



RATING ACTION COMMENTARY

Fitch Revises Outlook of Eletrobras to Negative; Affirms IDRs at 'BB-'

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Fitch Ratings - Rio de Janeiro - 16 Jun 2023: Fitch Ratings has affirmed Centrais Eletricas Brasileiras S.A.'s (Eletrobras) Long-Term Foreign and Local Currency Issuer Default Ratings (IDRs) and outstanding senior unsecured bond ratings at 'BB-'. Eletrobras' National Scale rating, as well as its rated subsidiaries and their outstanding local debentures is affirmed at 'AA(bra)'. Fitch has revised the Rating Outlook for the corporate ratings to Negative from Stable.

The Outlook revision to Negative reflects the expectation of lower cash generation coming from the sale of uncontracted energy, which should prevent Eletrobras from as expected. It also takes into account the increase on the risk of the hydro power plant (UHE) Belo Monte, where Eletrobras guarantees BRL14 billion of debt, as well as surrounding the new capex plan and the need to address around BRL20.4 billion of debt maturing until December 2024.

Eletrobras' ratings consider its relevant and diversified asset base, moderate to high leverage and strong liquidity position, with expected positive FCF from 2024 on. TI ratings are equalized to Eletrobras' rating due to medium to high incentives of support from the parent, if needed.

KEY RATING DRIVERS

Strong Business Profile: Eletrobras has a strong business position in the electricity energy sector in Brazil, as the country's largest player in the generation and transmission. Its 43 GW of installed capacity and 74,000 km of transmission lines represent 22% and 38% in terms of national market share, respectively. Around 70% of the group's contracts in the regulated market annually readjusted for inflation - 38% from transmission segment and 33% from generation. These revenues provide moderate visibility to medium term. Almost 10% of regulated revenues come from energy generation sold under quota regime that will gradually migrate to the unregulated market until 2026. Expectation of higher prices for the new contracts.

Moderate to High Leverage: Eletrobras' net adjusted financial leverage, including off-balance guarantees, should remain above 4.5x until at least 2026, with 5.6x in 2024. Eletrobras' off-balance debt of BRL28.7 billion at the end of March 2023 mainly incorporates guarantees provided to UHE Belo Monte (BRL14.2 billion) and to the power plant Angra 3 (BRL6.1 billion). Eletrobras' guarantees to Angra 3 should grow as this project still has an estimated BRL20 billion of capex during 2024-2028, with Eletrobras responsible for BRL7.2 billion, relative to its 35.9% stake. The sizable guarantee to UHE Belo Monte's debt currently has higher weight on the leverage metrics as this profile has deteriorated.

High Exposure to Price Risk: Eletrobras' high uncontracted energy generation capacity and Fitch's expectation of energy prices in Brazil around 25% lower than previously anticipated, should disrupt the group's forecast cash generation. The group needs to recontract 1.5GW in 2023, 3.0GW in 2024, 6.1GW in 2025 and 8.3GW in 2026, with an uncontracted position of 16%, 29%, 48% and 62%, respectively. Fitch's base case scenario considers energy sales prices of BRL128/MWh in 2023, BRL110/MWh in 2024, and an average of BRL131/MWh during the 2025-2026 period, around 25% lower than previous expectations. Currently, around 62% of Eletrobras' revenue comes from regulated transmission (38%) and generation (24%) segments, and the reduction of the energy sold to the regulated market increases the company's exposure to unfavorable energy prices in Brazil.

Synergies from Privatization Process: Higher prices in the generation segment compared with that of the quota regime and potential efficiency synergies from privatization moderately improve Eletrobras' EBITDA in the coming years. The base case scenario takes into account BRL9.9 billion in 2023 and BRL11.5 billion in 2024, assuming BRL savings in personal expenses as a result of dismissal plans promoted in 2022 and 2023, with full impact in 2024. Fitch estimates the dismissal plan cost of BRL2.0 billion in 2025. This initiative and other expected cash outflows will affect the company's cash flow from operations (CFFO), which should reach BRL4.7 billion in 2023 and BRL4.7 billion in 2024. FCF is expected to be negative in BRL300 million in 2023 and positive in BRL1.6 billion in 2024, after annual investments close to BRL4.0 billion and dividend payments.

Subsidiaries' Ratings Equalized: Fitch equalizes the National Scale ratings of Companhia Hidro Eletrica do Sao Francisco (Chesf) and Companhia de Geracao e Transmissao Eletrica do Sul do Brasil - Eletrobras CGT Eletrosul (CGT Eletrosul) with Eletrobras' rating due to the medium to high set of legal, operational and strategic incentives from controlling shareholder to support them, if needed.

Eletrobras holds a 100% stake of Chesf and CGT Eletrosul and these two subsidiaries are included in cross default clauses of the parent Eurobonds and local debentures. Operating and strategic incentives are mainly based on the importance of Chesf and CGT Eletrosul's assets for Eletrobras group and the centralized operational and financial management.

DERIVATION SUMMARY

Eletrobras' 'BB-' rating is three notches below the Local Currency (LC) IDR of the Brazilian generation company Engie Brasil Energia S.A. (Engie Brasil; BBB-/Stable) and transmission groups Alupar Investimento S.A. (Alupar; BBB-/Stable) and Transmissora Alianca de Energia Eletrica S.A. (Taesa; BBB-/Negative) due to its worst operating and weaker financial profile, despite its larger size and asset diversification.

Eletrobras will have higher gross and net leverage than these peers, particularly after the consolidation of Santo Antonio Energia S.A. and its incurring of privatization-related debt. Eletrobras' 2022 gross and net adjusted leverage were 7.8x and 5.7x, respectively, which includes off balance sheet guarantees as debt. These ratios were 2.7x and 2.4x for Engie Brasil, 4.7x and 3.6x for Alupar, and 4.3x and 3.7x for Taesa, respectively.

Eletrobras' leverage is expected to remain above that of its peers over the next two years, with 2023 net leverage of 5.5x and 4.7x in 2024, while Engie Brasil's will be 2.7x and 2.4x in 2024 and 2025, respectively. Alupar's leverage will be in the 3.0x-3.5x range, and TAESA's will be in the 4.0x-4.5x range. Additionally, Alupar and TAESA have a lower business risk profile due to their focus on electricity transmission, which has less variability than generation.

KEY ASSUMPTIONS

Fitch's Key Assumptions Within the Rating Case for the Issuer:

- Energy sales average 10.3 GW in 2023 and 10.7 GW in 2024, not including thermal and quotas capacity;
- Average sales price for the uncontracted capacity of BRL128/MWh in 2023, BRL110/MWh in 2024 and BRL126/MWh in 2025;
- 20% per year of capacity under the quota regime is repriced to reflect market prices;
- SG&A expenses adjusted by inflation;
- Dividends of 25% of net income;
- Capex of BRL12.6 billion from 2023 to 2025;
- No distributions associated with the outstanding guarantees to non-consolidated subsidiaries;
- Conclusion of Nuclear Plant Angra 3 construction in 2028.

RATING SENSITIVITIES

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

The Outlook may be revised to Stable if:

- Uncontracted energy position declines allowing greater cash flow visibility;
- The risk of off-balance debt guarantees materializes into cash reductions, mainly the one related to UHE Belo Monte;
- Improvement in the debt maturity schedule;
- Sustained total adjusted leverage below 6.0x and sustained net adjusted leverage below 5.0x, coupled with FFO interest coverage closer to 3.0x.

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

- Continuity of high uncontracted energy position;
- Increasing risk relative to the off-balance guarantees;
- Deterioration on the debt and liquidity profiles;
- Total adjusted leverage above 6.0x or net adjusted leverage above 5.0x on a sustainable basis;
- Higher pressure on the expected FCF.

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 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 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'. 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: Eletrobras' strong liquidity position is a key consideration in its ratings as it mitigates the existing debt maturity concentration. In March of 2023, Eletrobras reported robust consolidated cash and marketable securities of BRL20.0 billion compared with its short-term debt of BRL6.7 billion and BRL20.4 billion maturing from April 2023 to December 2024. The cash inflow of BRL950 million in April 2023, related to the transfer of Itaipu Binacional to Empresa Brasileira de Participações em Energia Nuclear (ENBPar), reinforced the liquidity position. Fitch views that Eletrobras has to solve its debt concentration within the next few quarters, but its financial flexibility is a positive consideration.

Eletrobras' adjusted consolidated debt of BRL86.0 billion as of March 2023 was mainly concentrated in debentures (29%) and Brazilian state-owned entities (27%). Bradesco Federal bank BNDES holds 16% of the consolidated on-balance-sheet debt, with Petrobras being responsible for 11%. Foreign currency debt is manageable, representing 10% of the group's debt. Off balance sheet debt of BRL28.6 billion was mainly comprised by corporate guarantees in loans of UHE Belo Monte (BRL14.2 billion) and Angra 3 (BRL14.4 billion).

ISSUER PROFILE

Eletrobras is the largest electric energy group in Brazil. It operates in the energy generation and energy transmission segments. The group is responsible for 22% of the generation capacity and 38% of the transmission lines in the country.

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.

RATING ACTIONS

ENTITY / DEBT ↕	RATING ↕			PRIOR ↕	
Companhia de Geracao e Transmissao de Energia Eletrica do Sul do Brasil (CGT ElectroSul)	Natl LT	AA(bra)	Rating Outlook Negative	Affirmed	AA(bra) Rating Outlook Stable
senior unsecured	Natl LT	AA(bra)	Affirmed		AA(bra)
senior secured	Natl LT	AA(bra)	Affirmed		AA(bra)
Centrais Eletricas Brasileiras S.A. (Eletrobras)	LT IDR	BB-	Rating Outlook Negative	Affirmed	BB- Rating Outlook Stable
	LC LT IDR	BB-	Rating Outlook Negative	Affirmed	BB- Rating Outlook Stable
	Natl LT	AA(bra)	Rating Outlook Negative	Affirmed	AA(bra) Rating Outlook Stable
senior unsecured	LT	BB-	Affirmed		BB-
Companhia Hidro Eletrica do Sao Francisco S.A.	Natl LT	AA(bra)	Rating Outlook Negative	Affirmed	AA(bra) Rating Outlook Stable
senior secured	Natl LT	AA(bra)	Affirmed		AA(bra)

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APPLICABLE CRITERIA

[Government-Related Entities Rating Criteria \(pub. 30 Sep 2020\)](#)
[Corporate Hybrids Treatment and Notching Criteria \(pub. 12 Nov 2020\)](#)
[National Scale Rating Criteria \(pub. 22 Dec 2020\)](#)
[Parent and Subsidiary Linkage Rating Criteria \(pub. 01 Dec 2021\)](#)
[Corporate Rating Criteria \(pub. 28 Oct 2022\) \(including rating assumption sensitivity\)](#)

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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Centrais Elétricas Brasileiras S.A. (Eletrobras)

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