



RATING ACTION COMMENTARY

Fitch Rates NTS's Proposed Sixth Debenture Issuance 'AAA(bra)'

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Fitch Ratings - Rio de Janeiro - 01 Feb 2024: Fitch Ratings has assigned a 'AAA(bra)' Long-Term National Rating to Nova Transportadora do Sudeste S.A. - NTS's (NTS) BRL8.0 billion sixth proposed unsecured debentures in three tranches with final maturity in 10 years. The proceeds will be invested in an exclusive fund, which will acquire BRL8.6 billion in notes to be issued by NTS shareholders. The structured transaction provides for the use/retention of the dividend flow to shareholders as the main source of payment for the issuance. NTS' National Long-Term Rating is 'AAA(bra)' with a Stable Rating Outlook.

NTS's rating reflects its solid, monopolistic business model in the natural gas transportation industry in Brazil, supported by long-term contracts without volumetric risk and with a guarantee structure, which provide revenue protection and high margins. The company's credit profile also benefits from robust FCF balances before dividend distributions. Fitch considers that the proposed debenture issuance is part of a structure for the advance of funds to shareholders, which implies additional financial commitments to NTS and a manageable increase in its financial leverage. Still, NTS's financial profile will remain strong and consistent with the current rating.

KEY RATING DRIVERS

Robust Business Profile: NTS's business profile is strong and benefits from the monopolistic nature of its natural gas transportation activity. 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 supports the high revenue predictability, as NTS is paid for the availability of its gas pipelines. 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 contracts whose tariffs are readjusted by the inflation index IGP-M. One of these contracts, representing around 30% of revenues, expires at the

end of 2025, while the others expire in 2030 and 2031. Fitch's rating base case scenario considers their renewal, with a 30% reduction in revenue corresponding to each contract after expiration.

Guarantees Minimize Risk of Revenue Concentration: Petrobras is the main counterparty of NTS's gas transportation contracts, representing almost all 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). Petrobras's payments to NTS are also guaranteed by receivables from a pool of gas distributors that are clients of the oil company, which are expected to 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 is expected to maintain its strong position as an FCF generator before dividends, even after the expiration and expected re-contracting of current contracts. The rating base case scenario contemplates EBITDA of BRL6.5 billion in 2024 and BRL6.7 billion in 2025, with a reduction to BRL6.2 billion in 2026, all with a high margin in the range of 92% to 93%. Expected average annual cash flow from operations (CFFO) is BRL4.0 billion in 2024-2025, with investments and robust average annual dividends estimated at BRL579 million and BRL3.1 billion, respectively, and FCF of BRL221 million, on average, in the two-year period.

Dividend Flow Supports Issuance: At least part of the high volume of dividends is expected to return to NTS with the payment by the shareholders of the debt service of BRL8.6 billion, whose main source of funds should be these dividends received, increasing the flow of company cash to pay its debt. NTS's BRL8.0 billion debentures and the BRL8.6 billion notes issued by the shareholders, to be acquired by NTS, were structured in such a way that the schedule and percentages of principal amortization, as well as the periods of interest payments, are the same.

The operations are carried out in Brazilian real and the remuneration to be received by NTS is 80 basis points (bps) higher than the cost of the debentures. The notes have a clause that requires the use of the dividends received by shareholders to pre-pay debt service due within the same fiscal year, which strengthens NTS's expectation of receipt. Over the past three years, NTS has distributed a total of BRL8.6 billion in dividends.

Increase in Financial Leverage: The proposed debenture issuance will increase NTS's financial leverage to a range of 2.7x to 3.0x by 2028, with a downward trend from 2029 onwards, when the repayment of the principal of this operation begins. In the previous rating base case scenario, the net debt/EBITDA ratio remained below 2.0x.

For the purpose of calculating leverage, Fitch did not consider in the company's cash position and financial investments the BRL8.6 billion in notes to be acquired by NTS from its shareholders, most of which financed with the resources from the proposed debenture issuance. Initially, the receipt of these notes by NTS must be associated with a payment of dividends by the company to its shareholders, generating a neutral cash flow. Therefore, the payment of BRL8 billion in debentures, as well as of the other debts, will be heavily dependent on the issuer's cash generation.

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 that 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. Despite the expected increase, NTS's financial leverage will remain lower compared with that of these two companies, while the energy transmission companies have greater dilution of operational risks due to greater asset diversification.

NTS's still 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 BRL3.2 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 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: The robustness and resilience of operating cash generation and broad access to the debt and capital markets limit NTS's risks of operating with moderate liquidity. As of September 2023, NTS cash and marketable securities were satisfactory, at BRL745 million, with a substantial strengthening being expected by the end of 2023. Part of the company's liquidity will be used for the acquisition of BRL8.6 billion in shareholder notes, as the proposed debenture issuance is in the amount of BRL8.0 billion.

At the same date, adjusted debt totaled BRL11.7 billion, with maturities of BRL3.7 billion until 2026. This mainly consisted of debentures (BRL6.0 billion) and bank loans, with no FX exposure. Once the transaction is completed, NTS will hold a total debt close to BRL20 billion, with the company's current debt amortization schedule unchanged until 2028, as the payment of the new issuance is scheduled to start in 2029.

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 ↕
Nova Transportadora do Sudeste S.A. - NTS	
senior unsecured	Natl LT AAA(bra) New Rating

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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 & Forecasting Model (COMFORT Model), v8.1.0 (1)

ADDITIONAL DISCLOSURES

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ENDORSEMENT STATUS

Nova Transportadora do Sudeste S.A. - NTS

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