2020 due to its considerable investment program, while quickly deleveraging from 2021 onwards.
- Additionally, we assigned a 'brAAA' rating and a '3' recovery rating on the company's 3<sup>rd</sup> and 4<sup>th</sup> debentures issuances due in 2027 and 2030, respectively, totaling R\$1.25 billion. The proceeds will be allocated to fund the capacity expansion.
- The stable outlook reflects our expectation that the execution of ongoing projects will occur without further delays and cost overruns, enabling a rapid deleveraging to levels close to 3.5x, after reaching a peak of around 4.5x in 2020.

## Rationale

The affirmation of Eneva's corporate rating reflects our expectation that the peak leverage we expect in 2020 will be temporary and due to the concentration of investments in the construction of two new thermal power generation plants, Parnaíba V and Jaguatirica, and will be naturally reverted as of 2021, as soon as these assets start to generate cash after they start operating. We believe that the group will continue to obtain adequate funding for the execution of these ongoing projects, and that its liquidity levels will remain comfortable during this period.

The proceeds of Eneva's 3<sup>rd</sup> and 4<sup>th</sup> debentures issuances, worth R\$650 million and R\$600 million, respectively, will be used to finance these projects, and our 'brAAA' issue rating reflects our view that there's no significant subordination of these issuances in relation to other debt. Since Eneva is an operational holding company that generates cash and counts mostly with unsecured debt in its capital structure (secured debt represents less than 5% of its total debt), the issuance ratings are on the same level as the company's long-term corporate rating.

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Eneva's expansion plan for the next years comprises the following projects:

- Parnaíba V steam power plant (the fifth thermal power plant of the Parnaíba complex), which will have 385 megawatts (MW) of installed capacity, and will be integrated with the Parnaíba I natural gas power plant, using steam from the burning of the existing plant gas to generate energy. Parnaíba V already has contracts to sell 326 average MW in reserve energy for 25 years as of 2024, with a fixed revenue of R\$ 272 million (as defined in March 2018) per year and variable revenues (to be received when energy dispatch is requested) of R\$105/MWh (March 2018). Eneva expects the assets to start operating in the second half of 2021, after the total investment of R\$1.3 billion is completed.
- The Jaguatirica II natural gas thermoelectric plant will have an installed capacity of 132MW and will be integrated with the supply of natural gas from the Azulão Field, located in the Amazon Basin and acquired by Eneva in 2018, through a “virtual pipeline” composed of liquefied natural gas in the extraction field, road transportation to Boa Vista (1,100 km) and regasification in an area near the plant. According to the Contract for the Commercialization of Electricity and Power in Isolated Systems, the Jaguatirica II plant is committed to delivering 117 average MW for 15 years starting on June 28, 2021, with fixed revenues of approximately R\$ 430 million (November 2018), adjusted annually based on the IPCA inflation index, in addition to variable revenue equivalent to fuel costs and other variable costs when dispatching energy. We expect this project to be delivered during 2021 at a total cost of R\$1.8 billion and that the Azulão field, whose proven reserves total 3.6 billion cubic meters (bcm), will meet the Jaguatirica II's demand during the entire term of the contract, even in a maximum dispatch scenario.

In addition to these projects, the company plans to build the Parnaíba VI steam plant, which will be integrated with Parnaíba III and will have 92 MW of capacity, similar to the integration of Parnaíba V to Parnaíba I. The plant has entered into a contract to sell 70 average MW for a 25-year term starting in January 2025, with fixed revenues of R\$85 million (April 2019) per year and variable revenues of approximately R\$220/MWh (April 2019). The project will require investments of almost R\$ 500 million and construction is expected to start in the second half of 2022, when we believe the company will be able to absorb new investments without approaching the leverage levels expected for 2020.

## Outlook

The stable outlook continues to reflect our expectation that Eneva will continue to deliver strong and predictable operating cash generation over the next 12 months, and that it will deliver its expansion projects without delays and cost overruns. Thus, after reaching a peak in 2020, we estimate that the net debt to EBITDA ratio will naturally return to below 3.0x. We also believe that the company benefits from certain flexibility in making investments and adequate access to the credit market, contributing to maintaining a comfortable liquidity during its investment cycle.

## Downside scenario

We could lower Eneva's rating to 'brAA+' over the next 12 months in case of a liquidity pressure amid a greater concentration of disbursements to deliver the expansion projects, as well as if the net debt to EBITDA ratio remains above 4.0x on a consistent basis, which could happen mainly in the event of project delivery delays.

## Upside scenario

Eneva is already rated at the highest level on the national scale.

## Company Description

Eneva is an electricity generator with total installed capacity of 2,153 MW, of which 1,428 MW corresponds to thermal power plants powered by gas and is distributed among the Parnaíba I (675MW), Parnaíba II (519MW), Parnaíba III (178MW) and Parnaíba IV (56MW) plants, all located in the Parnaíba complex, in the state of Maranhão, and 725 MW represents coal-fired power plants, with capacity distributed between the Itaqui (360MW) and Pecém II (365MW) power plants, located in the states of Maranhão and Ceará, respectively. With the completion of the Parnaíba V, Parnaíba VI and Jaguatirica II plants, Eneva's total capacity will be 2,770 MW.

The company is self-sufficient in gas, with its own certified reserves totaling 27.7 bcm (2P), of which 24.1 bcm are located in the Parnaíba basin (state of Maranhão) and 3.6 bcm in the Azulão field (Amazonas).

## Our base-case scenario

Our base-case scenario assumes:

- Inflation rate of 3.30% in 2020 and 3.80% in 2021 (most of Eneva's contracts and part of its costs are mainly adjusted for inflation);
- Henry Hub price, by which part of the Parnaíba I contract rates are indexed, at US\$2.25 per million btu (British Thermal Unit) in 2020 and US\$2.50/btu in 2021;
- Coal prices, which are fully passed through to the tariffs -- despite the impact on the cost of energy production in coal-fired plants --, at US\$70/ton (t) to US\$80/t in 2020 and 2021;
- Average exchange rate in Brazil of R\$4.11/US\$1.00 in 2020 and R\$4.16/US\$1.00 in 2021;
- Average availability of thermal power plants remaining around 95;
- Average dispatch between 35%-40% in 2020 and 2021;
- Investments (capex) of around R\$3.0 billion in 2020 and R\$900 million in 2021;
- No dividend distribution in the following years, considering the losses incurred in previous years.

Based on these assumptions, we arrive at the following credit metrics:

- Net revenue of approximately R\$2.6 billion in 2020 and R\$3.2 billion in 2021;
- EBITDA of around R\$1.3 billion in 2020 and R\$1.7 billion in 2021;
- Net debt to EBITDA ratio of around 4.3x–4.8x in 2020, reflecting the peak of investments, and returning to 3.5x in 2021;
- Funds from operations (FFO) to net debt between 10%-15% in 2020 and close to 20% in 2021.

## Liquidity

We continue to assess Eneva's liquidity as adequate, as we expect the company's sources over uses to remain significantly above 1.2x in the next 12 months and that sources continue to exceed uses even if EBITDA reduces by 15% in relation to our projections.

In addition, our analysis incorporates the company's flexibility provided by its access to the credit market and its ability to delay part of its expansion investments if necessary. We also consider

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Eneva's ability to absorb low probability, high impact events in the next two years without the need for refinancing, thanks to its high cash position and low concentration of short-term debt maturities.

### Principal Liquidity Sources:

- Cash position (unrestricted) of around R\$1.5 billion as of September 2019;
- Operating cash flow generation, after payment of interest and taxes, of roughly R\$750 million- R\$900 million per year;
- Proceeds of R\$1.25 billion from its 3<sup>rd</sup> and 4<sup>th</sup> debentures issuances.

### Principal Liquidity Uses:

- Short-term debt maturities of about R\$490 million as of September 2019;
- Annual working capital needs of up to R\$150 million;
- Minimum capex of R\$1.5 billion in 2020.

## Covenants

Eneva's debentures are subject to financial covenants that require a net debt to EBITDA below 5.0x from September 2020 to June 2022 and of 4.5x subsequently. A covenant breach could result in a non-automatic debt acceleration.

Despite the lower headroom in relation to the maximum levels in 2020, we don't foresee any problems, as a debt acceleration would only occur if the indicators were breached for four consecutive quarters.

## Issue Ratings - Recovery Analysis

We rate the following issuances:

Debt	Amount Issued	Maturity	Rating	Recovery Rating
2 <sup>nd</sup> debentures issuance	R\$1.3 billion	2024/2027/2029	brAAA	3(65%)
3 <sup>rd</sup> debentures issuance	R\$650 million	2027	brAAA	3(65%)
4 <sup>th</sup> debentures issuance	R\$600 million	2030	brAAA	3(65%)

### Key analytical factors

The recovery rating '3' on the 3<sup>rd</sup> and 4<sup>th</sup> issuances of unsecured debentures indicates an expected recovery of around 65% in a hypothetical default scenario. As a result, the issue rating is the same level as Eneva's corporate rating.

Our analysis considers a hypothetical default scenario due to operational issues, which would impair debt refinancing in the short term and lead to a potential delay in payments. In our simulated default scenario, we believe the company would be restructured, given its status as a strategic electricity generator in the North and Northeast subsystems, its vertical integration, and its contracts to sell electricity. In this context, we believe a restructuring would result in a higher recovery amount vis-à-vis a liquidation.

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## Simulated default assumptions

- Simulated year of default: 2024
- Emergence EBITDA: R\$1.8 billion
- EBITDA multiple: 5.5x

## Simplified waterfall

- Net enterprise value (EV) after applying an EBITDA multiple of 5.5x and deducting administrative costs of 5%: R\$6.0 billion
- Expected recovery for the senior unsecured debt: 65%

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

## RATING SCORE SNAPSHOT

### ENEVA S.A.

Issuer Credit Rating	
National Scale	brAAA/Stable/--
<b>Business Risk</b>	<b>Fair</b>
Country Risk	Moderately High
Industry Risk	Moderately High
Competitive Position	Fair
<b>Financial Risk</b>	<b>Significant</b>
Cash Flow/Leverage	Significant
<b>Modifiers</b>	
Diversification/Portfolio Effect	Neutral
Capital Structure	Neutral
Liquidity	Adequate
Financial Policy	Neutral
Management and Governance	Fair
Comparable Rating 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](http://www.standardandpoors.com) for further information. Complete ratings information is available to subscribers of RatingsDirect at [www.capitaliq.com](http://www.capitaliq.com). All ratings affected by this rating action can be found on S&P Global Ratings' public website at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column.*

## Related Criteria and Research

### Criteria

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- Criteria | Corporates | General: Recovery Rating Criteria For Speculative-Grade Corporate Issuers, December 7, 2016

- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, December 16, 2014
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- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, November 13, 2012
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