



RATING ACTION COMMENTARY

Fitch Affirms Alupar's Ratings

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Fitch Ratings - Rio de Janeiro - 19 Jan 2023: Fitch Ratings has affirmed Alupar Investimento S.A.'s Foreign Currency (FC) and Local Currency (LC) Issuer Default Ratings (IDRs) at 'BB' and 'BBB-', respectively. Fitch has also affirmed Alupar's and its subsidiary Foz do Rio Claro Energia S.A.'s National Scale Ratings and outstanding local debentures at 'AAA(bra)'. In addition, Fitch has affirmed Alupar's subsidiary Amazônia Empresa Transmissora de Energia S.A.'s (AETE) and its outstanding local debenture's National Scale Rating at 'AA+(bra)'. The Rating Outlook for the corporate ratings is Stable.

Alupar's ratings reflect its low business risk relative to its diversified portfolio of power transmission assets in Brazil, with predictable revenues and high operating margins. The company also benefits from its generation activity, which adds to dilution of operational and regulatory risks. The group should continue to reduce leverage and present positive FCF in 2023. The company's FC IDR is constrained by Brazil's country ceiling of 'BB', while Brazil's operating environment limits the LC IDR.

Foz do Rio Claro's rating mainly reflects the high legal incentives of Alupar to support this company, while these incentives are considered low to medium factors in the case of AETE.

KEY RATING DRIVERS

Low Business Risk: Alupar's credit profile benefits from the combination of its activities in energy transmission and generation, mainly in Brazil, through a sizable and diversified asset base that dilutes potential operational and regulatory risks. The group's concessions will not begin to expire until 2030 in transmission, and 2038 in generation, and will occur on a staggered basis over the following years.

In transmission, concession revenue (Annual Permitted Revenues [PAR]) is generated through the availability of its assets, without demand risk and annually adjusted for inflation. This segment will remain the company's main business. In the generation segment, long-term contracts for the sale of a large part of the asset's assured energy and the partial protection for hydrological risk also create an expectation of strong and predictable performance. This segment should represent 20%-25% of the consolidated EBITDA from 2023 on, considering the conclusion of the wind complex Agreste Potiguar - Phase 1 and solar complex Pitombeira in 2023.

Leverage to Be Reduced: Fitch expects Alupar's consolidated leverage to be consistent with the current LC IDR in the rating horizon, considering its current portfolio of projects. The base case scenario contemplates an adjusted net debt-to-EBITDA ratio between 3.0x-3.5x in 2023 and 2024, continuing to gradually decline from the peak of 4.7x in 2020 as capex reduces and new projects come into operation and contribute to cash generation. On Sept. 30, 2022, this ratio was 3.5x, according to Fitch's criteria. The group's financial covenants should limit the group's appetite for new sizable projects.

Fitch considers the development of the transmission line Transnorte Energia S.A. (TNE), which should require BRL635 million in capital injection from 2023 to 2025 and BRL865 million in off balance debt guarantee, already included in the leverage ratios, corresponding to Alupar's 51% stake in the project.

Capex Reduction Strengthens FCF: Alupar should present positive FCF of BRL373 million in 2023 and an annual average of BRL1.3 billion during 2024-2025 due to capex reduction and based on dividend distribution corresponding to 50% of net income. The base case scenario takes into account BRL914 million in capex in 2023 and an annual average of BRL158 million in the following two years, significantly below the annual average of BRL1.8 billion during the 2019-2021 period.

Consolidated EBITDA, calculated through regulatory accounting, should reach BRL2.8 billion in 2023 and BRL3.0 billion in 2024, benefitting from an 8.1% average PAR increase of the 2022/2023 cycle, as defined in July 2022. EBITDA margins are high at 80%-85%, characteristic of transmission companies in Brazil. In the LTM ended on Sept. 30, 2022, Alupar's consolidated EBITDA was BRL2.4 billion, with an 86% margin.

Manageable Construction Risk: Alupar's positive track record of developing and obtaining long-term financing for its new transmission and generation projects mitigates the risks associated with the construction phase. The pending long-term project finance debt structure of three transmission lines and of the generation projects is not a major concern. The group needs to raise BRL473 million to refinance bridge loans due in 2023 and BRL388 million for loans due in 2024. Alupar has two

transmission projects and three energy generation plants to be concluded by the end of 2023.

Transmission lines will add 275 km and require BRL661 million in capex, while the conclusion of construction of the generation plants will add an installed capacity of 125 MW and require capex of BRL200 million. Lot 6, a project won in the regulatory auction in December 2022, will also require capex of BRL420 million during 2023-2026.

Parent Strengthens Subsidiaries' Ratings: Taking into account the Parent and Subsidiary Linkage criteria, Fitch equalizes the National Scale Ratings of Foz do Rio Claro and Alupar due to the high legal incentives of the parent to support the subsidiary. Alupar holds 100% of Foz do Rio Claro's shares and is the guarantor of the company's single debt, whose financial covenants are based on Alupar's consolidated figures. Foz do Rio Claro also operates in Alupar's core business.

In the case of AETE, there are no legal or strategic incentives of support from the parent, but the operational incentive is considered as medium and benefits the rating. Alupar does not guarantee AETE's debt and there is no cross-default between them. Alupar owns 32,06% of AETE, which is part of its main business. AETE is not relevant in terms of consolidated revenues (around 1% of PAR), but presents synergies with four other assets of the group. On a standalone basis, AETE's should presents a low net leverage, with 2.5x at the end of 2023.

DERIVATION SUMMARY

Alupar's financial profile is stronger than Latin American peers Interconexión Eléctrica S.A. E.S.P. (FC IDR BBB/Stable) and Consorcio Transmantaro S.A. (FC IDR BBB/Stable), in Colombia, and Transelec S.A. (FC IDR BBB/Stable), in Chile. All these peers have low business risk profiles and predictable cash flow generation, characteristic of transmission electricity companies in a regulated industry. The main difference in the IDRs of Alupar and those companies is the country where they generate their main revenues and the location of assets.

While its peers are located in countries with higher IDRs, Alupar's ratings are negatively affected by Brazil's country ceiling of 'BB'. In the case of Transmissora Aliança de Energia Elétrica S.A.'s (FC IDR BB/Stable), also located in Brazil, both have similar credit profile, with a diversified portfolio of transmission companies and a robust financial profile, with some expected decrease in leverage metrics due to reduction in investments.

KEY ASSUMPTIONS

Fitch's Main Assumptions in its Base Scenario for the Issuer Include:

--PARs adjusted annually by inflation, with a 50% reduction for transmission assets signed until 2007, whose concession agreement contemplates this movement after the 15th year of operation;

--Generation scaling factor of 0.85 in 2023 and 0.93 in 2024;

--Operating expenses adjusted by inflation;

--Distribution of dividends equivalent to 50% of net income (net income based on regulatory accounting standards);

--Total investments of BRL2.3 billion during 2022-2026 period and absence of acquisitions and/or new investments out of the current portfolio.

RATING SENSITIVITIES

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

--Positive rating action for the company's FC IDR depends on an upgrade on Brazil's sovereign rating;

--Positive rating action for the company's LC IDR depends on improvements on Brazil's operating environment;

--An upgrade is not applicable to the National Scale rating as it is at the highest level;

--Higher incentive of Alupar to support AETE may lead to an upgrade on its rating.

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

--Negative rating action for the LC IDR would be associated to a deterioration in Alupar's consolidated financial profile, with net adjusted leverage above 3.5x and funds from operations net leverage above 4.0x, both on a sustainable basis;

--A weaker Brazilian operating environment may result in a downgrade of the LC IDR;

--A downgrade on Brazil's sovereign rating would result in a similar rating action on Alupar's FC IDR;

--A two-notch downgrade on Alupar's LC IDR would lead to a downgrade on the National Scale rating;

--Lower incentive of Alupar to support Foz do Rio Claro and AETE may lead to a downgrade on their ratings;

--Net debt/EBITDA ratio above 5.0x at AETE level could result in a negative rating action on its ratings.

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

Sound Liquidity Profile: Alupar group should continue to benefit from a high liquidity position and broad access to the banking and capital markets. On a consolidated basis, the group's cash position of BRL2.4 billion at the end of September 2022 covered its short-term debt of BRL619 million by 3.9x. Fitch also expects that the operating cash generation of new assets will be adequate to service their debt. On Sept. 30, 2022, total consolidated adjusted debt of BRL11.0 billion mainly consisted of debentures issuances (BRL8.5 billion or 78%) and Banco Nacional de Desenvolvimento Economico e Social (BNDES; BRL620 million, or 6% of the total).

The holding company should use its significant cash reserves to supply the needs of its projects, maintaining a debt maturity schedule compatible with its cash flow expectations. As of Sept. 30, 2022, its cash position of BRL662 million (27% of the consolidated amount) was slightly smaller than the total debt of BRL690 million. The dividends inflow is its main source of funds, with BRL660 million received in the LTM ended on Sept. 30, 2022. In the same period, the total debt-to-received dividends ratio was 1.0x. Alupar should be able to maintain the net debt-to-received dividends ratio below 1.0x over the following years.

ISSUER PROFILE

Alupar is a non-operational holding company active in the energy transmission and generation segments mainly in Brazil, with small operations in other Latin America

countries. The company's shares are traded at B3 in Brazil.

SUMMARY OF FINANCIAL ADJUSTMENTS

Net revenues and EBITDA net of construction revenues and cost.

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 ⇅			PRIOR ⇅
AETE - Amazonia Empresa Transmissora de Energia S.A.	Natl LT			AA+
	AA+(bra) Rating Outlook Stable			(bra) Rating Outlook Stable
	Affirmed			
senior unsecured	Natl LT	AA+(bra)	Affirmed	AA+(bra)
Foz do Rio Claro Energia S.A.	Natl LT			AAA(bra) Rating Outlook Stable
	AAA(bra) Rating Outlook Stable			
	Affirmed			
senior unsecured	Natl LT	AAA(bra)	Affirmed	AAA(bra)

Alupar Investimento S.A.	LT IDR	BB Rating Outlook Stable		BB Rating Outlook Stable
	Affirmed			
	LC LT IDR	BBB- Rating Outlook Stable		BBB- Rating Outlook Stable
	Affirmed			
	Natl LT			AAA(bra) Rating Outlook Stable
	AAA(bra) Rating Outlook Stable			
	Affirmed			
senior unsecured	Natl LT	AAA(bra)	Affirmed	AAA(bra)

[VIEW ADDITIONAL RATING DETAILS](#)

FITCH RATINGS ANALYSTS

Wellington Senter

Director

Primary Rating Analyst

+55 21 4503 2606

wellington.senter@fitchratings.com

Fitch Ratings Brasil Ltda.

Av. Barão de Tefé, 27 – Sala 601 Saúde Rio de Janeiro, RJ 20220-460

Lucas Rios, CFA

Associate Director

Secondary Rating Analyst

+55 11 4504 2205

lucas.rios@fitchratings.com

Mauro Storino

Senior Director

Committee Chairperson

+55 21 4503 2625

mauro.storino@fitchratings.com

MEDIA CONTACTS

Elizabeth Fogerty

New York

+1 212 908 0526

elizabeth.fogerty@thefitchgroup.com

Additional information is available on www.fitchratings.com

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APPLICABLE CRITERIA

[National Scale Rating Criteria \(pub. 22 Dec 2020\)](#)

[Metodologia de Ratings em Escala Nacional \(pub. 22 Dec 2020\)](#)

[Parent and Subsidiary Linkage Rating Criteria \(pub. 01 Dec 2021\)](#)

[Metodologia de Vínculo Entre Ratings de Controladoras e Subsidiárias \(pub. 01 Dec 2021\)](#)

[Corporate Rating Criteria \(pub. 28 Oct 2022\) \(including rating assumption sensitivity\)](#)

[Metodologia de Ratings Corporativos \(pub. 28 Oct 2022\)](#)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Corporate Monitoring & Forecasting Model (COMFORT Model), v8.1.0 ([1](#))

ADDITIONAL DISCLOSURES

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Alupar Investimento S.A.

EU Endorsed, UK Endorsed

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