Research Update:

Centrais Eletricas Brasileiras S.A. – Eletrobras 'BB-' Ratings Affirmed Following Privatization; Outlook Remains Stable

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Rating Action Overview

- On June 14, 2022, Brazilian electric utility Centrais Elétricas Brasileiras S.A. – Eletrobras delivered and settled the sale of 697.5 million shares, diluting the Brazilian government's direct and indirect ownership to about 45% from 61% of total capital (72% of controlling shares).
- Eletrobras' new corporate governance standards limit the government's influence on the company's administrative and strategic decisions, given the board's greater independence. As such, we revised our assessment of the link between Eletrobras and the Brazilian government to strong from very strong.
- On June 15, 2022, S&P Global Ratings affirmed its 'BB-' global scale issuer credit and issue-level ratings on Eletrobras. We revised our view of the likelihood of Eletrobras receiving extraordinary government support to high from extremely high, which doesn't affect the rating considering the company's 'bb-' stand-alone credit profile (SACP). We also affirmed our 'brAAA/brA-1+' national scale ratings on the company.
- The stable outlook on Eletrobras reflects our expectation that the company will continue deleveraging through higher EBITDA generation from the 5.7 gigawatt (GW) new concessions and the gradual migration of 7.5 GW of energy currently under the quota regime to independent contracts starting in 2023.

Rating Action Rationale

Eletrobras concluded its privatization process, lowering government voting rights to 10%. Eletrobras' new corporate governance standards limit the government's influence on the company's administrative and strategic decisions, given the board's greater independence. Under the new corporate governance framework, a single shareholder (direct or indirect) has its voting rights limited to 10%. In addition, there is a poison pill mechanism to limit the ownership by any shareholder to 30% (except the remaining government shares following the public offering dilution). The government retained a golden share with sole purpose of being able to veto to any changes to the new corporate bylaws--in particular, the one that limits single or multiple shareholder voting rights to 10%.

As a result of the lower government influence and owner position, we revised our assessment of the link between Eletrobras and the government to strong from very strong. This in turn triggered a downward revision of our assessment of an extraordinary likelihood of support (LOS) from the government in case of financial distress to high from extremely high. This assessment still reflects that the government owns about 45% of the company's total capital after the public offering, and that the sovereign has incentives, capacity, and tools to support the company if needed. The LOS also continues to capture the following factors:

- No change in our view of Eletrobras's critical role for the government. Eletrobras is the largest integrated utility in Brazil's electricity sector, accounting for about 30% of total generation capacity and 44% of transmission lines in the country. Given the company's size and the time it would take to replace and/or build new assets, we think another entity couldn't undertake these services in the next few years. We also believe that under the new corporate structure, Eletrobras will have more flexibility and agility to invest and expand its portfolio, which will maintain its importance to the Brazilian energy matrix over time.
- A strong link to the government. We revised downward this link to reflect the dilution of the company's control, with no single shareholder entitled to have more than 10% of the board's composition, and the clear limits under the government's golden share. At the same time, the government still guarantees part of Eletrobras's debt (about R$1.05 billion as of March 2022), and has a record of providing cash injections in financial distress scenarios.

We expect the company's deleveraging pace to accelerate. We expect Eletrobras to benefit from more independent governance to accelerate its ongoing strategy to focus on its core business and operating efficiencies, which we view as positive from a credit perspective, but as neutral for the ratings. We expect to see, for example, an acceleration of nonstrategic asset disposals and restructuring of contingent liabilities, including about R$21 billion in financial guarantees provided to projects, which in aggregate could reduce the group's adjusted financial debt from our current base case. In addition, we expect EBITDA to gradually increase as the energy generated by Eletrobras' power plants under the quotas regime gradually migrates to the independent production regime in the next five years: from 100% in 2022 to 80% in 2023, 60% in 2024, 40% in 2025, 20% in 2026, and 0% from 2027 onward. This is because the current average energy price under the quota regime is lower than prices negotiated in the free market and regulated contracts.

Outlook

The stable outlook on Eletrobras reflects our expectation that its intrinsic capacity to repay debt remains equal to that of the sovereign. As a result, the issuer credit rating remains unchanged even considering a weaker likelihood of the company receiving extraordinary government support, which we now view as high (from extremely high).

The outlook also reflects our expectation that Eletrobras will continue deleveraging through higher EBITDA from the 5.7 GW of new concessions and the gradual migration of 7.5 GW of energy under the quota regime to independent contracts starting in 2023. At the same time, we still project adjusted funds from operations (FFO) to debt of 5%-7% and adjusted debt to EBITDA above 5.0x in the next 12 months, considering the full consolidation of Santo Antonio Energia S.A. (SAESA; not rated) and additional debt-like liabilities from the R$27 billion contributions to the Conta do

Desenvolvimento Energético (Energy Development Account or CDE Account).

Downside scenario

We could lower our ratings on Eletrobras in the next 12 months if we lower the sovereign rating on Brazil. Absent any sovereign rating action, a downgrade could result from a weakening of Eletrobras's liquidity. We could also lower the rating if the divesture program takes longer to materialize, given that we expect the company to continue reducing its debt through asset sale proceeds in the next few years.

Upside scenario

We cap our ratings on Eletrobras by that on Brazil. We could revise the company's SACP upward if it deleverages more quickly than we expect, with adjusted debt to EBITDA converging to 4.0x and FFO to debt above 12% in 2023. Asset sales could accelerate the pace of deleveraging, which could include R$9.1 billion shares of publicly traded companies, and the shares of noncontrolling assets such as Belo Monte and Jirau that only contribute with contingent debt. Finally, improved management of provisions for contingencies could also help the company deleverage.

Company Description

Eletrobras is Brazil's national integrated electric utility that focuses on generation (with 50.5 GW in installed capacity) and transmission (74,087 kilometers [km] of lines), which represented about 60% and 40% of its 2021 revenue, respectively. Following the privatization, the government now has 10% of voting rights (down from 72%) and about 45% of total shares (down from 61% directly and indirectly).

Our Base-Case Scenario

Assumptions

- Brazil's GDP to grow 0.6% in 2022, 1.6% in 2023, 1.9% in 2024, and 2.0% afterward (according to our latest economic conditions article, "Global Macro Update: Growth Forecasts Lowered On Longer Russia-Ukraine Conflict And Rising Inflation", May 17, 2022).
- Brazil's average inflation of 10.6% in 2022, 4.9% in 2023, 3.7% in 2024, and 3.0% afterward. We forecast the Brazilian central bank's policy interest rates to peak at 13.25% by the end of 2022 and gradually fall to 6.50% in 2025, as inflation eases.
- Consolidation of recently acquired subsidiary SAESA's 2.4 GW assured energy sold at contracted prices and its R$19.4 billion debt at average cost of IPCA (Brazil's inflation index) plus 7.23%. We also consider the existing stand-still agreement with development bank BNDES on the interest and principal payments.
- New concessions including the renewal of 4.3GW capacity, and 1.4GW of new concessions from assets that received operations and management revenues. We consider that Eletrobras will sell this energy in the regulated market, free market, and spot market
- Gradual migration to independent regime of 7.5GW assured energy of hydro plants currently operating under the quota regime: 1.3GW in 2023, 2.7GW in 2024, 4.0GW in 2025, 5.3GW in

2026, and 6.7GW in 2027. We also consider the company will sell this energy in the regulated market, free market, and spot market.

- Grant fee payment of R$25 billion for the new concession agreements and R$32 billion of contributions to the CDE account, of which Eletrobras will pay R$5 billion in 30 days after the privatization completion and will pay the rest in installments in the next 25 years.
- About R$6 billion in annual indemnification of nondepreciated transmission assets related to the early renewal of the concessions (RBSE) in 2022 and 2023.
- Annual cash capital expenditures (capex) of about R$2 billion in 2022 and R$5.3 billion in 2023, including investment commitments under the privatization framework
- Capital increase in SAESA of R$1.5 billion.
- Net capitalization of R$26.2 billion from the shares sold under the primary offer.
- Minimum annual dividend of R$2.5 billion.

Key metrics:

- Annual FFO of about R$5.0 billion in 2022 and R$8.0 billion in 2023;
- Adjusted debt to EBITDA of above 5.0x in 2022 and 2023; and
- FFO to adjusted debt of 5%-8% in the same time period.

We analyze Eletrobras on a consolidated basis and make several adjustments to its debt, including guarantees provided to unconsolidated companies or projects (about R$21 billion, net of the guarantees provided to SAESA), pension fund contingencies (about R$6.1 billion), and the financial contributions to the CDE account (R$27 billion).

Liquidity

We continue to assess Eletrobras' liquidity as adequate. We expect cash sources over uses to be well above 1.2x for the next 12 months, and for the company to comply with debt covenants. Moreover, in our view, the company has adequate access to the capital markets. In addition, while it has a robust cash position, unexpected cash outlays--including settlement of judicial disputes--could weaken its financial flexibility.

Primary liquidity sources:

- Net cash and equivalents of R$18.4 billion as of March 2022 (including R$3.2 billion in restricted cash);
- Cash FFO of about R$7.0 billion in the next 12 months;
- R$2.5 billion committed loans that its subsidiary Furnas secured in May 2022;
- R$1.1 billion from the sale of a 32.66% stake in CEEE-T; and
- R$26.3 billion net proceeds from the sale of shares under the primary offer.

Primary liquidity uses in the next 12 months:

- Debt maturities of R$8.2 billion as of March 31, 2022;
- Working capital outflows of R$1.5 billion;

- Minimum capex of R$2.5 billion;
- Capital increase in SAESA of R$1.5 billion;
- Dividend distribution of R$1.3 billion;
- Grant fee payment of R$25.4 billion; and
- R$5.0 billion initial contribution to the CDE Account.

Covenants

The company is subject to financial covenant under its debentures of a maximum net debt to adjusted EBITDA of 3.75x. This is measured on an annual basis, and net debt is adjusted to deduct the financial asset related to hydroelectric dam Itaipu. The covenant calculation also excludes guarantees provided to unconsolidated projects, CDE Account contributions and pension-related liabilities that we adjust in our analysis. We think Eletrobras will comply with this covenant in the next few years with a sufficient cushion.

In addition, Furnas duly obtained bondholders' approval on the capitalization of SAESA, which will be higher than 5% of its EBITDA, as defined in the debenture indenture. This was a condition precedent for the privatization.

Environmental, Social, And Governance

ESG credit indicators: To E-3, S-2, G-3; From E-3, S-3, G-3

Following the execution of the privatization, Eletrobras will transfer the ownership of Eletronuclear and all its assets to a newly created government entity that will remain fully controlled by the government. As such, we have revised our view of potential health and safety issues related to the construction of the nuclear plant Angra 3.

Governance factors remain a moderately negative consideration in our credit analysis, because we expect the company to revise its internal governance and risk management procedures under the new corporate governance structure following the privatization.

Issue Ratings - Subordination Risk Analysis

Following the privatization, Eletrobras is now subject to the local insolvency regime in case of default. As a result, we analyze the potential subordination of the debt instruments that we rate in case of hypothetical default.

Capital structure

As of March 31, 2021, the company had about R$41 billion of reported debt, of which R$11.2 billion was secured. Following the full consolidation of SAESA in early June 2022, Eletrobras' adjusted debt increased to R$61.0 billion, of which R$30.2 billion was secured.

We rate Eletrobras' following debt instruments:

- $500 million senior unsecured notes due February 2025;
- $738 million senior unsecured notes due February 2030;

- R$5 billion second debentures with final maturity in 2029; and
- Furnas's R$1.25 billion debentures, guaranteed by Eletrobras.

Analytical conclusions

The senior unsecured debt ratings are at the same level as our issuer credit ratings on the company because the debt issued by the subsidiaries is mostly unsecured and guaranteed by the holding company, Eletrobras. At this point, considering the full consolidation of SAESA's R$19 billion secured debt, the company's secured debt ratio reached 49.7%, which is below 50% of Eletrobras' consolidated debt.

Ratings Score Snapshot

Issuer credit rating: BB-/Stable/--

Business risk: Satisfactory

- Country risk: Moderately high
- Industry risk: Intermediate
- Competitive position: Satisfactory

Financial risk: Highly leveraged

- Cash flow/leverage: Highly leveraged

Anchor: b+

Modifiers

- Diversification/portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Financial policy: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Management and governance: Fair (no impact)
- Comparable rating analysis: Positive (+1)

Stand-alone credit profile: bb-

Related government rating: BB-

Likelihood of government support: High (no impact)

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019

- General Criteria: Methodology For National And Regional Scale Credit Ratings, June 25, 2018
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | Industrials: Key Credit Factors For The Unregulated Power And Gas Industry, March 28, 2014
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria | Corporates | Utilities: Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Regulatory Support Underpins Latin American Utilities' Credit Quality, Although Political Interference Is Rising In Some Countries, June 13, 2022

Ratings List

Ratings Affirmed	
Eletrobras-Centrais Eletricas Brasileiras S.A.	
Issuer Credit Rating	BB-/Stable/--
Brazil National Scale	brAAA/Stable/brA-1+
Analytical Factors	
Local Currency	bb-
Eletrobras-Centrais Eletricas Brasileiras S.A.	
Senior Unsecured	BB-
Senior Unsecured	brAAA

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.