



## **RATING ACTION COMMENTARY**

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

Wed 27 Dec, 2023 - 1:15 PM ET

Fitch Ratings - Rio de Janeiro - 27 Dec 2023: Fitch Ratings has affirmed Nova Transportadora do Sudeste S.A.'s (NTS) National Long-Term Rating at 'AAA(bra)'. Fitch has also affirmed NTS's fifth unsecured debentures issuance at 'AAA(bra)'. The Rating Outlook for the corporate ratings is Stable.

NTS's ratings reflect its solid business model, supported by long-term contracts with no volumetric risk and the low-risk profile of the natural gas transportation industry in Brazil. These features provide revenue protection, high margins and predictability of operating cash flow. The ratings also factor in NTS's reduced capex needs, high FCF balances before distribution to shareholders and conservative financial metrics. Potential resource upstream maximizing strategies for shareholders should not change the company's credit profile, depending on the amounts involved.

#### **KEY RATING DRIVERS**

**Robust Business Profile:** NTS's 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 flow generation, as NTS's fees are paid for the availability of its gas pipelines, and not for the volume transported.

The company's installed capacity is mainly contracted by Petroleo Brasileiro S.A. (Petrobras; Long-Term Foreign and Local Currency Issuer Default Ratings BB/Stable and National Long-Term Rating AAA[bra]/Stable), by means of five long-term contracts, with the closest maturity in 2025, which represents about 30% of its revenues, with tariffs adjusted for the inflation index IGP-M.

**Concentration of Revenue at Petrobras:** Petrobras is the main counterparty of NTS's gas transportation contracts, representing almost the entire of the issuer's revenue. The concentration risk 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 the distributors' activity. Petrobras's 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.

The gas distributors' credit profiles are robust, which mitigates the risk of default, as payment for the gas supply is a priority for them. NTS also relies on letters of guarantee, contracted by Petrobras from

top tier banks, as an additional guarantee of these payments to NTS.

**Strong and Resilient CFFO:** NTS's cash generation is expected to remain strong. At the end of 2025, with the expiration of one of the five contracts with Petrobras, which represents around 30% of NTS's revenue, there may be some impact on the company's cash generation, but a unlikely to deteriorate its credit profile. Fitch's rating case forecasts EBITDA of BRL6.5 billion in 2024 and BRL6.7 billion in 2025, with a reduction to BRL6.2 billion in 2026, all with high margins in the range of 92% to 93%.

These compare to BRL6.6 billion in the 12-month period ended September 30, 2023, with a margin of 92%. The expected average annual cash flow from operations (CFFO) is BRL3.7 billion in 2024-2025, enough to support the estimated capex of BRL620 million and robust annual dividends of BRL3.0 billion, on average, resulting in a FCF of BRL139 million, on average, in the two-year period.

**Strong Financial Profile:** NTS is expected to maintain a conservative net leverage below 2.0x until 2026. The company should also maintain its robust financial profile over the next three years, even in the event of new debt issuances to support a potential growth strategy with the provision of additional services in the liquefied natural gas (LNG) industry. NTS's reduced level of leverage should support an increase in indebtedness for higher capex, if necessary, without pressuring its credit profile. At the end of September 2023, the net debt/EBITDA ratio was 1.7x. Fitch estimates the company's maximum leverage at around 3.0x, incorporating a possible scenario of increase in the investment cycle and maximizing the shareholders' value, still consistent with the current rating.

**Favorable Diversification Strategy:** NTS is focused on diversifying its customer base and expanding its transportation infrastructure to serve new shippers, with new customers being subject to the same existing contractual conditions. The Southeast region, where NTS's infrastructure is located, is the most economically important in the country and concentrates around 50% of Brazil's gas demand, which needs its infrastructure, which in turn strengthens its business profile. The company's pipeline network is also important for transporting gas from Bolivia, from the Santos and Campos basins and from LNG terminals in the Southeast to other regions of Brazil.

**Neutral Regulatory Environment:** The opening of the gas market in Brazil does not change NTS's credit profile. Fitch believes that the regulatory changes provide greater flexibility in the purchase and sale of natural gas, increasing demand and, consequently, investments in transportation and distribution. The base case scenario assumes that the potential increase in consumption and production of gas in the country in the coming years should remain and strengthen the importance of the assets operated by NTS, which currently transport, in some stretches of the pipeline, gas volumes below the capacities foreseen in its gas transportation contracts.

## **DERIVATION SUMMARY**

NTS's business profile, characterized by its robustness and cash flows predictability, is similar to that of Fitch-rated Brazilian electric power transmission companies, such as Transmissora Alianca de Energia Eletrica S.A. (Taesa; AAA[bra]/Stable) and Companhia de Transmissao de Energia Eletrica Paulista S.A.

(CTEEP; AAA[bra]/Stable), which bill for the electric network availability, and not for the transported volume.

Long-term contracts automatically adjusted for inflation are also a common feature in the gas transportation and energy transmission businesses. NTS has lower financial leverage compared to these two companies, while the energy transmission companies have greater dilution of operational risks due to greater asset diversification.

NTS's solid financial and business profiles are also similar to that of Transportadora Associada de Gas S.A. (TAG; AAA[bra]/Stable), although the latter has slightly lower EBITDA margins. Both companies operate in the gas transportation industry in Brazil through long-term contracts without volumetric risk.

### **KEY ASSUMPTIONS**

- Revenue based on contracted figures adjusted annually by the IGP-M index;
- Reduction of around 8% in revenue in 2026 due to termination of one of the transportation contracts that expires at the end of 2025, with recontract under new basis;
- Average capex of BRL501 million between 2024 and 2026;
- Average dividend pay-out of BRL3.1 billion between 2024 and 2026;
- Fulfilment 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 the 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's credit profile, resulting in the company's rating being downgraded to the 'A(bra)' category;
- Weakening of the guarantee structure of Petrobras's customers who make deposits in the NTS's collection account;
- Net leverage above 3.5x on a sustainable basis;
- Regulatory or contractual changes that negatively impact the fundamentals of the gas transportation industry and/or NTS's business model.

## LIQUIDITY AND DEBT STRUCTURE

High Financial Flexibility: NTS operates with moderate liquidity ratios and has broad access to debt and capital markets, and it also has the flexibility to manage its aggressive shareholder remuneration strategy. As of September 2023, NTS cash and marketable securities were satisfactory at BRL745 million, while the adjusted debt totaled BRL11.7 billion, consisting mainly of debentures (BRL6.0 billion) and bank loans, with no exchange rate exposure. The company's debt amortization schedule was extended, with short-term debt amounting to BRL497 million.

## ISSUER PROFILE

NTS operates 2,048km of gas pipelines under an indefinite term authorization in the three most economically important states of Brazil: Sao Paulo (SP); Rio de Janeiro (RJ) and Minas Gerais (MG). The company's shareholders are Nova Infraestrutura Fundo de Investimento em Participacoes Multiestrategia (FIP), managed by Brookfield, with 91.50%, and Itausa S.A. (Itausa), with 8.50%.

## RATING ACTIONS

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

### VIEW ADDITIONAL RATING DETAILS

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**APPLICABLE CRITERIA**

Metodologia de Ratings em Escala Nacional (pub. 22 Dec 2020)

Metodologia de Ratings Corporativos (pub. 10 Nov 2023)

**APPLICABLE MODELS**

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

Corporate Monitoring &amp; Forecasting Model (COMFORT Model), v8.1.0 (1)

**ADDITIONAL DISCLOSURES**

Solicitation Status

Endorsement Policy

**ENDORSEMENT STATUS**

Nova Transportadora do Sudeste S.A. - NTS

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