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RATING ACTION COMMENTARY

Fitch Affirms Engie Brasil's Ratings; Outlook Stable

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Fitch Ratings - Rio de Janeiro - 04 Feb 2025: Fitch Ratings has affirmed Engie Brasil Energia S.A.'s (Engie Brasil) Foreign Currency (FC) and Local Currency (LC) Long-Term Issuer Default Ratings (IDRs) at 'BB+' and 'BBB-', respectively. Fitch has also affirmed Engie Brasil's Long-Term National Scale Rating and its senior unsecured debenture issuances at 'AAA(bra)'. The Rating Outlook for corporate ratings is Stable.

Engie Brasil's ratings reflect its prominent market position as the second-largest electric energy generation company in Brazil, with a sizable, diversified asset base and operational efficiency. The company's credit profile also benefits from a track record of robust operating cash flow generation and a solid financial profile, with moderate leverage and strong financial flexibility.

Fitch believes Engie Brasil is prepared to manage its high capex plan, despite the challenges from expected lower prices for its uncontracted energy in the coming years. Engie Brasil's FC IDR is constrained by Brazil's Country Ceiling of 'BB+', while Brazil's operating environment anchors the LC IDR.

KEY RATING DRIVERS

Robust Business Profile: Engie Brasil's ratings benefit from a strong business position in the electric power generation segment in Brazil. It is the second-largest energy generation company in the country, with a total installed capacity of 9.3 GW, to be expanded to 10.7GW in 2025 with the conclusion of new projects. The company has a successful track record in its commercial strategy and monthly allocation of assured capacity. It also benefits from the diluted operational risks due to its diversified asset base.

The transmission segment provides further diversification and improves predictability to operating cash flow. Engie Brasil has 2,710 km of transmission lines in operation and 1,780 km under development, to be concluded by 2029. Permitted annual revenues of BRL771 million in this segment should represent roughly 10% of consolidated EBITDA in 2025.

High Capex Pressures FCF: The base case scenario for the ratings considers high investments of BRL8.3 billion, mainly concentrated in 2025, and strong dividend distribution, which will pressure Engie Brasil's FCF. Fitch estimates EBITDA of BRL6.9 billion in 2025 and BRL7.0 billion in 2026, and cash flow from operations (CFFO) of BRL4.1 billion in 2025 and BRL4.0 billion in 2026, with negative FCF of BRL1.9 billion in 2025 and positive FCF of BRL190 million in 2026.

Fitch expects the EBITDA margin to increase over the next few years, reaching 65% in 2025, due to reduced energy purchase expenses with the new generation projects conclusion. The base case scenario anticipates sales of 4.7 average GW (aGW) in 2025 and 4.8 aGW in 2026, with average tariffs of BRL232/MWh and BRL226/MWh, respectively.

Leverage Expected to Peak in 2025: Fitch estimates Engie Brasil's net leverage ratio will reach 3.2x in 2025, up from 2.3x in 2023 and an expected 3.0x in 2024. These ratios remain consistent with the current LC IDR. A reduction in dividends received from Transportadora Associada de Gás S.A. (TAG) to roughly BRL151 million in 2025 from BRL583 million in 2024 will negatively affect leverage ratios in 2025.

The net debt-to-EBITDA ratio should begin to approach 3.0x from 2026 onward. The company has a positive track record in capital structure management, which has included reducing dividend distribution in the past.

Manageable Hydrologic and Curtailment Risks: Fitch estimates Engie Brasil's uncontracted energy volumes of 16% in 2025 and 19% in 2026 would be sufficient to support the expected generating scaling factor (GSF) of 0.89 and 0.91 in the same years, respectively. If needed, Engie Brasil has to obtain energy purchase contracts at prices compatible with those established in sales contracts to cover the reduction in its own generation to avoid higher negative impacts on cash generation.

The company has protection against hydrological risk in contracts in the regulated market, which represents approximately 35% of the energy sold and limits its assured energy exposure to GSF to 31%. A diversified asset base also mitigates curtailment impact, with 10% constrained off in renewables plants considered manageable for the group.

Exposure to Repricing and Concession Risk in the Medium Term: Engie Brasil's uncontracted position above 35% from 2028 onward represents a pricing risk in the medium term. The base case scenario for the ratings incorporates average prices of BRL210/MWh for new contracts from 2028 onward, less than BRL256/MWh for the current contracts.

In addition, important concessions, which totals 3.9GW and represents 43% of the company current installed capacity, expire during 2030-2032. Fitch believes the group still has time to manage these exposures and expects potential impacts in the cash flow, capital structure or liquidity position to be addressed in advance.

Weak Parent-Subsidiary Linkage: Engie Brasil's ratings are based on its Standalone Credit Profile, as legal, operational and strategic incentives for parent company Engie S.A. (Engie, BBB+/Stable) to support the Brazilian subsidiary, if needed, are weak. Engie controls 68.71% of Engie Brasil, but there are no guarantees or cross-default clauses.

Strategic incentives of support are low as Engie Brasil represents less than 10% of the group's EBITDA despite being the largest market outside Europe and having some growth potential. Fitch views operational incentives as low to medium, with some reputational risks related to the use of a common name.

DERIVATION SUMMARY

Engie Brasil's FC IDR (BB+/Stable) is one to two notches below peers in Latin America, such as Engie Energia Chile S.A. (Engie Chile; BBB/Stable), the fourth-largest generator in Chile; Enel Colombia S.A. E.S.P. (Enel Colombia; BBB/Stable), the second-largest generation company in Colombia; and AES Andes S.A. (AES Andes; BBB-/Stable), the second-largest generator in Chile and one of the leaders in Colombia. This is primarily as a result of Brazil's 'BB+' Country Ceiling.

Engie Chile, Enel Colombia and AES Andes benefit from better economic environments in Chile and Colombia, which are rated higher than Brazil. Engie Brasil's FC IDR is capped by the Brazilian Country Ceiling.

Engie Brasil's LC IDR (BBB-/Stable) is more comparable with these 'BBB' category rated peers. It is well positioned relative to other Latin American power generators in terms of installed capacity, asset diversification and contracted position. Engie Brasil has an installed capacity of approximately 9.3GW, which compares favorably with AES Andes (6.1GW), Engie Chile (2.5GW) and Enel Colombia (4.3GW).

The energy mix of Engie Chile and AES Andes differs from Engie Brasil and Enel Colombia. Engie Brasil and Enel Colombia are more exposed to hydrological conditions, while AES Andes and Engie Chile need to deal with coal and natural gas price volatility. All the companies have predictable and robust cash flow generation since they have managed business risks properly. However, Engie Brasil has a stronger financial profile.

Compared with European integrated groups with operations in Brazil, Engie Brasil's FC and LC IDRs are also two to three notches below Enel S.p.A. (BBB+/Stable) and Iberdrola, S.A. (Iberdrola; BBB+/Stable). The two European companies benefit from international footprints with large presences in higher-rated geographies — the U.K. and U.S. for Iberdrola, and Italy for Enel S.p.A. Both are fully integrated utilities that benefit from diversified profiles by business line and geography, with a significant portion of regulated networks and quasi-regulated renewable generation.

In energy generation, both Enel S.p.A. and Iberdrola have much higher scale compared with Engie Brasil. Iberdrola has installed capacity of 55GW and Enel S.p.A. has 81GW.

KEY ASSUMPTIONS

-- Energy sales of 4.7 aGW in 2025 and 4.8 aGW in 2026, not including quotas capacity;

-- Average sales price of BRL232/MWh in 2025 and BRL226/MWh in 2026;

-- Energy purchase of 0.9 aGW in 2025 and 0.8 aGW in 2026;

-- Selling, general and administrative expenses adjusted to inflation;

-- Average GSF of 0.89 in 2025 and 0.91 in 2026;

-- Capex of BRL8.3 billion from 2025 to 2027;

-- Acquisition of the Jirau Hydropower Plant does not occur.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade:

-- Negative rating action for the LC IDR would be associated with a deterioration in Engie Brasil's consolidated financial profile, with net adjusted leverage above 3.5x and/or funds from operations net leverage of more than 4.0x, both on a sustained basis;

-- A downgrade on Brazil's sovereign rating would result in a similar rating action on Engie Brasil's FC IDR;

-- A weaker operating environment in Brazil could result in a downgrade of the LC IDR;

-- A two-notch downgrade of Engie Brasil's LC IDR may lead to a downgrade of the National Scale Rating.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade:

-- Positive rating action for the company's FC IDR would be associated with an upgrade of Brazil's sovereign rating;

-- Positive rating action for the company's LC IDR would be associated with improvements in Brazil's operating environment;

-- Upgrades are not applicable to the National Scale Rating, as it is at the highest level.

LIQUIDITY AND DEBT STRUCTURE

Engie Brasil has ample access to funding sources and a strong liquidity profile, with robust cash position and no short-term debt concentration. As of Sept, 2024, cash and marketable securities of BRL4.0 billion, net of restricted cash of BRL384 million, were strong enough to cover the short-term debt of BRL2.8 billion. The high cash balance, reinforced by capex financing, will be partially used to fund the negative FCF in 2025.

The Asa Branca and Grauna project will require capex of BRL3.8 billion in 2025 and 2026, mostly supported by long-term project finance debt at the holding Engie Brasil level. The BRL1.5 billion debentures raised in October 2024 due in 2030 will be mainly used for capex. As of Sept. 2024, Engie Brasil's total debt of BRL24.0 billion was mainly comprised of Banco Nacional de Desenvolvimento Econônico e Social (BNDES) (BRL10.8 billion) and debentures (BRL9.0 billion).

ISSUER PROFILE

Engie Brasil is the second-largest energy generator in Brazil, with a total operational installed capacity of 9.3GW and 1.4GW under development. The company also has 2,710 km of transmission lines in operation and 1,780 km in the pre-operational phase.

SUMMARY OF FINANCIAL ADJUSTMENTS

Net revenues and EBITDA net of construction revenues and cost.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

MACROECONOMIC ASSUMPTIONS AND SECTOR FORECASTS

Click here to access Fitch's latest quarterly Global Corporates Macro and Sector Forecasts data file which aggregates key data points used in our credit analysis. Fitch's macroeconomic forecasts, commodity price assumptions, default rate forecasts, sector key performance indicators and sector-level forecasts are among the data items included.

ESG CONSIDERATIONS

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

RATING ACTIONS

ENTITY / DEBT	RATING			PRIOR
Engie Brasil Energia S.A.	LT IDR	BB+ Rating Outlook Stable	Affirmed	BB+ Rating Outlook Stable
	LC LT IDR	BBB- Rating Outlook Stable	Affirmed	BBB- Rating Outlook Stable
	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

Corporate Hybrids Treatment and Notching Criteria (pub. 12 Nov 2020)

National Scale Rating Criteria (pub. 22 Dec 2020)

Parent and Subsidiary Linkage Rating Criteria (pub. 16 Jun 2023)

Sector Navigators – Addendum to the Corporate Rating Criteria (pub. 06 Dec 2024)

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

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

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Engie Brasil Energia S.A.	EU Endorsed, UK Endorsed

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No 1060/2009 of the European Parliament and of the Council of 16 September 2009 and The Credit Rating Agencies (Amendment etc.) (EU Exit) Regulations 2019 respectively.

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The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Fitch also provides information on best-case rating upgrade scenarios and worst-case rating downgrade scenarios (defined as the 99th percentile of rating transitions, measured in each direction) for international credit ratings, based on historical performance. A simple average across asset classes presents best-case upgrades of 4 notches and worst-case downgrades of 8 notches at the 99th percentile. For more details on sector-specific best- and worst-case scenario credit ratings, please see Best- and Worst-Case Measures under the Rating Performance page on Fitch's website.

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