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FitchRatings

09 APR 2021

Fitch Issues ‘AA+(bra)’ Rating for Eneva; Outlook is Stable

Fitch Ratings - Rio de Janeiro - 09 Apr 2021: Fitch Ratings today issued an ‘AA + (bra)’ National Long Term Rating for Eneva S.A. (Eneva). The Outlook is Stable.

The classification considered Eneva’s favorable business model and its prominent position in the thermoelectric generation segment in Brazil, with long-term contracts for the sale of a significant portion of its energy and internal supply of natural gas, its main raw material. The company enjoys a strong liquidity position and manageable financial leverage considering the diverse dispatch scenarios for its plants – despite the expected peak in 2021 due to greater investments. Eneva’s operational cash generation is robust and benefits from increased dispatch scenarios.

The need for investments in prospecting and developing natural gas reserves, within the company’s strategy of replacing the use of gas, is a risk factor given the uncertainties inherent to the exploratory activity.

KEY RATING DRIVERS

Potential Acquisition is Manageable: According to Fitch’s preliminary analysis, the potential acquisition of Polo Urucu should not put pressure on Eneva’s rating. Although there is still little information available regarding oil and gas sales contracts, the purchase price and the form of financing of the transaction, the company’s net financial leverage should remain below 4.5x from 2022, considering the generation of cash from the acquired asset, which is already operational, for a period of 12 months.

Favorable Business Profile: Eneva benefits from its relevant and synergistic asset base, composed mainly of four thermoelectric plants (UTEs) using natural gas and two using coal - all of them operational. The company has 2.2 GW of installed capacity and is investing to expand it to 2.8 GW by the end of 2024 with two steam plants and one natural gas plant. The entire gas supply is integrated into processing units for this input, capable of processing up to 9.0 mcm/day. Eneva has sufficient reserves to fully serve its current contracts, maintaining a level of dispatch of 50% in gas-powered UTEs, and its rate of replacement of its reserves is higher than that of consumption.

Positive Exposure to Hydrological Risk: The hydrological risk inherent to the national electricity system favors the group, since its plants are dispatched more in scenarios of lower rainfall, which have been frequent in the last five years. The company benefits when its UTEs are dispatched by the National System Operator (ONS), since the variable revenue obtained exceeds the effective production costs, generating a positive variable margin and turning greater volumes of extracted natural gas profitable. The base scenario for the rating incorporates an average dispatch of 47% from 2021 to 2024, including coal-fired power plants, peaking at 52% in 2024.

Strong Cash Generation: Eneva benefits from its contracts in the regulated market, which expire gradually from December 2026. They represent BRL 2.1 billion in fixed revenue, regardless of whether the UTEs are dispatched. In

2022, with the start of the UTE Jaguatirica II contract, fixed revenue will rise to BRL 2.8 billion. The company is also favored by a variable portion of revenue and tariff adjustment parameters with the same characteristics as input purchase contracts, eliminating the risk of mismatch between tariffs and cost. In the case of zero dispatch, EBITDA is expected to be above BRL 1.0 billion, with BRL 1.6 billion in 2021 and BRL 2.1 billion in 2022 based on average dispatches of 46% and 42%, respectively.

Manageable Negative FCF in 2021: Eneva’s free cash flow (FCF) is expected to be negative by BRL 1.1 billion in 2021, after BRL 2.1 billion investments, which include BRL 1.1 billion for the construction of the Parnaíba V and Jaguatirica II plants. The negative FCF of 2021 will be partially financed by credit facilities of approximately BRL 600 million already contracted and to be directed to these two projects. After the peak of investments in 2021, FCF is expected to be BRL 1.1 billion in 2022, benefiting from the entry of both plants into full operation and the absence of dividend distribution, which should begin in 2023.

Rapid Adjustment of the Capital Structure: The expected net debt/EBITDA ratio for 2021 is 4.1x, and it is expected to decrease to 2.5x in 2022 - a level compatible with the rating. Eneva’s level of leverage may fluctuate because its cash generation is tied to a non-manageable level of dispatching. The classification includes growth of net financial leverage up to 4.5x in a scenario of average dispatch orders of 20% or less. At the end of 2020, net leverage, measured by net debt to EBITDA and net debt to operations resources (FFO), was 3.3x.

RATING SENSITIVITIES

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

- - Net debt/EBITDA and net debt/FFO ratio below 2.5x, on a sustained basis and considering a scenario of average plant dispatches (real or simulated) of 40% or less.

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

- - Net debt/EBITDA and net debt/FFO ratio over 3.5x, on a sustained basis, and dispatch volume of 40% or higher;

- - Net debt/EBITDA and net debt/FFO ratio above 4.5x, on a sustained basis and in a scenario of average plant dispatching of 20% or less;

- - Completion of the acquisition of Polo Urucu, with operational and financial aspects that are materially different from those initially considered;

- - Material worsening of the liquidity profile.

MAIN ASSUMPTIONS

- - Fixed revenue from operating assets of BRL 2.1 billion (based on December 2020) in long-term contracts, adjusted for inflation and with new projects being added over the years;

- - Average dispatch rate of 46% in 2021 and 42% in 2022;

- - Total investments of BRL 3.4 billion from 2021 to 2024;

- - Absence of acquisitions and/or new investments in addition to those under development;

- - Absence of dividend distribution by 2022, 50% distribution in 2023 and 100% in 2024.

SUMMARY OF THE ANALYSIS

Eneva’s rating is one grade lower than that of two other power generators assessed by Fitch, Engie Brasil Energia S.A. (Engie) and Aliança Geração de Energia S.A., both classified with the ‘AAA (bra)’ National Long Term Rating, Stable outlook. In operational terms, Engie has a larger size and a more diversified asset base, with 9.5 GW of installed capacity in operation or under construction. Aliança is of a smaller size: 1.3 GW of installed capacity, consisting mainly of hydroelectric plants, all of which are mature and with energy sale contracts in place for the entire length of the respective concession terms. The constant need for investments in prospecting and development to replenish its natural gas reserves disadvantages Eneva over these two groups because it brings a higher recurring volume of investments than that of the other two companies. In financial terms, Fitch understands that Engie has greater financial flexibility than Eneva, with a historically robust liquidity profile and conservative leveraging. Since it was created with a merging of assets and without debt, Aliança should maintain a lower net financial leverage than Eneva, with a cash position higher than the total debt.

Compared with AES Tietê Energia S.A., assessed by Fitch in the same ranking as Eneva (‘AA + (bra)’/Stable), the longer concession period for Eneva’s plants offsets its higher volume of recurring investments. The two companies should continue to preserve cash on an adequate basis in order to sustain the expected negative FCF of 2021.

LIQUIDITY AND DEBT STRUCTURE

Robust Liquidity Profile: Fitch believes that Eneva will maintain a strong liquidity profile in the coming years, due to a debt maturity schedule with no concentration in the short term and access to longer-term financing sources, such as development banks and incentivized debentures.

At the end of 2020, the company’s liquidity was robust (BRL 2.0 billion) and sufficient to meet the debt repayments projected for the next four years. On the same date, issues of debentures (BRL 5.7 billion) and loans with Banco da Amazônia and Banco do Nordeste (BRL 1.5 billion) accounted for around 80% of the total debt, of BRL 7.1 billion.

REGULATORY INFORMATION:

This publication is a credit risk rating report, for the purposes of complying with article 16 of CVM Instruction n° 9/20.

The information used in this analysis was provided by Eneva.

Fitch takes all necessary measures to ensure that the information used in the credit risk rating is sufficient and originates from reliable sources, including, where appropriate, third-party sources. However, Fitch does not perform audit services and is unable to carry out independent verification or confirmation of the information received in all cases.

Ratings History:

Eneva

Date on which the nationwide rating was first issued: April 22, 2019.

Date on which the nationwide rating was last updated: April 27, 2020.

The risk rating has been communicated to the assessed entities or related parties, and the rating assigned has not been changed as a result of this communication.

The ratings assigned by Fitch are reviewed at least annually.

Fitch publishes the list of actual and potential conflicts of interest in Appendix X of the Reference Form, available at www.fitchratings.com/brasil

For information on possible changes in the credit risk rating, see the item: Rating Sensitivities.

Additional information is available from ‘www.fitchratings.com ‘and’ www.fitchratings.com/ brasil.‘

Fitch Ratings was paid to determine each credit rating listed in this credit risk rating report by the rated debtor or issuer, by a related party other than the debtor or rated issuer, by the sponsor, Underwriter, or the depositor of the instrument, security or bond under assessment.

Applied Methodology and Related Research:

-- Nationwide Rating Methodology (December 22, 2020);

-- Corporate Ratings Methodology (December 21, 2020).

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Rating Actions

ENTITY/DEBT	RATING			RECOVERY	PRIOR
Eneva S.A.	Natl LT	AA+(bra) O	Affirmed		AA+(bra) O

RATINGS KEY OUTLOOK WATCH

POSITIVE	©	❖
NEGATIVE	©	❖
EVOLVING		

RATINGS KEY OUTLOOK WATCH

STABLE	O

Applicable Criteria

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

Corporate Ratings Methodology (pub.21 Dec 2020)

Nationwide Rating Methodology (pub.22 Dec 2020)

Nationwide 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)

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Endorsement Status

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