

RATING ACTION COMMENTARY

Fitch Affirms NTS' Rating at 'AAA(bra)'; Outlook Stable

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Fitch Ratings - Rio de Janeiro - 18 Jan 2022: Fitch Ratings has affirmed Nova Transportadora do Sudeste S.A.'s (NTS) National Long-Term Rating at 'AAA(bra)'. Fitch has also affirmed NTS' BRL5.2 billion second debentures issue due April 2023 at 'AAA(bra)'. The Rating Outlook for the corporate ratings is Stable.

NTS' ratings reflect its solid business model, supported by long-term contracts and the Brazilian gas transportation industry's low risk profile, which allows healthy protection of its revenues, high margins and strong and stable operating cash flows. These features should continue to preserve the company's robust credit profile. The ratings also factor in NTS' low need for capex, high free cash flow (FCF) balances before distribution to shareholders, in addition to the conservative credit metrics.

The Stable Outlook on the corporate rating reflect that, over the rating horizon, NTS will continue to show robust operating cash generation and credit metrics in line with its strong credit quality.

KEY RATING DRIVERS

Robust Business Profile: NTS' credit profile is strong and benefits from a natural monopoly in the industry. The company's entire installed capacity for transporting natural gas is contracted under ship or pay clauses, which protects it from fluctuations in the volume of gas actually transported. This translates into high predictability of operating cash

generation, as NTS' fees are paid for the availability of its gas pipelines, and not for the volume transported.

The company's installed capacity is 100% contracted by Petroleo Brasileiro S.A. (Petrobras; Long-Term Foreign and Local Currency Issuer Default Ratings (IDRs) 'BB-/Negative and National Long-Term Rating 'AA(bra)'/Stable), by means of five long-term contracts, the closest maturity in 2025, which represents about 30% of its total revenues, and tariffs adjusted by the inflation index IGP-M (General Price Index - Market).

Revenue Concentration at Petrobras: Petrobras is the only counterparty to NTS' operating gas transportation contracts. The risk of concentration is mitigated by the very low possibility of interruption in the supply of gas by the oil company to its customers (gas distributors), since it is a basic input of distributor activity. Petrobras' payments to NTS are also guaranteed by receivables from a pool of gas distributors that are clients of the oil company, which must represent at least 120% of the monthly amount to be received by NTS, a percentage that has been above this level. The gas distributors' credit profiles are robust, which mitigates default risk, as payments for gas supply is a priority.

Strong and Resilient CFFO Generation: NTS' operating cash generation should continue to strengthen in 2022, with the increase in its tariffs contractually linked to the IGP-M index, which increased by approximately 17.8% in 2021. Fitch's base scenario projects an EBITDA of BRL5.1 billion in 2021, with growth to BRL6.2 billion in 2022 and BRL6.6 billion in 2023, and margins between 89% and 92% in the period.

As of 2022, the company's profitability should benefit from a reduction in costs, with the internalization of services performed by Petrobras Transporte S.A. (Transpetro) by July 2021. The expected CFFO is BRL3.8 billion per year during 2021-2023, which is considered robust to sustain estimated investments of BRL298 million on average per year in the period, and dividends of BRL2.9 billion. This also allows the company to continue generating positive free cash flow (FCF) of BRL580 million on average per year in the period.

Strong Financial Profile: NTS is expected to maintain a conservative net leverage below 2.0x, already considering off-balance obligations in the amount of BRL1.6 billion related to the guarantee offered by the company for the first debentures issuance by Nova Infraestrutura Gasodutos Participacoes S.A. (NISA), one of NTS' shareholders, holding a 10% stake. The company is expected to maintain its robust financial profile over the next three years in the event of new debt issues or additional guarantees.

Diversification Strategy: NTS is focused on diversifying its customer base and expanding its transportation infrastructure to serve new shippers. Currently, the company operates a network of gas pipelines considered strategic for the country's infrastructure. The Southeast region of Brazil, where the company is located, is the most economically important and concentrates 50% of the country's gas demand, which needs its infrastructure and strengthens its business profile.

The company's infrastructure is also important for transporting gas from Bolivia, from Santos and Campos basins and from liquefied natural gas (LNG) terminals in the Southeast to other regions of the country.

Regulatory Changes Expected to Be Neutral: A greater opening of the gas market in Brazil is expected, due to the sale of Petrobras' assets in the industry. The agency believes that potential regulatory changes in the short term may provide greater flexibility in the purchase and sale of natural gas, increasing demand and, consequently, investments in transportation and distribution.

The incentives to reduce the prices of gas to the final consumer and the potential increase in consumption and production of gas in the country in the coming years, strengthen the importance of the assets operated by NTS, which currently move a volume of gas below the capacities foreseen in its gas transportation contracts.

DERIVATION SUMMARY

NTS' business profile, characterized by its robustness and predictability of cash flows, is similar to that of Fitch-rated Brazilian electric power transmission companies, such as Transmissora Alianca de Energia Eletrica S.A. (Taesa; National Long-Term Rating AAA(bra)/Stable) and Companhia de Transmissao de Energia Eletrica Paulista S.A. (CTEEP; National Long-Term Rating AAA(bra)/Stable), which bill for the electric network availability, and not for the conveyed volume.

Long-term contracts automatically adjusted by inflation are another common feature in the gas transportation and energy transmission businesses. Like NTS, both power transmission companies have strong financial profiles. Alupar Investimento S.A. (Alupar; National Long-Term Rating AAA(bra)/Stable) also operates mainly in the transmission segment. Alupar is expected to reduce its leverage based on the delivery of projects, which should favor its cash generation in the coming years. Consolidated adjusted net leverage is expected to be 4.0x for 2021 and below 3.5x from 2022 onwards, after the expected peak of 4.7x in 2020, due to investment concentration.

KEY ASSUMPTIONS

- Revenue based on contracted amounts adjusted annually by the IGP-M index;
- Average capex of BRL267 million between 2021 and 2023;
- Dividend payouts of BRL2.7 billion in 2021 and BRL2.9 billion (95% of the company's net income), on average, from 2022 onwards;
- Fulfillment of transportation contracts currently in effect between NTS and Petrobras.

RATING SENSITIVITIES

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

- Not applicable, as NTS' rating is already at the highest level of Fitch's national scale.

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

- Substantial deterioration in Petrobras' credit profile, resulting in the company's rating being revised to 'A(bra)';
- Weakening of the guarantee structure of Petrobras' customers who make deposits in the collection account;
- Net leverage above 3.5x on a sustainable basis;
- Regulatory or contractual changes altering the fundamentals of the gas transportation industry and/or NTS' business model.

LIQUIDITY AND DEBT STRUCTURE

High Financial Flexibility: NTS operates with moderate liquidity ratios. Cash outflows have occurred more consistently, since dividend distributions to shareholders have been quarterly. Interest payments, which are expected to increase, are supported by the company's robust operating cash flow. NTS has broad access to debt and capital markets, and has flexibility to manage its aggressive shareholder remuneration strategy.

This ability will be important over the next few quarters, considering the approaching maturity of its BRL5.2 billion debentures in April 2023. Fitch expects NTS to address the refinancing of the debentures over the next few quarters.

As of September 2021, NTS' cash and marketable securities position was BRL1.2 billion, as per Fitch's criteria, which excludes the restricted cash balance of BRL259 million. In the same period, NTS's total adjusted debt was BRL6.9 billion, consisting mainly of the second debenture issue and the off-balance guarantee offered to NISA's debentures, in the amount of BRL1.6 billion.

ISSUER PROFILE

NTS operates 2,048 km of gas pipelines under an indefinite term authorization in the three most economically important states of Brazil, located in the Southeast region: Sao Paulo (SP), Rio de Janeiro (RJ) and Minas Gerais (MG).

SUMMARY OF FINANCIAL ADJUSTMENTS

-- NISA's debentures in the amount of BRL1.6 billion guaranteed by NTS were adjusted to the debt (off-balance);

-- Fitch considered as restricted cash the amount referring to the right of way that is being negotiated with Petrobras.

RATING ACTIONS

ENTITY / DEBT ↕	RATING ↕			PRIOR ↕
Nova Transportadora do Sudeste S.A. - NTS	Natl LT	AAA(bra) Rating Outlook Stable		AAA(bra) Rating Outlook Stable
	Affirmed			
senior unsecured	Natl LT	AAA(bra)	Affirmed	AAA(bra)

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APPLICABLE CRITERIA

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

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

[Corporate Rating Criteria \(pub. 15 Oct 2021\) \(including rating assumption sensitivity\)](#)

[Metodologia de Ratings Corporativos \(pub. 15 Oct 2021\)](#)

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](#))

ADDITIONAL DISCLOSURES

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[Endorsement Policy](#)

ENDORSEMENT STATUS

Nova Transportadora do Sudeste S.A. - NTS

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Energy and Natural Resources Corporate Finance Latin America Brazil
