

Research Update:

# Chilean Electricity Transmission Firm Celeo Redes Operacion Chile 'BBB' Debt Rating Affirmed, Outlook Still Stable

February 25, 2021

## Rating Action Overview

- Upon reviewing Chile-based electricity transmission company Celeo Redes Operacion Chile S.A.'s (CROCH or the project) 2020 performance, we have also updated our analysis by incorporating the rate revision delay and the earlier start of tax payments in 2030, Operational performance, in terms of availability, remains in line with our expectations.
- On Feb. 25, 2021, S&P Global Ratings affirmed its 'BBB' issue-level rating on CROCH's senior secured notes.
- The stable outlook reflects our view of steady cash flows during the next 12-24 months, resulting in debt service coverage ratio (DSCR) above 1.35x based on our expectation of no further delays beyond 2021 for the collection of the Alto Jahuel's second circuit revenues and given CROCH's long-term concession contracts at fixed prices and availability levels above the minimum regulatory requirement.

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## Project Description And Key Credit Factors

CROCH owns two trunk transmission lines located in Chile's power grid. The assets benefit from perpetual concessions granted by the Ministry of Energy in which revenues are not subject to any demand risk and are not based on utilization rate of the lines. The project's assets consist of:

- Alto Jahuel Transmisora de Energía, S.A. (AJTE): A 256- kilometer (km) 500 kilovolts (kV) transmission line, consisting of two circuits. AJTE circuit 1 is entitled to receive fixed availability payments until 2035, and AJTE circuit 2 receives the same type of payments with reviews every four years. AJTE circuit 1 is operational since September 2015 and AJTE circuit 2 since January 2016.
- Charrúa Transmisora de Energía, S.A. (CHATE): A single 198-km circuit that started commercial operations in December 2017 and is entitled to receive fixed availability payments until 2038.

Based on the concession contracts, CROCH receives fixed revenue based on its availability.

providing predictable and stable revenue flow with no exposure to market risk. Rates are in place for a 20-year period since commencement of operations (COD) for AJTE circuit 1 and CHATE lines, whereas the regulator revises rates for AJTE circuit 2 every four years.

## Strengths

- Revenue based on lines' availability levels, eliminating market risk and providing stable cash flows.
- Relatively low operational complexity with proven technology.
- No exposure to counterparty risk, given that payments come from the electricity system.

## Risks

- Exposure to fixed-rate recalculation before the notes' maturity in 2047.
- U.S. inflation's sustained decreases in the long term, given its direct impact on the project's revenue.
- Although unlikely, a natural disaster--usually an earthquake in Chile--could damage the project's transmission lines.

## Rating Action Rationale

**The rate revision postponement lowered the DSCR in 2020.** The delay in revising rates for AJTE circuit 2 for 2020-2023 was due to errors found in the valuation study. The National Energy Commission (CNE) determined to redo the study delaying rate revisions by more than a year. Therefore, assets continued to earn previous rates, and more importantly the delay prevented the project from collecting the revenues related to expansion works on the second circuit, which the regulator requested. Such revenues consist of the remuneration for an additional structure built on pre-existing assets, while the regulations state that the project would receive compensation during four years following the implementation of the 2020-2023 rate period. As a result, the 2020 DSCR was 1.18x, versus our expectations of 1.32x.

As of this report's date, the final version of the valuation report prepared by an independent consultant is available, while the regulator's Preliminary Technical Report will be available in early March 2021 and the official decree is now likely to be published in the third quarter of 2021.

We believe that the issues that caused the delay have been addressed, and while causing the DSCR to fall, we view it as a one-off event. We maintain our view of the Chilean regulatory framework for the transmission lines as robust and predictable. In this sense, we expect the project to receive the pending amounts during the second half of 2021, resulting in a DSCR of about 1.5x for this year. Once the decree is published, the DSCR should reach around 1.35x or higher, except for in 2030 (see below for details).

**The earlier start of tax payments reduces the minimum DSCR for 2030.** The project expects corporate tax payments to start in 2029-2030, instead of 2031, which will result in a minimum DSCR of about 1.2x for that year. The original financing structure incorporated the start of tax payments in 2031, and consequently, the debt service were to be lower for that year, enabling the DSCR to remain steady. Despite the lower DSCR than 1.25x in our previous scenario forecast, we

view this change as rating-neutral because it's a one-time shift from 2031 to 2030. Aside from that year, we expect a DSCR around 1.35x or above for other years; therefore, the metric for 2030 is abnormally low in our base case. We also don't believe this change influences the underlying business model and our view of the project's robustness.

**Operating performance in line with expectations.** The assets in CROCH's portfolio continue to benefit from regulated rates and fixed operations and maintenance (O&M) expenses; therefore, cash flows have remained stable and predictable since the assets' CODs. In 2020, the project performed in line with expectations with no availability issues or regulatory penalties. CROCH serviced its debt in a timely manner, while reserve accounts (six-month debt service reserve account [DSRA] and three-month O&M reserve account) remain fully funded. In 2020, CROCH's availability levels were above the minimum regulatory requirement of 99.85%.

## Liquidity

We assess the project's liquidity as neutral, because of the six-month DSRA and three-month O&M reserve accounts are funded with cash. In addition, there's a backward- and forward-looking distribution lock-up of 1.15x until 2035, which will be 1.15x backward-looking and 1.2x forward-looking after January 2036. Also, even if further delays occur in 2021, preventing the project from receiving compensation for the expansion of AJTE's second circuit, we don't expect DSCR below 1x or the use of the reserve accounts this year.

## Outlook

The stable outlook reflects our view of stable cash flows during the next 12-24 months, resulting in average DSCR above 1.35x. This is based on our expectation of no further delays in 2021 for the compensation for the expansion of AJTE's second circuit, and given CROCH's long-term concession contracts at fixed prices and availability levels above the minimum regulatory requirement.

## Downside scenario

A downgrade in the next two years is possible if the project's revenues are lower than expected, for instance, if annual U.S. inflation decreases consistently below 1.8% in the long term or if costs or corporate taxes are higher than our projections, resulting in minimum DSCR of 1.15x and average DSCR below 1.4x, while the project's resilience to the downside-case scenario diminishes.

## Upside scenario

Although unlikely, we could upgrade CROCH if its resilience to a downside-case scenario increases, while maintaining minimum DSCR above 1.30x.

## Base Case

## Assumptions

- We consider key macroeconomic variables, such as inflation in the U.S. and Chile, and exchange rate. We expect Chile's CPI of 3.2% in 2021, 3.1% in 2022, and 3.0% afterwards; U.S. CPI of 1.7% in 2021 and 2% afterwards; with average exchange rate of Chilean peso (CLP) 760 per \$1 in 2021, and CLP755 per \$1 in 2022 and 2023.
- Fixed rates adjusted to inflation in Chile and/or the U.S., depending on the asset. We assumed circuit 2 receives pending regulatory approvals during the second half of 2021. After the initial fixed-rate period, the regulator will recalculate the asset remuneration incorporating the asset's replacement value and an after-tax return on investment that will range from 7% to 10%. We calculate the new rate, incorporating an after-tax return of 8%, the transmission lines' depreciable period of 50 years, and the abovementioned macroeconomic variables.
- The project to maintain the O&M agreements with Celeo Redes Chile Limitada (not rated), totaling about UF47,000 per year for AJTE's two circuits and about UF31,000 per year for CHATE, adjusted to Chile's inflation. The agreements include an automatic renewal clause unless either party chooses to terminate them.
- No penalties due to unavailability of the assets, given solid track record of the transmission lines and the operator.

## **Key metrics**

We expect minimum DSCR of 1.2x in 2030 and average DSCR of 1.48x during the notes' term.

## **Downside Case**

### **Assumptions**

- We stress both U.S. inflation and foreign exchange, because U.S. inflation has a positive effect on the project's revenues. We assume a 50 basis point (bps) decrease in the U.S. rate from our base-case scenario and a 15% appreciation of the Chilean peso for a five-year period starting in 2030, the project's most vulnerable phase.
- After the initial regulated period, we calculated the rate based on a 7% after-tax return, the stressed macroeconomic variables, and the transmission lines' depreciation period of 50 years. We have also kept a two-month delay in payment from the largest generator for a five-year period starting in 2030.
- Operational expenses 12% higher than in our base-case scenario.
- Penalties of about \$1.8 million for a five-year period starting from the weakest phase of the project due to unavailability (3%).

## **Key metrics**

We expect a minimum DSCR of 0.9x and average DSCR above 1x during the notes' term. Nonetheless, the project would cover any potential shortfall through the reserve accounts.

## Rating Score Snapshot

### Operations phase SACP (senior debt)

- Operations phase business assessment: bbb-
- Preliminary SACP: bbb-
- Downside impact on preliminary SACP: Neutral
- Debt structure (average): Positive + 1 notch
- Liquidity: Neutral
- Comparative analysis assessment: Neutral
- Adjusted preliminary operations phase SACP: bbb
- Operations counterparty ratings adjustment: N/A
- Financial counterparty ratings adjustment: N/A
- Operations phase SACP: bbb

### Modifiers (senior debt)

- Parent linkage: Delinked
- Structural protection: Neutral
- Senior debt issue rating: bbb

### Related Criteria

- Criteria | Structured Finance | General: Counterparty Risk Framework: Methodology And Assumptions, March 8, 2019
- Criteria | Corporates | Project Finance: Project Finance Transaction Structure Methodology, Sept. 16, 2014
- Criteria | Corporates | Project Finance: Project Finance Operations Methodology, Sept. 16, 2014
- Criteria | Corporates | Project Finance: Project Finance Framework Methodology, Sept. 16, 2014
- Criteria | Corporates | Project Finance: Key Credit Factors For Power Project Financings, Sept. 16, 2014
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria | Corporates | Project Finance: Project Finance Construction And Operations Counterparty Methodology, Dec. 20, 2011
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

## Ratings List

### Ratings Affirmed

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#### Celeo Redes Operacion Chile S.A.

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Senior Secured BBB/Stable

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Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at [www.standardandpoors.com](http://www.standardandpoors.com) for further information. Complete ratings information is available to subscribers of RatingsDirect at [www.capitaliq.com](http://www.capitaliq.com). All ratings affected by this rating action can be found on S&P Global Ratings' public website at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column.

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