

Rating Action: Moody's assigns Ba1/Aaa.br ratings to Rio Paraná's proposed BRL480 million senior unsecured debentures; outlook stable

15 Jun 2018

Sao Paulo, June 15, 2018 -- Moody's América Latina Ltda., ("Moody's") assigned a Ba1 rating on the global scale and Aaa.br on the Brazilian national scale to Rio Paraná Energia S.A. (Rio Parana)'s planned issuance of BRL480 million senior unsecured debentures with final maturity in 2025 (1st Issuance). Rio Parana's Ba1/Aaa.br corporate family ratings remain unchanged. The outlook for the ratings is stable.

The assigned ratings are based on preliminary documentation. Moody's does not anticipate changes in the main conditions that the debentures will carry. Should issuance conditions and/or final documentation deviate from the original ones submitted and reviewed by the rating agency, Moody's will assess the impact that these differences may have on the ratings and act accordingly.

RATINGS RATIONALE

The proposed debentures will be issued in two tranches with issuance amounts and interest rates defined in the book building process. The first tranche pegged to the Brazilian base rate (CDI) will have a 5-year tenor and will amortize in two annual payments starting on the fourth year after the issuance date. The second tranche, adjusted by inflation (IPCA index), will have a 7-year tenor with two annual amortization payments on the sixth and seventh year. The debentures include acceleration clauses for, among others, the following events: (i) the non-payment of any financial obligation above BRL75 million, (ii) change of indirect control from China Three Gorges Corporation (CTG, A1 stable), unless the new shareholder is rated at least at Aa1.br, and (iii) early termination of the concession contract. The debentures will also comprise maintenance financial covenants of Net Debt to EBITDA ratio lower or equal to 3.2x (0.8x as of the last twelve months ended March, 31 2018), and EBITDA to Net Financial Result higher or equal to 2.0x (4.3x as of March 31 2018), that will be verified on an annual basis.

Proceeds of the issuance will be used to support the capital investments in the Jupia and Ilha Solteira power plants, including the reimbursement of certain costs and expenses related to concession fee payments incurred in 2016. Those investments have been given priority status by the Ministry of Energy and Mining (MME), allowing the issuances to be classified as infrastructure debentures pursuant to Law 12.431. The proposed debt issue is also in line with Rio Parana's strategy to lengthen its debt amortization schedule.

The Ba1/Aaa.br ratings assigned to the debentures are in line with the corporate family ratings of Rio Parana, reflecting its stable and predictable cash flows, derived from a long-term concession agreement to operate and maintain two hydro power stations with 5.0 GW of combined installed capacity, with 70% of the physical guarantee contracted to the regulated market under the quota regime, which is reimbursed through fixed-capacity payments, adjusted annually for inflation and insulated from hydrologic risks. The ratings also incorporate our assessment of the likelihood of continued support from CTG, as Rio Parana's ultimate controlling shareholder and guarantor of its other financing arrangements.

On the other hand, Rio Parana's credit profile also reflect its (1) limited asset diversification, along with the expectation of an accelerated investment program to recover and upgrade its existing 34 generation units in the first years of the concessions; (2) exposure to foreign-currency volatility because 55% of its financial liabilities are related to an intercompany loan denominated in US dollars without hedging to local currency; (3) large refinancing needs in the short term, given a BRL2.7 billion loan due by mid-2019; and (4) aggressive dividend distribution strategy.

In 2017, Rio Parana's cash flow from operations before working capital changes CFO (pre-WC) to net debt, calculated according to Moody's standard adjustments, reached 28%, while the cash interest coverage ratio was at 3.9x. In 2018, we expect a reduction in the company's credit metrics owing to changes in the mix of its power purchase agreements to the free market and a non-recurring judicial deposit of BRL416 million, related to certain tax disputes. As such, CFO (pre-WC) to net debt will likely decrease to about 6% in 2018, while the cash interest coverage will be close to 2.0x. Nevertheless, we anticipate recovery in the company's ratios to a CFO (pre-WC) in the 20%-25% range with cash interest coverage in the 3.1x-3.8x range over the next three to

five years, supported by the predictable recurring revenues on the regulated business.

RATING OUTLOOK

The outlook on the ratings is stable, reflecting the outlook on the Government of Brazil (Ba2, stable). Given the highly regulated nature of the energy sector and the operating environment in Brazil, we expect the company to be rated no more than one notch above the sovereign bond rating. The stable outlook also incorporates Moody's view of consistent operating performance and prospective improvement in the company's credit metrics.

WHAT COULD CHANGE THE RATING -- UP / DOWN

An upgrade of the rating assigned to the debentures would take into account the company's liquidity position and business profile, and the regulatory environment in which Rio Parana operates. Quantitatively, an upgrade would require a consistent improvement in the company's credit metrics, as indicated by a ratio of cash flow from operations before working capital changes (CFO pre-WC) to net debt stays above 35% and the cash interest coverage ratio above 4.5x.

The ratings for the debenture will face downward pressure if the stability and transparency of the regulatory regime for the generation segment is weakened, ultimately resulting in more volatility or decreased visibility into Rio Parana's cash flow base. The global-scale ratings can also be downgraded upon a similar rating action on the Brazilian government's rating. Our assumption of a decline in the shareholders' willingness to support, as evidenced by higher than expected dividend distributions could also increase downward rating pressure. Quantitatively, a downgrade would be considered if the company's ratio of CFO pre-WC to net debt remains below 20%, or the interest coverage ratio stays below 2.8x, without the expectation of improvement over the next 12 months.

Based in Sao Paulo, Rio Parana Energia S.A. is an operating power company controlled by CTG Brasil, which holds 67% of the company's voting capital. The other 33% is held by Huikai Clean Energy S.A.R.L, a Chinese fund that invests in Latin America. In November 2015, the company won the bid for a 30-year concession to operate the Jupia and Ilha Solteira hydropower stations. Located along the Parana river, between the states of Sao Paulo and Mato Grosso do Sul, the two power stations combined comprise 5.0 GW of installed capacity and 2.6 GW average of physical guarantees. As of December 31, 2017, Rio Parana reported annual net sales of BRL3.7 billion and annual net profit of BRL845 million.

The principal methodology used in these ratings was Unregulated Utilities and Unregulated Power Companies published in May 2017. Please see the Rating Methodologies page on www.moody.com.br for a copy of this methodology.

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