



Fitch Affirms Comgas' IDR at 'BB'; Outlook Stable

Fitch Ratings-Rio de Janeiro-29 May 2019: Fitch Ratings has affirmed Companhia de Gas de Sao Paulo - COMGAS' (Comgas) Long-Term Foreign Currency Issuer Default Rating (FC IDR) at 'BB', Local Currency IDR (LC IDR) at 'BBB-' and National Scale Long-Term Rating at 'AAA(bra)'. The Ratings Outlook is Stable. A full list of rating actions follows at the end of this release.

Comgas' ratings reflect the solid fundamentals of its natural gas distribution business and historically robust financial profile, supported by reduced leverage, strong liquidity profile and significant cash flow from operations (CFFO). Comgas' business profile benefits from its operations in the state of Sao Paulo, Brazil's most important state economically, and from the company's long-term concession agreement, which comprises clauses with non-manageable cost pass-through that protect its cash flow generation.

Comgas' activities offer favourable growth prospects in the medium and long term, given the expectation of expansion of its gas distribution network and customer base given its still low penetration. Fitch believes that this energy source should continue to be competitive compared with alternatives, which adds to billed volumes increase. The agency assumes the company will be able to continuously recontract its gas supply needs before existing agreements expire, with potential contractual changes not materially affecting the company's cash flow generation capacity.

The company's FC IDR is limited by the Brazilian Country Ceiling of 'BB'. The Stable Outlook for the FC IDR is aligned with the Outlook for the sovereign rating, while the LC IDR and the National Scale Rating reflects Fitch's expectation that the natural gas distribution industry will continue to preserve strong fundamentals and that Comgas will sustain its robust credit metrics, with net adjusted leverage below 2.0x over the next three years. Fitch also incorporated no major changes in the company's credit profile due to regulatory issues.

KEY RATING DRIVERS

Low to Moderate Business Risk: Comgas is the largest natural gas distribution company in Brazil in terms of volume billed, but is subject to natural gas consumption volatility within the industrial segment, which represents around 55% of its gross profit. This segment's performance is highly linked with GDP and results in moderate cash flow variation. Nevertheless, Comgas' competitive manageable cost structure and continued efforts to expand its residential and commercial client base, with higher profitability, mitigates the impact of industrial segment volatility. In addition, natural gas purchase, which is the main cost, is considered as nonmanageable and is passed-through to tariffs based on contract clauses. Gas demand has influenced GDP performance and price competitiveness, although switching costs in some industrial segments represent a barrier to alternative sources of energy.

Manageable Supply Risk: Fitch assumes no gas supply disruptions for Comgas within the next three years as the company has successfully renewed its supply contract with Petrobras until 2021 despite single supplier concentration risk remains, which is an industry common feature in Brazil. Positively, Comgas has the option to renew its supply agreement until 2027 at its discretion, which mitigates medium term supply risks. The expectation of gas production increase in the country and divestments of Petrobras on gas transportation and production assets should allow for competition on the natural gas chain, increase competitiveness for the natural gas and stimulate demand. Comgas' region of activity benefits from diverse

gas duct connections to its distribution network, which favors pursuing alternative gas sources.

Sound Cash Generation: Fitch estimates Comgas will maintain sound normalized EBITDA during the next three years, including BRL2.1 billion in 2019. EBITDA is based on expectation of adequate tariff increases, maintenance of operating and cost efficiency and expansion of its client base, with annual volumes billed annual average growth of 1.5% from 2019 to 2021. Normalized EBITDA is adjusted for higher or lower nonmanageable costs than those contemplated in the tariff. Under the concession agreement, these differences are incorporated into the next tariff adjustment process. According to IFRS, the company's EBITDA was BRL1.5 billion in the LTM ended March 31, 2019, as per Fitch's methodology.

FCF Pressured by Dividends and Capex: Fitch estimates strong dividends distribution and capex increase during 2019-2021 will make Comgas FCF negative at around BRL674 million per year on average. Fitch estimates strong pressure for Comgas to maximize dividends distribution to support additional debt at shareholder level. During the next three years, Fitch projects annual average dividend payments of BRL1.3 billion and investments of BRL800 million. The expectation of the company's robust CFFO generation at BRL1.3 billion-BRL1.4 billion during this period should partially alleviate FCF pressure.

Low Leverage to Remain: Fitch expects Comgas' net leverage to remain at a conservative level in the coming years, despite of increasing capex and strong dividends distributions. According to the base case scenario, net debt-to-EBITDA ratio will not exceed 2.0x, with 1.0x in 2019. In the LTM ended on March 31, 2019, total debt/EBITDA and net debt/EBITDA were 2.2x and 1.0x, respectively, according to Fitch's methodology.

Part of the Cosan Group: Comgas' ratings consider that the company is part of the Cosan group, whose main shareholder is Cosan S.A. Industria e Comercio (FC IDR BB; LC IDR BB+; and National Scale Rating AAA(bra); all with a Stable Outlook). Despite the higher debt of its main shareholder to fund tender offer on 1Q19 to increase Comgas ownership - now at 95% from 80%, the group's access to the company's cash is limited to distribution of dividends, given its concessionaire status. Fitch estimates robust dividends distribution from Comgas to support higher debt.

DERIVATION SUMMARY

Comgas' credit profile favorably compares with Companhia de Saneamento Basico do Estado de Sao Paulo (Sabesp; LC and FC IDRs BB/Stable), a water/wastewater utility company that also operates in the state of Sao Paulo and presents significant unhedged FX debt exposure, political risk and a higher level of CFFO committed to capex, given its more capital-intensive operations, despite both companies presenting sound capital structure and liquidity profile. In the case of Transmissora Alianca de Energia Eletrica S.A. (Taesa; LC IDR BBB-/Stable and FC IDR BB/Stable), a power transmission company in Brazil, Comgas' lower leverage is counterbalanced by Taesa's lower regulatory and business risks, given no volumetric exposure leading to more predictable CFFO.

The Colombian Promigas S.A. E.S.P (Promigas; LC and FC IDRs BBB-/Stable) presents strong business position on its region of operation and predictable cash flow generation although with gross leverage level around 4.0x-4.5x, which is higher than Comgas' ratios (around 2.0x-2.5x). Promigas business profile, however, benefits from diversification within natural gas transportation and distribution, compared to Comgas that only distributes gas and can present some demand volatility. Promigas's IDRs also incorporates its operation in a country with better operating environment than Comgas.

KEY ASSUMPTIONS

Fitch's Key Assumptions Within Our Rating Case for the Issuer

- A 1.5% volume increase (excluding thermo power generation segment) on average from 2019 to 2021;
- Payout dividend ratio on average of 121% of distributable net profit;
- Annual average capex of BRL800 million during 2019-2021;
- Contribution margin increase of 5.5% in 2019 and 4.0% thereafter.

RATING SENSITIVITIES

Developments That May, Individually or Collectively, Lead to Positive Rating Action

--Brazil's Country Ceiling upgrade would lead to a positive rating action on Comgas' FC IDR.

--Improvement of the company's client base segment diversification, combined with an upgrade of Brazil's sovereign rating, could result in an upgrade of the company's LC IDR.

Developments That May, Individually or Collectively, Lead to Negative Rating Action

--Expectation of a sustainable increase in net leverage measured by net debt/EBITDA to above 3.0x;

--Fitch's perception of regulatory and/or gas supply risk deterioration.

--A downgrade of the sovereign rating would trigger a downgrade for the FC IDR.

LIQUIDITY

Robust Liquidity Position: Comgas' credit profile benefits from robust liquidity and a lengthened debt maturity schedule. The company also has proven track record in accessing the local debt and capital markets with suitable cost of funding during the last five years, which strengthens its financial flexibility and mitigates the expected negative FCF in the coming years. The company's total cash balance at March 31, 2019 of BRL1.8 billion represented strong coverage of its short-term debt of BRL593 million by 3.0x.

Comgas' total debt of BRL3.3 billion, according to Fitch's methodology, presented lengthened amortization schedule and consisted mainly of unsecured debenture issuances (BRL2.4 billion) and Banco Nacional de Desenvolvimento Economico e Social (BNDES) debt (BRL572 million). The debentures coupon is inflation-linked, which suits well with its CFFO dynamics, given that its tariff and fee adjustments formula also is linked with inflation rates.

FULL LIST OF RATING ACTIONS

Fitch has affirmed Comgas' ratings as follows:

--Long-Term Foreign Currency IDR at 'BB';

--Long-Term Local Currency IDR at 'BBB-';

--National Long-Term Rating at 'AAA(bra)';

--BRL540 million 3rd debentures issuance National Long-Term Rating at 'AAA(bra)';

--BRL592 million 4th debentures issuance National Long-Term Rating at 'AAA(bra)';

--BRL500 million 5th debentures issuance National Long-Term Rating at 'AAA(bra)';

--BRL400 million 6th debentures issuance National Long-Term Rating at 'AAA(bra)';

--BRL215 million 7th debentures issuance National Long-Term Rating at 'AAA(bra)'.

The corporate Rating Outlook is Stable.

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Summary of Financial Statement Adjustments -

- Construction revenues are excluded from net revenues.
- BRL802 million excluded from 2018 EBITDA related to non recurrent indemnities and tax recovery.
- Debt adjusted with hedging derivatives.

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Additional information is available on www.fitchratings.com

Applicable Criteria

Corporate Rating Criteria (pub. 19 Feb 2019)

National Scale Ratings Criteria (pub. 18 Jul 2018)

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