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Ratings

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Transmissora Alianca de Energia Eletrica S.A.

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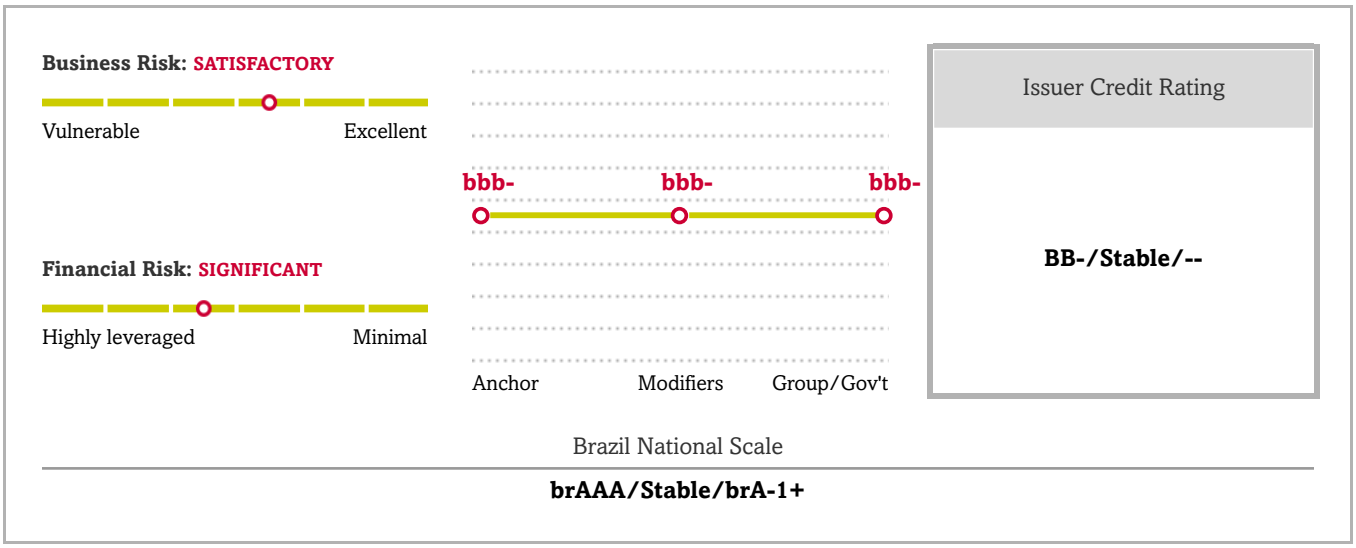
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Transmissora Alianca de Energia Eletrica S.A.



Credit Highlights

Overview

Key strengths	Key risks
Predictable cash flow generation because revenues are based on the availability of its transmission assets.	Potential delays of the seven projects under construction and weakening of counterparties' credit quality amid COVID-19 pandemic.
Strong operating performance, with adjusted EBITDA margins above 90% and line availability above 99%.	Reduction of 50% of the permitted annual revenues (RAP) in some assets, according to their concession contracts.
Brazil's regulations provide an adequate framework.	Worsening of credit metrics over the next few years to support investment plan.

Transmission lines have lower exposure to the COVID-19 impact. Given that Brazilian transmission lines' remuneration is based on availability, and therefore doesn't depend on demand levels or commodity prices, we believe that overall the sector is less exposed to the impacts of the coronavirus pandemic. However, we may see potential delays in the commercial operations date of projects under construction. So far, this has not been the case for Transmissora Alianca de Energia Eletrica S.A. (Taesa), because the company's timetable is usually ahead of schedule. Furthermore, we will also continue monitoring if credit quality of key counterparties weakens. We've observed initial actions from Brazil's federal government aiming to mitigate systemic risk and provide liquidity to the sector, such as the proposed Provisional Measure 950 (MP 950) and Decree 10.350 (known as the COVID account), measures to financially and structurally aid the sector throughout the pandemic.

Worsening of credit metrics over the next few years to support investments. As part of Taesa's strategy to diversify growth from acquisitions, the company has seven fully funded projects under construction. These projects should demand investments of almost R$3.3 billion over the next four years and generate RAP (Annual Permitted Revenues) of R$572 million per year. This, in our view, will help the company to make up for cash flows from certain transmission lines that are approaching the middle of their concession, when revenues drop by 50% according to the terms of their concession contracts, and will also increase the average concession life of its portfolio. The investments will lead to a temporary worsening of Taesa's credit metrics. We expect leverage to peak in 2021 with debt to EBITDA of 4.2x-4.5x and funds from operations (FFO) to debt of 13%-17%, gradually improving once the cash flows of new assets come on stream.

Robust liquidity to navigate the pandemic. At the end of the first quarter of 2020, Taesa's cash position totaled R$1.67 billion. Additionally, in order to financially support itself during the pandemic and reinforce its cash position, Taesa issued a total of R$900 million in April 2020, in the form of one R$450 million debenture issuance maturing in April 2022 and two bank credit notes: R$350 million maturing in April 2022 and R$100 maturing in April 2021. In May 2020, its board approved R$242 million in interim dividends and interest on equity to be paid at the end of the month. Per bylaw, the company has the obligation to distribute 50% of the previous' year net income. Given the challenging scenario going forward, we believe Taesa will evaluate the dividend distribution throughout the year, using it as a liquidity hedge and having the flexibility of reducing it to the minimum 50% payout or postponing the payments.

Outlook: Stable

The stable outlook on Taesa reflects that on the sovereign rating on Brazil.

Downside scenario

We could lower our ratings on Taesa in the next 12 months if a similar rating action occurs on the sovereign rating on Brazil. We could also lower the ratings if the company's leverage increases significantly, with FFO to debt below 9% or debt to EBITDA above 5.5x. This could occur if the company further expands its investment program with new debt-financed projects while maintaining maximum dividend distribution.

We could revise the company's stand-alone credit profile (SACP) downwards in the same period if gradually improving cash flows originating from acquisitions don't materialize, or if the company faces significant working capital needs in case of delayed payments from distributors, which we view as unlikely at this point, resulting in FFO to debt consistently below 13% and debt to EBITDA above 4.5x.

Upside scenario

We expect the sovereign ratings to continue to cap those on Taesa. For an upward revision of the company's SACP, we would expect the investments to result in much higher cash flows than in our base case, leading consistently to FFO to debt above 23% and debt to EBITDA below 3.5x

Our Base-Case Scenario

Assumptions

- The scheduled 50% reduction in RAP for certain transmission lines. Contracts determine this reduction in the 16th year of these concessions. For the other lines, we expect their RAPs to grow in line with inflation for Brazil, which is also the main interest index of Taesa's debt (about 80%). We expect inflation of 3.3% in 2020, 3.8% in 2021, and

Key Metrics

	2019A	2020E	2021E
EBITDA (Bil. R$)	1.0	1.1-1.2	1.2-1.3
FFO/Debt (%)	27.7	13-17	13-17
Debt/EBITDA (x)	2.7	4.0-4.5	4.0-4.5

A--Actual. E--Estimate.

4.5% in 2022.

- Capital expenditures (capex) plan of R$1 billion in 2020 and R$350 million in 2021, already fully funded with debt
- Taesa will continue distributing the maximum available (95%) of the previous year's net income as dividends.

Base-case projections

In order to mitigate the effects of concessions reaching their 16th year when revenues drop by 50%, we expect that Taesa will continue to extend its average concession life by evaluating brownfield and greenfield opportunities.

Given the large required investments for these new projects, leverage will peak in 2021 but will gradually converge to about 4.0x by 2022, when Taesa starts receiving the cash flows from these new assets that are currently under construction.

The closing of Taesa's acquisition of 51% of the shares of Triângulo Mineiro Transmissora de Energia SA and São Bartolomeu Transmissora de Energia SA is still subject to the fulfillment of conditions precedent. On May 12, 2020, Aneel (the regulator) relaunched a public hearing to analyze an R$10 billion investment transmission auction scheduled for December. It is up to the Ministry of Mines and Energy (MME) to come up with a final resolution. At the end of March, the MME suspended all the auctions in the sector indefinitely, given the uncertainties caused by the COVID-19 pandemic.

If TAESA closes the acquisitions and/or if the auctions take place and TAESA is awarded new auctions, we will reassess the impact on the company's business and financial risk profiles.

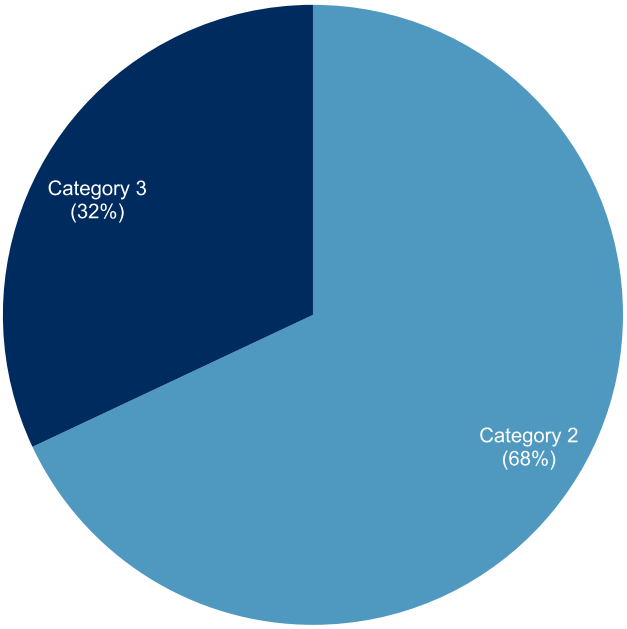
Company Description

Brazil-based electric power transmission company Taesa is the second largest electric transmission company in Brazil and the largest player in the high voltage (above 230 kilovolts) segment. Taesa has 39 concessions with 13,576 km in transmission lines, R$2.75 billion in RAP (2019-2020 cycle), and an average concession term of 16.5 years.

Taesa operates two main types of transmission concessions. The first is category 2: concessions auctioned from 1999 to November 2006, in which RAP decreases by 50% in the 16th year of the 30-year concession and continues to be annually adjusted by inflation until the end of the concession, with no tariff reviews. About 68% of Taesa's RAP comes from this asset type. The other type is category 3: concessions from November 2006 onwards, in which RAP is annually adjusted by inflation and subject to periodic tariff reviews. This category represents 32% of Taesa's RAP.

Chart 1

RAP Cycle 2019-2020



Source: S&P Global Ratings.

Business Risk: Satisfactory

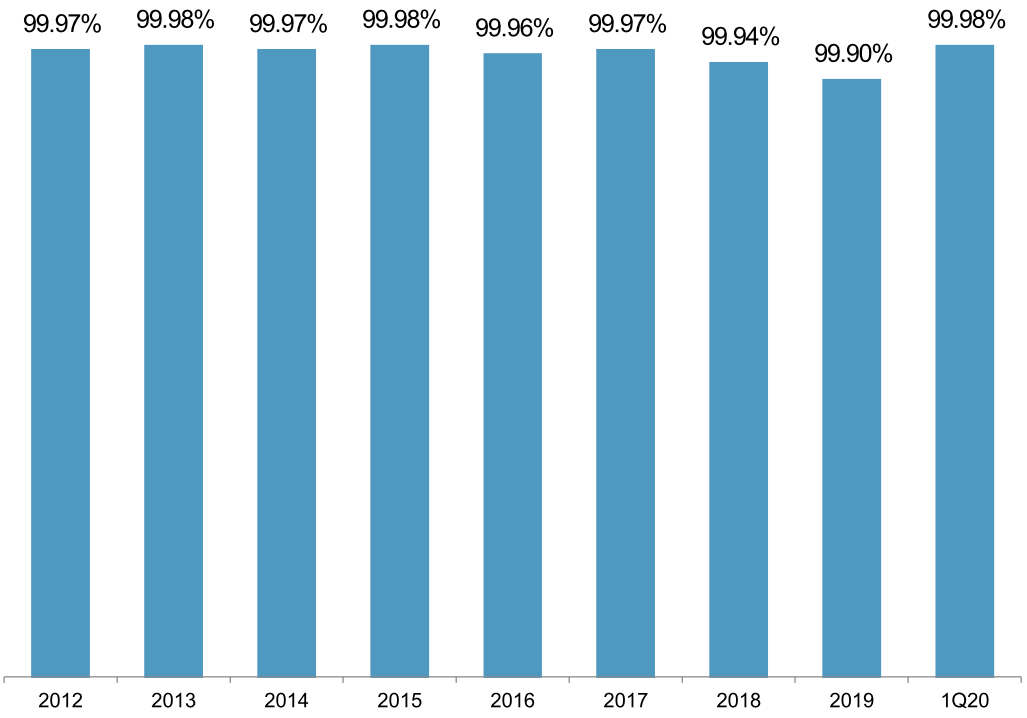
Taesa benefits from a favorable regulatory framework for electric power transmission companies in Brazil, allowing for stable and predictable cash flow generation derived from the RAP model, which relates to the availability of the transmission lines rather than the actual volume of power that each line transmits. In our view, this shields the segment from electricity demand volatility and adverse economic conditions.

Taesa has transmission lines throughout the country, which guarantees some diversity, although the company remains exposed to a single regulator (ANEEL) and a single country (Brazil). This lack of diversification is a disadvantage for Taesa when compared with international peers.

The company has been complying with the terms of its operating license, illustrated by its line availability above 99.9%. The transmission activity doesn't demand large maintenance costs so the company can have high and sustainable profitability margins.

Chart 2

Line Availability Rate (%)



Source: S&P Global Ratings.

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Peer comparison

Table 1

Transmissora Alianca de Energia Eletrica S.A. -- Peer Comparison

Industry Sector: Electric Utility

	Transmissora Alianca de Energia Eletrica S.A.	Transelec S.A.	Red Electrica Corporacion S.A.
Ratings as of June 5, 2020	BB-/Stable/--	BBB/Stable/--	A-/Stable/A-2
	--Fiscal year ended Dec. 31, 2019--		
(Mil. R$)			
Revenues	1,089.5	2,023.9	9,054.2
EBITDA	1,048.2	1,735.9	7,122.4
FFO	798.1	1,343.9	5,523.7
Interest expense	231.8	404.2	695.9
Cash interest paid	200.2	392.1	704.1
Cash flow from operations	696.0	1,163.2	4,513.4
Capital expenditures	387.9	565.7	2,141.8

Table 1

Transmissora Alianca de Energia Eletrica S.A. -- Peer Comparison (cont.)

Industry Sector: Electric Utility

	Transmissora Alianca de Energia Eletrica S.A.	Transelec S.A.	Red Electrica Corporacion S.A.
Free operating cash flow	308.1	597.5	2,371.6
Discretionary cash flow	(343.2)	83.2	(411.7)
Cash and short-term investments	2,419.8	587.3	1,482.1
Debt	2,879.3	7,744.9	27,954.9
Equity	4,926.8	4,527.8	16,303.8
Adjusted ratios			
EBITDA margin (%)	96.2	85.8	78.7
Return on capital (%)	15.7	11.8	12.2
EBITDA interest coverage (x)	4.5	4.3	10.2
FFO cash interest coverage (x)	5.0	4.4	8.8
Debt/EBITDA (x)	2.7	4.5	3.9
FFO/debt (%)	27.7	17.4	19.8
Cash flow from operations/debt (%)	24.2	15.0	16.1
Free operating cash flow/debt (%)	10.7	7.7	8.5
Discretionary cash flow/debt (%)	(11.9)	1.1	(1.5)

Pure transmission companies such as Chile-based Transelec S.A. (BBB/Stable/--) and Spain-based Red Electrica Corporacion S.A (A-/Stable/A-2) are generally investment grade. This would also be the case for Taesa (with a SACP of 'bbb-') but we cap our ratings on it by those on Brazil.

All three companies act in regulated activities with regulatory frameworks that have proven records of adequate return on investments made. The companies are also complying with their regulatory standards, sustaining strong cash flow generation throughout the years. While Taesa shares the same significant financial risk profile as Red Electrica, both companies are less leveraged than Transelec, which has relatively sizeable debt and high dividend payouts.

Financial Risk: Significant

We expect the company to post higher leverage in the next few years, related to its expansion investments, with leverage peaking in 2020-2021, while the new lines are under construction. However, once these start operating after 2022, we expect the company to reduce debt with the stronger cash flow generated.

Financial summary

Table 2

Transmissora Alianca de Energia Eletrica S.A. -- Financial Summary

	--Fiscal year ended Dec. 31--				
	2019	**2018**	**2017**	**2016**	**2015**
(Mil. R$)					
Revenues	1,089.5	1,219.8	988.2	1,332.7	1,503.8
EBITDA	1,048.2	1,204.2	967.2	1,389.1	1,488.4
FFO	798.1	958.9	709.2	1,081.7	1,155.8
Interest expense	231.8	175.8	233.0	323.7	712.0
Cash interest paid	200.2	147.7	218.2	272.8	302.1
Cash flow from operations	696.0	1,049.7	1,254.6	1,340.6	1,382.8
Capital expenditures	387.9	36.4	16.3	6.6	7.7
Free operating cash flow	308.1	1,013.2	1,238.3	1,334.0	1,375.1
Discretionary cash flow	(343.2)	53.0	630.0	402.5	618.2
Cash and short-term investments	2,419.8	819.5	626.6	363.1	215.3
Gross available cash	2,419.8	819.5	626.6	363.1	215.3
Debt	2,879.3	2,450.6	2,412.8	2,972.8	3,200.1
Equity	4,926.8	4,572.1	4,347.6	4,307.6	4,377.1
Adjusted ratios					
EBITDA margin (%)	96.2	98.7	97.9	104.2	99.0
Return on capital (%)	15.7	19.3	14.2	19.2	20.7
EBITDA interest coverage (x)	4.5	6.9	4.2	4.3	2.1
FFO cash interest coverage (x)	5.0	7.5	4.2	5.0	4.8
Debt/EBITDA (x)	2.7	2.0	2.5	2.1	2.2
FFO/debt (%)	27.7	39.1	29.4	36.4	36.1
Cash flow from operations/debt (%)	24.2	42.8	52.0	45.1	43.2
Free operating cash flow/debt (%)	10.7	41.3	51.3	44.9	43.0
Discretionary cash flow/debt (%)	(11.9)	2.2	26.1	13.5	19.3

FFO--Funds from operations.

Liquidity: Adequate

We expect Taesa's sources of cash to continue to surpass its uses of cash by more than 10%, and sources should continue to exceed uses even if EBITDA were to decline by 10% in the next 12 months.

The company has good relationships with banks and access to the capital markets, as seen in the sizable amount of debentures issued. Although Taesa's operations are stable and predictable, and don't demand a large liquidity cushion, we believe Taesa will have the appropriate mechanisms to face any high-impact, low-probability event with limited need for refinancing, in which case we expect it to reduce the dividend payout and postpone investments, if needed.

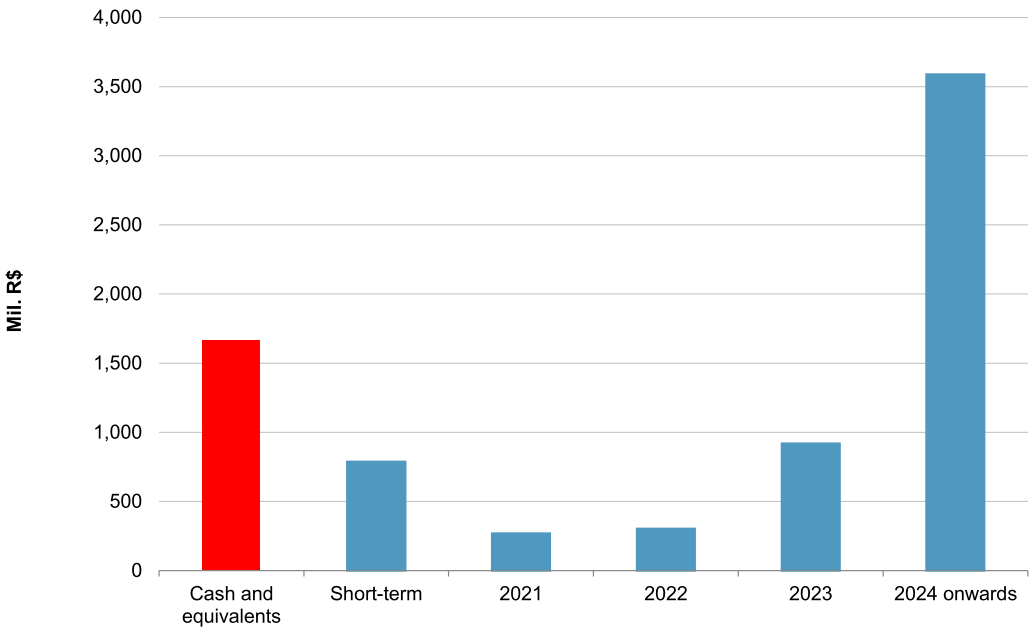
Principal Liquidity Sources	Principal Liquidity Uses

- Consolidated cash of R$1.67 billion as of March 31, 2020;
- Projected cash FFO of about R$1 billion during the next 12 months; and
- A debenture (R$450 million) and two bank credit notes (R$100 million and R$350 million) amounting to a total of R$900 million issued on April 2020.
- Debt maturities of R$787 million during the next 12 months;
- Working capital outflow of about R$317 million in the next 12 months
- Capex of about R$1 billion in the next 12 months; and
- Minimum dividend payout of 50% of previous year's net income.

Debt maturities

Chart 3

Debt Amortization Profile
As of March 31, 2020



Source: S&P Global Ratings.

Covenant Analysis

Taesa is not subject to financial covenants at the holding level.

Group Influence

Companhia Energetica de Minas Gerais - CEMIG (B/Stable/--; brA+/Stable/--) and Interconexion Electrica S.A.E.S.P. (ISA: BBB-/Negative/--) have jointly controlled Taesa since 2017 through their shareholders' agreement. However, we view Taesa as a stand-alone company because any material decision requires the approval of nine board members out of the thirteen, requiring ISA and CEMIG to always agree on all strategic matters. CEMIG has the right to nominate five members, while ISA nominates four and the remaining four are independent.

Rating Above The Sovereign

If it weren't capped by our rating on Brazil, we could rate Taesa 'BBB-', the same level as its SACP. However, we continue to cap our rating on Taesa by that on Brazil (BB-/Stable/B), where the company operates.

We cap the final rating at the sovereign foreign currency rating because we believe that as a regulated business, Taesa could be subject to intervention from the government, such as tariff freezes, which would jeopardize the company's ability to generate cash.

Issue Ratings - Subordination Risk Analysis

Capital structure

Taesa doesn't have a material level of secured debt or debt at its subsidiaries level that would result in a structural subordination of the debt at the holding level to the ones of the operating companies. We note that in addition to its subsidiaries, Taesa also has operations at its level. As of March 31, 2020, its total debt was R$5.7 billion.

Analytical conclusions

Without material secured debt ahead of Taesa's 3rd senior unsecured debentures of R$793 million (1st series) and R$702 million (2nd series), maturing October 2020 and October 2024, respectively, we rate this debt 'brAAA',the same as our national scale long-term issuer credit rating.

Reconciliation

Table 3

Reconciliation Of Transmissora Alianca de Energia Eletrica S.A. Reported Amounts With S&P Global Ratings' Adjusted Amounts (Mil. R$)

	--Rolling twelve months ended March 31, 2020--					
Transmissora Alianca de Energia Eletrica S.A. reported amounts						
	Debt	**Revenue**	**EBITDA**	**Operating income**	**S&P Global Ratings' adjusted EBITDA**	**Cash flow from operations**
	5,865.6	2,143.1	1,743.7	1,730.4	1,154.0	793.4
S&P Global Ratings' adjustments						
Cash taxes paid	--	--	--	--	(40.9)	--

Table 3

Reconciliation Of Transmissora Alianca de Energia Eletrica S.A. Reported Amounts With S&P Global Ratings' Adjusted Amounts (Mil. R$) (cont.)						
Cash interest paid	--	--	--	--	(195.9)	--
Reported lease liabilities	35.0	--	--	--	--	--
Accessible cash and liquid investments	(1,667.8)	--	--	--	--	--
Dividends received from equity investments	--	--	299.3	--	--	--
Income (expense) of unconsolidated companies	--	--	(423.0)	--	--	--
Nonoperating income (expense)	--	--	--	94.0	--	--
Reclassification of interest and dividend cash flows	--	--	--	--	--	(195.9)
Debt: Foreign currency hedges	(175.4)	--	--	--	--	--
Revenue: Other	--	(909.1)	(909.1)	(909.1)	--	--
SG&A: Other nonoperating nonrecurring items	--	--	443.1	443.1	--	--
Working capital: Taxes	--	--	--	--	--	40.9
Working capital: Other	--	--	--	--	--	(1,203.1)
Operating cash flow: Taxes	--	--	--	--	--	(40.9)
Operating cash flow: Other	--	--	--	--	--	1,203.1
Total adjustments	(1,808.2)	(909.1)	(589.7)	(372.0)	(236.8)	(195.9)
S&P Global Ratings' adjusted amounts						
	Debt	**Revenue**	**EBITDA**	**EBIT**	**Funds from operations**	**Cash flow from operations**
	4,057.4	1,234.1	1,154.0	1,358.5	917.2	597.6

Ratings Score Snapshot

Issuer Credit Rating

BB-/Stable/--

Business risk: Satisfactory

- **Country risk:** Moderately high
- **Industry risk:** Very low
- **Competitive position:** Satisfactory

Financial risk: Significant

- **Cash flow/leverage:** Significant

Anchor: bbb-

Modifiers

- **Diversification/portfolio effect:** Neutral (no impact)
- **Capital structure:** Neutral (no impact)
- **Financial policy:** Neutral (no impact)
- **Liquidity:** Adequate (no impact)
- **Management and governance:** Satisfactory (no impact)
- **Comparable rating analysis:** Neutral (no impact)

Stand-alone credit profile : bbb-

Related Criteria

- Group Rating Methodology , July 1, 2019
- Corporate Methodology: Ratios And Adjustments , April 1, 2019
- Criteria - Corporates - General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- Methodology For National And Regional Scale Credit Ratings , June 25, 2018
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Methodology: Industry Risk, 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
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Business And Financial Risk Matrix

	Financial Risk Profile					
Business Risk Profile	Minimal	Modest	Intermediate	**Significant**	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	a-/bbb+	bbb	bb+	bb
Satisfactory	a/a-	bbb+	bbb/bbb-	**bbb-/bb+**	bb	b+
Fair	bbb/bbb-	bbb-	bb+	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

Ratings Detail (As Of June 5, 2020)*

Transmissora Alianca de Energia Eletrica S.A.		
Issuer Credit Rating		BB-/Stable/--
Brazil National Scale		brAAA/Stable/brA-1+
Senior Unsecured *Brazil National Scale*		brAAA
Issuer Credit Ratings History		
07-Apr-2020		BB-/Stable/--
12-Dec-2019		BB-/Positive/--
12-Jan-2018		BB-/Stable/--
16-Aug-2017		BB/Negative/--
23-May-2017		BB/Watch Neg/--
17-Feb-2016		BB/Negative/--
10-Sep-2015		BB+/Negative/--
28-Jul-2015		BBB-/Negative/--
11-Jul-2018	*Brazil National Scale*	brAAA/Stable/brA-1+
12-Jan-2018		brAA-/Stable/brA-1+
16-Aug-2017		brAA-/Negative/brA-1+
23-May-2017		brAA-/Watch Neg/brA-1
17-Feb-2016		brAA-/Negative/brA-1
10-Sep-2015		brAA+/Negative/brA-1
28-Jul-2015		brAAA/Negative/brA-1

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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