S&P Global
Ratings

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Neoenergia S.A. And Subsidiaries

March 27, 2023

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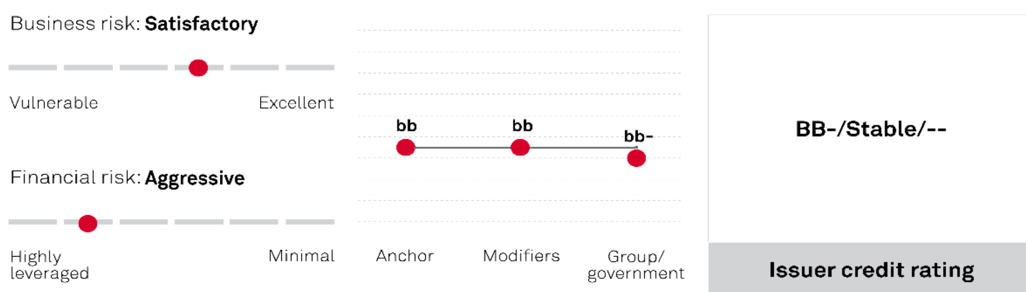
Ratings Score Snapshot



Brazil National Scale

brAAA/Stable/brA-1+

Credit Highlights

Overview

Key strengths	Key risks
An integrated electricity group that distributes energy to roughly 16 million clients, has more than 2,500 kilometers (km) of operational transmission lines, along with 4.4 gigawatts (GW) of installed capacity in the generation segment.	Potential execution risks related to substantial investments, as the group will need to raise additional debt to finance them amid Brazil's tightening financing conditions.
About 80% of EBITDA comes from stable and regulated electricity activities. In the distribution segment, the client base is skewed towards residential customers, which protects the group during market downturns.	Rising domestic interest rates and inflation increase Neoenergia's interest expenses, because 48% of its debt bears floating rates indexed to the benchmark interest rate.
Neoenergia is focusing on expanding its transmission business and divesting some non-core assets, which will increase financial flexibility in light of sizable capital expenditures (capex) in the next few years.	Exposure to hydrology increases energy costs and working capital needs in the distribution segment.
High standing in the domestic capital markets and good relationship with banks, including development agencies, which fund Neoenergia's investments and debt refinancing.	

Focus on delivery of projects, internal growth, and portfolio-rotation strategy in the next two years. Following record-high investment of R$9.8 billion in 2022 (after having invested R$9.3 billion in 2021), Neoenergia will spend R$18 billion in 2023 and 2024 to expand and maintain its distribution networks, and on transmission projects. Starting in 2025, in the absence of new substantial investments, we assume the group will invest R$5 billion - R$6 billion, mostly in its distribution business, although we believe the group would continue looking for opportunities for greenfield developments especially in the transmission and renewables segments. Because of sizable investments, we expect Neoenergia to post negative free operating cash flows (FOCF) for two consecutive years, especially in 2023, which will require the group to raise additional debt in capital and debt markets to fund investments as well as to refinance its upcoming maturities of up to R$6.5 billion in 2023. Despite Neoenergia's sizable financing needs, we're not concerned about the group's ability to refinance its debt, as it has a wide access to the domestic capital markets and benefits from good relationship with a variety of lenders, including development agencies, which broadens its options for the refinancing and raising new debt. In addition, the group's cash flows are increasing with the ramp-up of new renewable and transmission assets that were previously under construction, which will help finance new investments with internal cash flows. Also, as of Dec. 31, 2022, Neoenergia posted a healthy cash position of R$6.9 billion plus undisbursed committed credit facilities of R$4.0 billion.

In addition, we believe the group's asset rotation strategy may alleviate the need to issue new debt if Neoenergia sells non-core assets. This is in line with Neoenergia's strategy of reducing leverage and simplifying its corporate structure, as many of its assets are currently reported as equity affiliates. For instance, the group announced in December 2022 an asset exchange with Centrais Elétricas Brasileiras S.A. – Eletrobrás (Eletrobras; global scale: BB-/Stable/--; national scale: brAAA/Stable/brA-1+), which entails transferring Neoenergia's 51% stake in the 1,820 megawatt (MW) hydro plant Teles Pires and 140 MW consortia Baguari. In the meantime, the group will receive from Centrais Elétricas do Norte do Brasil S.A., Eletrobras' subsidiary, 49% of its equity stake in the 261 MW hydro plant Dardanelos. As a result, Neoenergia will have full control of the latter, which has roughly R$30 million in net debt and R$280 million in EBITDA. In addition, the transaction includes Neoenergia receiving Eletrobras' 0.04% indirect stake in Neoenergia Coelba, Neoenergia Cosern, and Afluente T. We expect the group to look for additional asset-rotation opportunities, which might include:

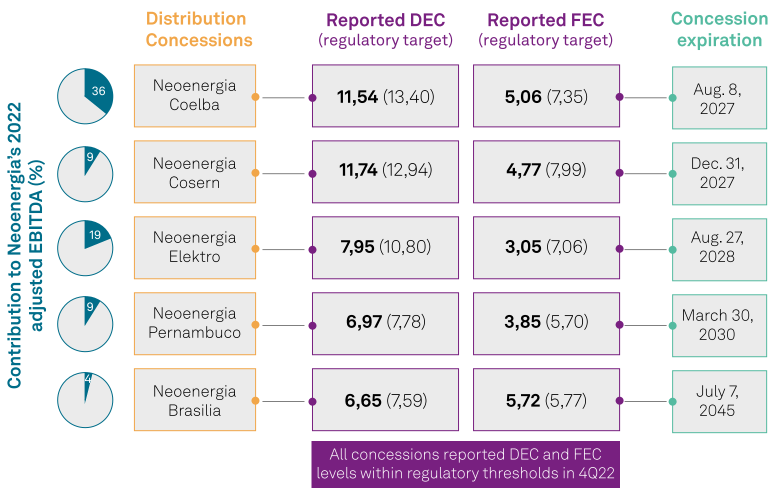
- The sale of its thermal plant, Termopernambuco S.A., in line with its energy transition strategy;
- Looking for strategic investors in the transmission segment; and
- The divestment of its 10% stake in Belo Monte, which is already booked as an asset held for sale. In our view, this could be more challenging because it involves negotiations with other shareholders, but if it occurs, it would strengthen Neoenergia's credit metrics because, besides receiving the equity amount upon on the sale, the group would eliminate about R$2.9 billion in debt guarantees related to the construction of Belo Monte.

We don't incorporate these potential transactions in our base-case scenario because timing and amounts are still uncertain. Any improvement in the group's financial risk profile related to these transactions would also depend on the use of proceeds and on the longer-term investment strategy.

We expect relatively stable credit metrics in 2023 and a gradual improvement starting in 2024. We believe the group's sizable investments and high interest rates in Brazil will continue weighing on Neoenergia's credit metrics, while increasing cash generation from renewables and transmission assets, along with favorable hydrology, will prevent credit metrics from deteriorating in 2023. As a result, we expect relatively stable debt to EBITDA in 2023: 4.0x-4.5x and FFO to debt at 10%-15%, compared with 4.3x and 16.6% in 2022. We assume a gradual improvement in credit metrics starting next year, with debt to EBITDA below 4.0x and FFO to debt of 15%-20% thanks to increasing cash generation and our expectation of softening interest rates.

We assume the renewal of Neoenergia's concessions. We currently expect Neoenergia to renew all of its distribution concession contracts, starting with the one for Neoenergia Coelba and Neoenergia Cosern due in 2027, and followed by Neoenergia Elektro and Neoenergia Pernambuco, which expire in 2028 and 2030, respectively. Neoenergia's concessions' service quality metrics, measured by duration and frequency of service interruptions (DEC and FEC), have been within the regulatory limits in the past few years. Compliance with such quality targets, in addition to financial balance of the concession, is key to the regulator's, the National Agency of Electric Energy (ANEEL), analysis when granting the renewal of concessions. In our view, Neoenergia's expertise in operating its concession areas and its investments in past years are also factors that might facilitate the concession renewal.

Neoenergia's Distribution Concessions



DEC: Duration of energy interruption, FEC: Frequency of energy interruption. Source: S&P Global Ratings.

Outlook

The stable outlook on Neoenergia for the next 12 months is based on our view that its investments in 2023 and 2024 won't materially affect its leverage, which in 2023 should be similar to that last year, with debt to EBITDA of 4.0x-4.5x and FFO to debt of 10%-15%. We expect these metrics to improve below 4.0x and to 15%-20%, respectively, in 2024 on increasing cash generation as the group ramps up new transmission lines and continues internally expanding its distribution business. The outlook also reflects our view that Neoenergia will continue benefiting from ample access to capital and debt markets in order to fund its capex of R$18 billion in the next two years and refinance its upcoming maturities. The outlook on Neoenergia also mirrors that on the sovereign rating on Brazil and incorporates our view that the group, as a regulated utility, could be subject to government intervention in a hypothetical sovereign stress scenario.

Downside scenario

We could downgrade Neoenergia in the next 12 months if a similar action occurs on Brazil. We could also lower the global and national scale ratings on Neoenergia if its controlling shareholder, **Iberdrola S.A.** (BBB+/Stable/A-2), has fewer incentives to provide support to its Brazilian operations, combined with a deterioration in Neoenergia's credit metrics. The latter scenario would consist of FFO to debt below 9% and debt to EBITDA above 5.5x on a consistent basis, which could result from lower electricity consumption, worsening of hydrology conditions that raise working capital needs as a result of energy costs, or due to higher-than-expected investments or a large debt-financed acquisition. The ratings on the subsidiaries, Neoenergia Coelba, Neoenergia Pernambuco, Neoenergia Cosern, Neoenergia Elektro and Neoenergia Brasilia, will move in tandem with those on Neoenergia in case of a negative rating action.

Upside scenario

Currently, the sovereign rating on Brazil caps the rating on Neoenergia. Therefore, we would raise the rating on the group if we upgrade the sovereign. On a stand-alone basis, we could revise the stand-alone credit profile (SACP) upward if Neoenergia posts adjusted debt to EBITDA of about 3.0x and FFO to debt above 20% thanks to increasing cash flows, as Neoenergia is ramping up new assets, and interest rates in Brazil fall. Under this scenario, we would also expect the group to generate positive FOCF, enabling it to finance investments with its own cash. The national scale rating is already at the highest level possible. An upgrade of Neoenergia would result in a similar action on its subsidiaries.

Our Base-Case Scenario

Assumptions

- We expect energy demand in Neoenergia's concession areas to rise in line with our expectation of Brazil's GDP growth of 0.8% in 2023, 1.7% in 2024, and 2.0% in 2025. The macroeconomic assumptions follow our latest report published on March 27, 2023, "Economic Outlook Emerging Markets Q2 2023: Global Crosscurrents Make For A Bumpy Deceleration". Although we expect the distribution generation segment to dent Neoenergia's energy demand growth, the investments made by the group to connect new clients should compensate for that.
- For 2022, we incorporated rate adjustments approved by ANEEL, and starting in 2023, they're to mirror the inflation rate of the previous year: 5.8% in 2022, 4.8% in 2023, 4.5% in 2024 and 3.6% in 2025.
- Average cost of energy in the distribution business of R$260/megawatt hour (MWh) – R$270/MWh in 2023, which is about 5% below the 2022 average cost of energy, supported by favorable hydrology and low dispatch of Brazil's thermal plants, which should keep energy spot prices at R$90/MWh – R$100/MWh. Itaipu Binacional's lower provisory energy rate will also help lower energy costs in 2023 for Neoenergia Elektro and Neoenergia Brasilia.
- For hydro plants, we assume a generation scaling factor (GSF), which determines the group's level of energy delivery of 85% starting in 2023. We also assume that the asset exchange with Eletrobras will be completed by mid-2023. Therefore, the group will consolidate the Dardanelos dam's 261 MW into the total installed capacity, reaching 723 MW in this segment.
- For wind and solar plants, we assume availability levels of 97%-98% and utilization rates at 55% and 30% annually, respectively.
- In the transmission segment, we assume permitted annual revenues (RAP) of R$680 million in 2023, R$1.4 billion in 2024, and roughly R$2.0 billion in 2025, as a result of the start-up of projects that are currently under construction.
- We assume investments of R$9.5 billion in 2023, R$8.6 billion in 2024, and R$5.3 billion in 2025, mostly for expanding and maintaining the distribution segment and developing new transmission lines. We also assume these investments will be mostly financed through new debt.
- We assume year-end basic interest rates of 12.5% in 2023, 9.0% in 2024, and 8.5% in 2025, affecting the group's interest expenses and FFO.
- A conservative dividend policy, distributing the minimum required by law, which is equivalent to 25% of previous year's net income.
- Our adjusted debt figures include pension-related liabilities of about R$1.2 billion and financial guarantees of R$4.4 billion, while our adjusted EBITDA excludes the effects of variations in the distribution concession's financial assets and the IFRS 15 accounting in the transmission segment.

Key metrics

Neoenergia S.A.--Key Metrics*

Mil. $	2021A	2022A	2023P	2024E	2025E
Energy distributed (GWh)	64,848	66,777	66,750 – 67,250	68,000 – 68,500	69,500 – 70,000
Revenue	33,756	32,458	33,000 - 34,000	36,000 - 37,000	39,500 - 40,500
EBITDA	7,047	9,697	10,500 - 11,000	12,300 - 12,800	13,700 - 14,200
EBITDA margin (%)	20,9	29,9	31,5-32,5	34,0-35,0	34,5-35,5
FFO	5.208	6.962	4,800 - 5,200	7,800 - 8,300	9,500 - 10,000
Capex	7.635	7.354	9,000-10,000	8,000-9,000	5,000 - 6,000

Debt to EBITDA (x)	5.1	4.3	4.0 - 4.5	3.6 - 4.1	3.0 - 3.5
FFO to debt (%)	14.4	16.6	10 - 15	15 - 20	20 - 25
FOCF to debt (%)	(20.7)	(6.5)	(13) - (8)	(5) - 0	8 - 13
EBITDA interest coverage (x)	2.7	2.4	1.8 - 2.3	3.5 - 4.0	4.2 - 4.7
FFO cash interest coverage (x)	5.1	3.6	2.0 - 2.5	3.2 - 3.7	4.0 - 4.5

*All figures adjusted by S&P Global Ratings. a--Actual. e--Estimate. f--Forecast.

Base-case projections

Still negative FOCF in 2023 and 2024 due to considerable investments. We expect Neoenergia to continue accessing debt and capital markets to refinance debt and to fund its investments in the next two years, as it expands and maintains its distribution concessions and constructs new transmission lines. We don't incorporate the asset-rotation plan in our base-case scenario as negotiations are currently non-binding, although we believe likely divestments throughout 2023 would alleviate Neoenergia's financing needs. In addition, Neoenergia has R$4.0 billion in available committed facilities, illustrating its ability to obtain financing for its investments and its good relationship with banks. EBITDA margins should continue rising in the next two years due to our expectation of favorable hydrology, while the group benefits from cash generation of its new wind and solar power plants, consolidates the Dardanelos dam, and ramps up its new transmission lines.

Company Description

Neoenergia is an integrated energy group operating in a wide range of electricity-related businesses: distribution, transmission, generation, and trading activities. It operates solely in Brazil, primarily in the northeastern region. Neoenergia has more than 16 million clients in the distribution segment through its five distribution companies (discos) and a regulatory asset base of about R$40.2 billion, considering its distribution and transmission assets. In addition, Neoenergia has 2,543 km of transmission lines and 13 substations in operation, totaling RAP of about R$532 million in the 2022-2023 cycle, along with eight transmission assets under construction that should add R$1,269 million in RAP. Pro forma the asset exchange with Eletrobras, which entails consolidating 100% of the Dardanelos dam and transferring Teles Pires, Neoenergia's installed capacity will reach 4.4 GW through hydro (50%), wind (35%), thermal (12%), and solar (2%) power plants, including its 10% stake (1,123 MW) in Belo Monte, a hydro power asset that's booked as held for sale.

Neoenergia's Operations

Source: S&P Global Ratings.

Iberdrola controls Neoenergia through a 53.5% stake. Caixa de Previdência dos Funcionários do Banco do Brasil (not rated) holds 30.29% of the group, and the remaining 16.17% is free floating. Iberdrola is the second-largest power generator and distributor in Spain, as well as the leader in renewables, and it has operations in the U.K. through Scottish Power, in Latin America through Iberdrola Renovables, and in the U.S. through Avangrid.

Peer Comparison

We selected the following companies as peers for Neoenergia:

- CPFL Energia, which is also one of the largest private players in the Brazilian electricity sector;
- Equatorial Energia S.A., another large player in Brazil's energy segment, which has been expanding internally and through acquisitions;
- Iberdrola, the parent company; and
- Enel Americas S.A., which operates across Latin America, with Brazil as its largest market.

We believe Neoenergia compares well with CPFL and Equatorial in terms of size and geographic diversification, as they operate multiple distribution concessions in Brazil. Given Neoenergia's currently higher level of investments, its credit metrics are slightly weaker than those of CPFL, and better than Equatorial's, which also has a considerable growth strategy, which explains our view of

Neoenergia’s and Equatorial’s financial risk profiles as aggressive. Enel Americas, and especially Iberdrola, are better positioned because they operate in multiple regulatory jurisdictions. Neoenergia's parent has operations in countries with well-established, stable, and predictable regulatory regimes.

Neoenergia S.A.-- Peer Comparisons

	Neoenergia S.A.	CPFL Energia S.A.	Equatorial Energia S.A.	Iberdrola S.A.	Enel Americas S.A.
Foreign currency issuer credit rating	BB-/Stable/--			BBB+/Stable/A-2	BBB-/Stable/--
Local currency issuer credit rating	BB-/Stable/--			BBB+/Stable/A-2	BBB-/Stable/--
Local scale issuer credit rating		brAAA/Stable/--	brAAA/Stable/--		
Period	Annual	Annual	Quarterly (RTM*)	Annual	Annual
Period ending	2022-12-31	2022-12-31	2022-09-31	2021-12-31	2022-12-31
Mil.	R$	R$	R$	R$	R$
Revenue	32,458	33,342	21,133	247,851	83,154
EBITDA	9,697	10,991	5,678	70,159	26,225
Funds from operations (FFO)	6,962	7,763	3,745	58,665	18,744
Interest	4,071	2,228	3,064	10,319	4,617
Cash interest paid	2,675	1,516	1,874	6,223	4,293
Operating cash flow (OCF)	4,620	8,927	3,051	44,066	16,272
Capital expenditure	7,354	5,133	5,175	45,503	19,063
Free operating cash flow (FOCF)	(2,734)	3,793	(2,124)	(1,437)	(2,791)
Discretionary cash flow (DCF)	(3,444)	(79)	(3,199)	(18,819)	(6,308)
Cash and short-term investments	6,901	4,602	7,802	25,632	7,068
Gross available cash	6,901	4,602	7,802	26,272	7,068
Debt	42,035	26,699	27,859	281,907	32,621
Equity	26,937	17,540	18,284	329,511	81,662
EBITDA margin (%)	29.9	33.0	26.9	28.3	31.5
Return on capital (%)	12.4	23.2	13.0	8.1	11.7
EBITDA interest coverage (x)	2.4	4.9	1.9	6.8	5.7
FFO cash interest coverage (x)	3.6	6.1	3.0	10.4	5.4
Debt/EBITDA (x)	4.3	2.4	4.9	4.0	1.2
FFO/debt (%)	16.6	29.1	13.4	20.8	57.5
OCF/debt (%)	11.0	33.4	11.0	15.6	49.9
FOCF/debt (%)	(6.5)	14.2	(7.6)	(0.5)	(8.6)
DCF/debt (%)	(8.2)	(0.3)	(11.5)	(6.7)	(19.3)

*RTM: rolling 12 months

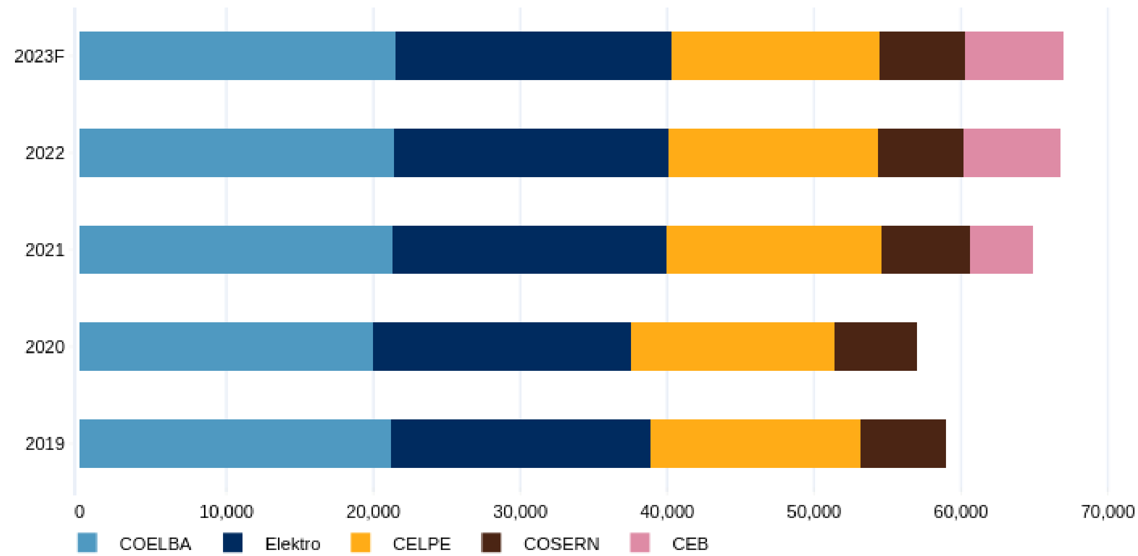
Business Risk

Neoenergia’s cash flows are mostly stable as they come from regulated activities in a favorable regulatory framework. One of Neoenergia's business strengths is that electric power distribution and transmission activities represent 80%-85% of the group's EBITDA, offering a high degree of cash flow predictability. This is particularly so for transmission lines: since revenues are based on availability, there's no volume risk exposure. We expect the transmission segment to represent about 5% of Neoenergia’s EBITDA in 2023 (up from 2.9% in 2022) and rise to 5%-10% as the group completes the construction of new transmission lines and substations. Meanwhile, the distribution segment should continue representing the bulk of Neoenergia’s EBITDA in the next few years, with 70%-73%. The cash flow stability of regulated activities is supported by a regulatory framework that we view as favorable in Brazil, based on the track record of fully respected contracts among industry players. In Brazil, discos operate with cost pass-through mechanisms and investment-reward schemes. In addition, discos are subject to rate readjustments every three to five years (depending on the concession contract). The latter enables passing through incurred electricity costs, and general and administrative expenses (usually pegged to inflation). Neoenergia's highly regulated distribution business operates five concessions in Brazil, whereas three of them (operated by Neoenergia Coelba, Neoenergia Pernambuco, and Neoenergia Cosern) serve the country's largest states in terms of GDP in northeastern Brazil. Neoenergia Elektro operates in the states of São Paulo, the country's most populous and wealthiest state, and Mato Grosso do Sul. Neoenergia Brasilia, the acquisition of which the group completed in March 2021, serves the densely populated Federal District. Electricity consumption across Neoenergia's concession areas has historically grown above the national consumption pace, with exception of recent years due to the economic slowdown.

Despite the increasingly captive-client migration to the distributed generation segment lately, we believe Neoenergia's investments to connect new clients (the group's client base grew by 295,000 in 2022, an increase of 2% relative to 2021) and given that three of its discos (Neoenergia Coelba and Neoenergia Cosern in April 2023, and Neoenergia Elektro in August 2023) will undergo their rate reviews this year - which entails remeasuring the size of the market – offsets the impact of distributed generation for Neoenergia. As such, we assume that energy demand starting in 2023 will grow in line with our expectation of Brazil's GDP growth.

Electricity Consumption (GWh)

Neoenergia's distribution companies - captive and free markets



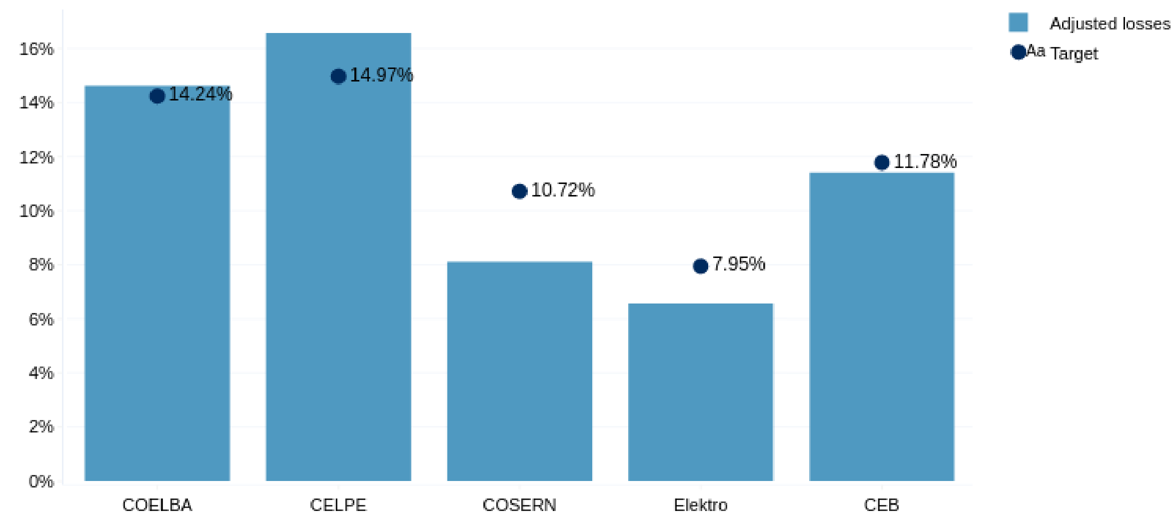
F: Forecast

Source: S&P Global Ratings.

Operating efficiency continues improving. Neoenergia has been investing consistently to raise the service quality at its five concession areas and has managed to improve the average DEC and FEC metrics across its concession areas throughout 2022, in compliance with regulatory thresholds, including Neoenergia Brasilia, which is experiencing a rapid turnaround since its acquisition. In terms of energy losses, the group continues investing on increasing inspections, replacing obsolete power meters, and regularizing illegal connections in all its concessions, but especially at Neoenergia Coelba and Neoenergia Pernambuco, energy losses of which are still above the regulatory target. The group's investments to reduce losses at Neoenergia Brasilia helped it reach the regulatory target ahead of the initial business plan. In addition, the group has been implementing various measures to help its customers cover their electricity bills, including offering moratoriums on payments and disconnecting services for delinquent clients, raising collection rates above 99% for most of its concession areas.

Adjusted Electricity Losses

As of Dec. 31, 2022



Source: S&P Global Ratings.

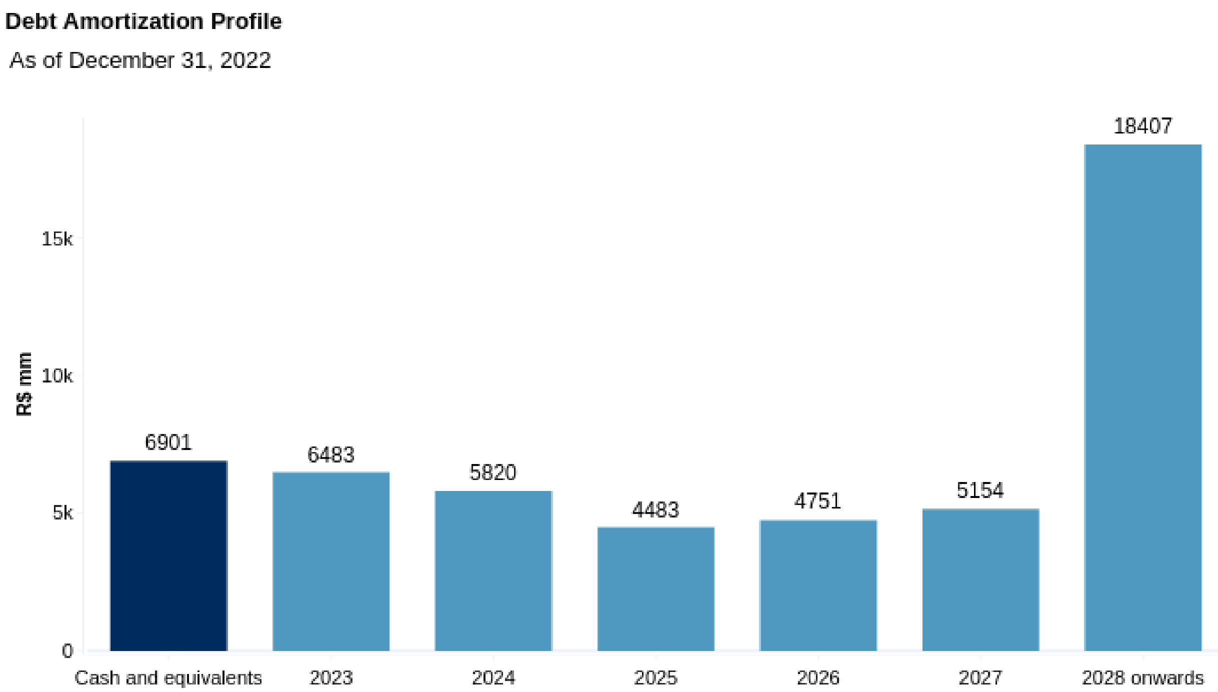
Increasing cash flows in the generation segment as a result of corporate restructuring and ramp-up of new assets. Pro forma the asset exchange with Eletrobras, Neoenergia will consolidate Dardanelos' 261 MW, which is currently an asset recorded as an equity affiliate, and therefore will fully benefit from its cash flows derived from PPAs fully contracted in the regulated market at relatively high prices. In addition, Neoenergia finalized the construction of the Oitis wind farm and Luzia solar park, which added 566.5 MW and 100 MW to the group's installed capacity, respectively, reaching 4.4 GW on a consolidated basis. The total installed capacity includes 10% of Belo Monte's hydro dam capacity, which Neoenergia now reports as an asset held for sale, and excludes 928 MW in capacity attributable to Neoenergia's shares in Teles Pires, which will be transferred to Eletrobras. In our view, the group's expansion of its renewables capacity is in line with Iberdrola's global strategy to maintain its leading position in renewable energy generation. Moreover, Neoenergia's diversified generation capacity across hydro, wind, thermal, and solar supports stable cash flows as it mitigates volatile conditions of a specific segment, especially hydrology risks.

Financial Risk

Our assessment of Neoenergia's financial risk profile incorporates its sizable capex, mainly in distribution and transmission, and the required additional debt to finance it. As a result, we expect negative FOCF in the next two years, especially in 2023. In addition, we consider the group's plans to distribute minimum mandatory dividends of 25% of previous year's net income, and we assume that maturing concessions will be renewed. Consequently, we expect Neoenergia's leverage, measured by net debt to EBITDA, to be 4.0x-4.5x in 2023, similar to 4.3x reported in 2022, and to drop slightly below 4.0x in 2024, while FFO to debt should improve from 10%-15% in 2023 to 15%-20% as we expect increasing cash generation from new assets that are ramping up (especially renewables and new transmission lines) and due to our expectations of lower basic interest rates and inflation, which will help lower Neoenergia's interest expenses.

Debt maturities

As of Dec. 31, 2022, Neoenergia reported R$43.5 billion in gross debt, with the following debt maturity profile:



Source: S&P Global Ratings.

Neoenergia S.A.--Financial Summary

Period ending	Dec-31-2017	Dec-31-2018	Dec-31-2019	Dec-31-2020	Dec-31-2021	Dec-31-2022
Reporting period	2017a	2018a	2019a	2020a	2021a	2022a
Display currency (mil.)	R$	R$	R$	R$	R$	R$
Revenues	17,320	21,981	23,525	26,331	33,756	32,458
EBITDA	2,568	4,067	4,810	6,664	7,047	9,697
Funds from operations (FFO)	1,118	2,534	3,215	5,160	5,208	6,962
Interest expense	1,114	1,295	1,330	1,484	2,627	4,071
Cash interest paid	1,276	1,276	1,270	948	1,265	2,675
Operating cash flow (OCF)	694	1,328	3,410	3,543	132	4,620
Capital expenditure	3,807	4,143	4,309	4,732	7,635	7,354
Free operating cash flow (FOCF)	(3,113)	(2,815)	(899)	(1,189)	(7,503)	(2,734)

Neoenergia S.A.--Financial Summary

Discretionary cash flow (DCF)	(3,134)	(3,349)	(1,596)	(1,656)	(8,211)	(3,444)
Cash and short-term investments	3,873	3,955	4,066	5,076	5,617	6,901
Gross available cash	3,873	3,955	4,066	5,076	5,617	6,901
Debt	14,492	16,919	18,141	24,303	36,280	42,035
Common equity	15,608	17,577	19,259	21,509	24,238	26,937
Adjusted ratios						
EBITDA margin (%)	14.8	18.5	20.4	25.3	20.9	29.9
Return on capital (%)	6.9	10.0	10.2	12.3	9.1	12.7
EBITDA interest coverage (x)	2.3	3.1	3.6	4.5	2.7	2.4
FFO cash interest coverage (x)	1.9	3.0	3.5	6.4	5.1	3.6
Debt/EBITDA (x)	5.6	4.2	3.8	3.6	5.1	4.3
FFO/debt (%)	7.7	15.0	17.7	21.2	14.4	16.6
OCF/debt (%)	4.8	7.9	18.8	14.6	0.4	11.0
FOCF/debt (%)	(21.5)	(16.6)	(5.0)	(4.9)	(20.7)	(6.5)
DCF/debt (%)	(21.6)	(19.8)	(8.8)	(6.8)	(22.6)	(8.2)

Reconciliation Of Neoenergia S.A. Reported Amounts With S&P Global Adjusted Amounts (Mil. R$)

	Debt	Shareholder Equity	Revenue	EBITDA	Operating income	Interest expense	S&PGR adjusted EBITDA	Operating cash flow	Dividends	Capital expenditure
Financial year	Dec-31-2022									
Company reported amounts	43,503	26,739	42,787	11,582	9,339	4,071	9,697	4,620	1,036	7,354
Cash taxes paid	-	-	-	-	-	-	(60)	-	-	-
Cash interest paid	-	-	-	-	-	-	(2,675)	-	-	-
Accessible cash and liquid investments	(6,901)	-	-	-	-	-	-	-	-	-
Dividends from equity investments	-	-	-	87	-	-	-	-	-	-
Income (expense) of unconsolid. cos.	-	-	-	(19)	-	-	-	-	-	-
Nonoperating income (expense)	-	-	-	-	890	-	-	-	-	-
Noncontrolling/ minority interest	-	198	-	-	-	-	-	-	-	-

Reconciliation Of Neoenergia S.A. Reported Amounts With S&P Global Adjusted Amounts (Mil. R$)

	Debt	Shareholder Equity	Revenue	EBITDA	Operating income	Interest expense	S&PGR adjusted EBITDA	Operating cash flow	Dividends	Capital expenditure
Debt: Guarantees	4,406	-	-	-	-	-	-	-	-	-
Debt: Workers comp/ self insurance	744	-	-	-	-	-	-	-	-	-
Debt: Derivatives	283	-	-	-	-	-	-	-	-	-
Revenue: other	-	-	(10,329)	(10,329)	(10,329)	-	-	-	-	-
COGS: other nonoperating nonrecurring items	-	-	-	8,001	8,001	-	-	-	-	-
EBITDA - Gain/(loss) on disposals of PP&E	-	-	-	174	174	-	-	-	-	-
EBITDA: Valuation gains/(losses)	-	-	-	201	201	-	-	-	-	-
D&A: other	-	-	-	-	(37)	-	-	-	-	-
Working capital: Taxes	-	-	-	-	-	-	-	60	-	-
Working capital: other	-	-	-	-	-	-	-	3,515	-	-
OCF: Taxes	-	-	-	-	-	-	-	(60)	-	-
OCF: other	-	-	-	-	-	-	-	(3,515)	-	-
Total adjustments	(1,468)	198	(10,329)	(1,885)	(1,100)	-	(2,735)	-	-	-
S&P Global Ratings adjusted	**Debt**	**Equity**	**Revenue**	**EBITDA**	**EBIT**	**Interest expense**	**Funds from Operations**	**Operating cash flow**	**Dividends**	**Capital expenditure**
	42,035	26,937	32,458	9,697	8,239	4,071	6,962	4,620	1,036	7,354

Liquidity

We assess Neoenergia's liquidity as adequate because we expect its sources of cash to exceed uses by more than 1.1x in the next 12 months, even if EBITDA were to fall 10%. Neoenergia has meaningful debt maturities in 2023 and 2024, of about R$6.4 billion and R$5.8 billion, respectively, in addition to its sizable capex of about R$18 billion in the next two years. We believe the group's cash position and expected cash generation, in addition to about R$4 billion in committed facilities, are enough to cover its debt maturities and to finance part of its investments in 2023, although we expect the group to continue refinancing its debt while funding part of its investments with additional debt. We believe that Neoenergia has flexibility to postpone dividend payments and investments in case of stressful conditions, and although we don't incorporate the execution of the asset rotation strategy in our base-case scenario, we recognize it might bring flexibility in case the group sells its non-core assets. In addition, in our view, the group has a good standing in capital markets and a solid relationship with banks, as seen in broad access to funding from development agencies.

Principal liquidity sources

- Cash and cash equivalents of R$6.9 billion as of Dec. 31, 2022.
- Committed credit lines of about R$4 billion available to finance investments.
- Expected cash flows of R$5.3 billion – R$5.8 billion in 2023.
- Proceeds from new loans and issuances of about R$1.5 billion.

Principal liquidity uses

- Short-term debt of about R$7.3 billion in 2023.
- Maintenance investments of about R$5.7 billion in 2023.
- Working capital requirements of about R$1.2 billion annually, including intra-year working capital needs.
- Minimum dividend distributions of about R$1.2 billion in 2023.

Covenant Analysis

Requirements

Neoenergia and its subsidiaries are subject to the following financial covenants, measured either quarterly, semiannually, or annually:

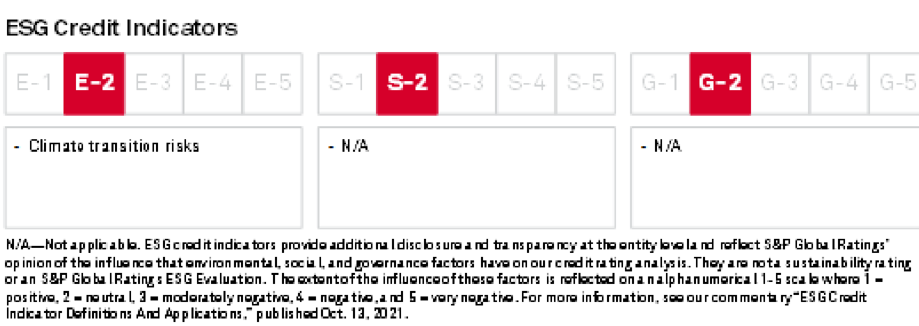
- Net debt to EBITDA of up to 4.0x; and
- EBITDA to interest of at least 2.0x.

The calculation of covenants differs from our methodology, as variations in the concession's financial assets are considered as part of discos' EBITDA. In addition, at the consolidated level, the covenant calculation doesn't adjust for the effects of IFRS 15 in the transmission segment, while we remove construction margins in the pre-operating period. Also, our adjusted metrics include debt adjustments related to pension liabilities and financial guarantees provided to equity affiliates, while the covenant calculation doesn't include them.

Compliance expectations

We expect Neoenergia to comply with the required financial covenants under its bank loans and debentures in the next couple of years with a cushion of at least 20%.

Environmental, Social, And Governance



ESG factors have an overall neutral influence on our credit rating analysis of Neoenergia. The company operates mainly distribution and transmission networks (roughly 80% of the group's EBITDA) and mostly in the northeastern region of Brazil, with 20% of its client base belonging to the low-income slice of the population. In line with other integrated energy groups in Brazil, such as CPFL Energia and Companhia Energetica de Minas Gerais – CEMIG, we consider that Neoenergia is well positioned for energy transition. Roughly 83% of its installed capacity is renewable (excluding Neoenergia's 10% stake in Belo Monte, given that it intends to sell this asset and pro forma the asset exchange with Eletrobras). Neoenergia has a stake in Termope, a gas-powered thermoelectric plant, but our ESG assessment isn't affected: Termope represents a small share of the group's total installed capacity, it uses a relatively clean fossil fuel (natural gas), and serves as energy reserve to support Brazil's energy matrix, which is skewed towards hydro. In addition, in line with Neoenergia's asset-rotation strategy, the group is evaluating the sale of Termope, which also is in line with Neoenergia's and its parent's energy transition strategy.

Group Influence

We consider operations in Brazil to be strategically important to Iberdrola's strategy of expanding regulated activities (electricity distribution and transmission) in high-growth markets, as well as in the renewable segment. Neoenergia represents roughly 15% of the parent's consolidated EBITDA, and this is likely to remain the case. In addition, we expect Neoenergia to continue operating as a stand-alone entity and not rely on the parent's direct financial support. We believe Neoenergia Coelba, Neoenergia Pernambuco, Neoenergia Cosern, Neoenergia Elektro, and Neoenergia Brasilia are the group's most important subsidiaries as they're electricity discos generating 70%-75% of Neoenergia's cash flows. Even though these subsidiaries are operated on a stand-alone basis due to regulatory purposes, we consider that Neoenergia adopts an integrated financial strategy towards all of its subsidiaries.

Rating Above The Sovereign

Neoenergia--through its subsidiaries in the electric power distribution, transmission, and generation segments--operates in a heavily regulated industry. It's regulated at the federal level through ANEEL. We believe that in a sovereign stress scenario, the government could interfere in the electric utility sector, given its ability to determine the guidelines for the segment. Therefore, we believe that default of Brazil would provide incentives for the government to intervene in the sector's companies, including Neoenergia, which could hamper its ability to repay debt. Therefore, given that Neoenergia is a regulated utility, we limit our ratings on it and on its subsidiaries to those on Brazil.

Issue Ratings--Subordination Risk Analysis

Capital structure

As of Dec. 31, 2022, Neoenergia's gross debt totaled R$45.5 billion, consisting of debentures (41%) and bank loans (58%) from several financial institutions, including development banks. Out of the total amount, roughly 10% of debt is at the holding level and the remaining 90% is at the subsidiaries' level. We rate several of Neoenergia's and its subsidiaries' debt instruments on the national scale (please see the table below).

Debt-Level Ratings

Issue	Amount	Maturity	Rating
Neoenergia S.A.			
6th debentures issuance	R$1.3 billion	Jun-33	brAA+
Companhia de Eletricidade do Estado da Bahia (Neoenergia Coelba)			
10th debentures issuance	R$1.2 billion	Apr-23	brAAA
12th debentures issuance	R$700 million	Apr-26	brAAA
13th debentures issuance	R$800 million	Dec-35	brAAA
1st commercial notes issuance	R$800 million	Dec-28	brAAA
14th debentures issuance	R$1.2 billion	Apr-29	brAAA

2nd commercial notes issuance	R$ 500 million	Jul-29	brAAA
Companhia Energetica de Pernambuco (Neoenergia Pernambuco)			
8th debentures issuance	R$500 million	Feb-23	brAAA
10th debentures issuance	R$500 million	Apr-26	brAAA
11th debentures issuance	R$500 million	Dec-35	brAAA
1st commercial notes issuance	R$500 million	Dec-28	brAAA
12th debentures issuance	R$1.2 billion	Apr-29	brAAA
2nd commercial notes issuance	R$450 million	Jul-29	brAAA
Companhia Energetica do Rio Grande do Norte (Neoenergia Cosern)			
7th debentures issuance	R$370 million	Oct-24	brAAA
1st commercial notes issuance	R$200 million	Dec-28	brAAA
10th debentures issuance	R$800 million	Jul-29	brAAA
Elektro Redes S.A. (Neoenergia Elektro)			
7th debentures issuance	R$1.3 billion	May-25	brAAA
9th debentures issuance	R$700 million	May-28	brAAA
10th debentures issuance	R$650 million	Oct-31	brAAA
11th debentures issuance	R$500 million	Jul-29	brAAA
Neoenergia Distribuição Brasilia S.A. (Neoenergia Brasilia)			
5th debentures issuance	R$300 million	Jul-29	brAAA
Calango 6 Energia Renovavel S.A.			
1st debentures issuance	R$43.5 million	Jun-28	brAA+
Lagoa 1 Energia Renovavel S.A.			
1st debentures issuance	R$46.2 million	Mar-29	brAA+
NC Energia S.A.			
1st debentures issuance	R$31.6 million	Dec-25	brAA+

Analytical conclusions

The 'brAAA' issue-level ratings on issuances by Neoenergia Coelba, Neoenergia Pernambuco, Neoenergia Cosern, Neoenergia Elektro, and Neoenergia Brasilia are the same as issuer credit ratings on the same entities, because they're the group's main operating companies and they finance themselves mostly through unsecured debt at their level. The 'brAA+' issue-level rating on Neoenergia's debt is one notch lower than the issuer credit rating because about 90% of the consolidated debt is at the operating subsidiaries' level, indicating a structural subordination of the holding's obligations. Finally, the 'brAA+' issue-level ratings on issuances by Calango 6, Lagoa 1, and NC Energia reflect the reliance on Neoenergia's guarantees (credit substitution). We treat these debt instruments as the group's obligation; therefore, they are subordinated to other obligations.

Rating Component Scores

Foreign currency issuer credit rating	**BB-/Stable/--**
Local currency issuer credit rating	**BB-/Stable/--**
Business risk	**Satisfactory**
Country risk	Moderately High
Industry risk	Low
Competitive position	Satisfactory
Financial risk	**Aggressive**
Cash flow/leverage	Aggressive
Anchor	**bb**
Diversification/portfolio effect	Neutral (no impact)
Capital structure	Neutral (no impact)
Financial policy	Neutral (no impact)
Liquidity	Adequate (no impact)
Management and governance	Fair (no impact)
Comparable rating analysis	Neutral (no impact)
Stand-alone credit profile	**bb**

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- General Criteria: Methodology For National And Regional Scale Credit Ratings, June 25, 2018
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- Criteria | Corporates | General: Recovery Rating Criteria For Speculative-Grade Corporate Issuers, Dec. 7, 2016
- General Criteria: Guarantee Criteria, Oct. 21, 2016
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | Industrials: Key Credit Factors For The Unregulated Power And Gas Industry, March 28, 2014
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- 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
- 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, 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

Related Research

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Ratings Detail (as of March 27, 2023)*

Neoenergia S.A.		
Issuer Credit Rating		BB-/Stable/--
Brazil National Scale		brAAA/Stable/brA-1+
Issuer Credit Ratings History		
07-Apr-2020		BB-/Stable/--
12-Dec-2019		BB-/Positive/--
12-Jan-2018		BB-/Stable/--
11-Jul-2018	*Brazil National Scale*	brAAA/Stable/brA-1+
12-Jan-2018		brAA-/Stable/brA-1+
16-Aug-2017		brAA-/Negative/brA-1+
Related Entities		
Companhia de Eletricidade do Estado da Bahia		
Issuer Credit Rating		BB-/Stable/--
Brazil National Scale		brAAA/Stable/--
Senior Unsecured		
Brazil National Scale		brAAA
Companhia Energetica de Pernambuco (CELPE)		
Issuer Credit Rating		BB-/Stable/--
Brazil National Scale		brAAA/Stable/--
Senior Unsecured		
Brazil National Scale		brAAA
Companhia Energetica do Rio Grande do Norte		
Issuer Credit Rating		BB-/Stable/--
Brazil National Scale		brAAA/Stable/--
Senior Unsecured		
Brazil National Scale		brAAA
Elektro Redes S.A.		
Issuer Credit Rating		
Brazil National Scale		brAAA/Stable/--
Senior Unsecured		
Brazil National Scale		brAAA
Neoenergia Distribuicao Brasilia S.A.		
Issuer Credit Rating		
Brazil National Scale		brAAA/Stable/--
Senior Unsecured		
Brazil National Scale		brAAA

*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.