FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Cemig's IDRs at 'BB'

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Fitch Ratings - Rio de Janeiro - 18 Oct 2023: Fitch Ratings has affirmed Companhia Energetica de Minas Gerais' (Cemig) and its subsidiaries Cemig Distribuicao S.A.'s (Cemig D) and Cemig Geracao e Transmissao S.A.'s (Cemig GT) Local Currency (LC) and Foreign Currency (FC) Issuer Default Ratings (IDRs) at 'BB'. Fitch has also affirmed the National Scale Ratings for the three entities at 'AA+(bra)'. The Rating Outlook is Stable.

Cemig's ratings reflect the group's solid and diversified asset base, sound financial profile and positive operating performance in the Brazilian power sector. Fitch estimates the group's aggressive capex plan will drive negative FCFs throughout the rating horizon and will increase leverage.

KEY RATING DRIVERS

Aggressive Capex Plan Pressures FCF: Fitch estimates that Cemig will be consistently cash flow negative in the next four years, as it executes its aggressive capex plan of BRL25 billion for 2023-2026 period, with BRL5.0 billion in 2023 and BRL5.3 billion in 2024. The capex plan is mainly concentrated at Cemig D (Distribution Business) with the aim to reinforce its asset base, which will be considered in the next tariff review in 2028. The base case scenario for the rating estimates negative consolidated FCFs of BRL1.9 billion in 2023 and BRL2.7 billion in 2024, incorporating a dividend payment of 50% of net income. Fitch forecasts EBITDA around BRL7.0 billion in 2023 and 2024 and cash flow from operations of BRL5.4 billion and BRL4.7 billion, respectively.

Higher Leverage: Cemig's consolidated adjusted net leverage is expected to increase to around 3.0x in 2026 from 1.7x expected for 2023, as a result of the debt fund capex plan. EBITDA to interest expense will be pressured, weakening to 3.5x in 2026 from 7.0x in 2023. Consolidated net leverage, excluding off-balance-sheet from guarantees to nonconsolidated investments, should continue below 2.5x until 2026. Fitch's adjusted debt for Cemig includes guarantees of BRL3.4 billion to nonconsolidated companies, while adjusted EBITDA includes dividends received of BRL730 million.

Favorable Generation Segment: Cemig's asset diversification and operations in different segments within the Brazilian power sector is viewed as a credit strength. The generation segment (Cemig GT) performance is key for its consolidated credit profile; Gemig GT is fully contracted until 2026, and is estimated to generate an average annual EBITDA of BRL2.7 billion during 2023-2026 with an EBITDA margin of around 30%. Outside the rating horizon, Cemig GT faces recontracting risk, as it has two generation concessions that will expire in 2027 that represent 51% of its contracted energy.

High Predictability from Distribution: Cemig D has been able to drive strong performance despite an unfavorable trend in energy volumes distributed in its concession area - a drop of 0.3% in 2022 and an expected growth of modest 1.6% in 2023. Cemig D's tariff review in May 2023 increased by 12% (+BRL349 million) the regulatory EBITDA to BRL3.2 billion, from BRL2.8 billion. Fitch's base case scenario incorporates annual increase in demand of 1.7%, on average, from 2023 to 2025. Cemig D should generate EBITDA of BRL3.0 billion in 2023 and BRL3.5 billion in 2024, remaining above the regulatory level.

Ratings Equalization: As per as Fitch's Parent and Subsidiary Linkage Rating Criteria, Fitch equalizes Cemig, Cemig D and Cemig GT's ratings. This mainly reflects the high legal incentives that the holding company would have to support the subsidiaries in a stress scenario. Cemig consolidates the subsidiaries and guarantees a significant portion of their debts. There are also cross-default clauses in the majority of the group's debt instruments. Debt financial covenants are measured on a consolidated basis, with centralized strategy and cash management. Fitch also views the subsidiaries as the core business of Cemig. Cemig's ratings are not capped by the credit profile of its controlling shareholder, the State of Minas Gerais.

DERIVATION SUMMARY

Compared with Brazilian peers in the power sector, Cemig's credit profile is weaker than Engie Brasil S.A. (Engie Brasil) and Transmissora Alianca de Energia Eletrica S.A. (Taesa), both LC and FC IDRs rated 'BBB-' and 'BB+', respectively. Cemig presents higher business risk coming from its distribution segment and typically worse operational performance as a state-owned company. Taesa operates in the highly predictable transmission segment (13,800km of transmission lines across the country, compared with 5,017km for Cemig), while Engie Brasil is the largest private player in the generation segment (installed capacity of 8.2 GW, compared with 5.3 GW for Cemig).

Compared with Brazilian peers on the National Scale, Cemig's credit profile is weaker than Companhia Paranaense de Energia (Copel; AAA(bra)/Stable) and higher than Centrais Eletricas de Santa Catarina (Celesc; AA(bra)/Stable). In comparison with Copel, which has a similar business profile, this company has greater relevance in the generation segment in the consolidated results (66% of the consolidated EBITDA, compared with 46% for Cemig), without concession risk in generation segment and lower capex program over the next years. Fitch considers that, despite the solid financial profile of Celesc, benefiting from a conservative leverage ratio (net leverage below 2.0x) and less intense investment plan, its worse business profile with much higher exposure to the distribution segment (80% of the consolidated EBITDA) justifies the rating differentiation.

KEY ASSUMPTIONS

--Cemig D energy distribution increase in its concession area of 1.6% in 2023 and average annual growth of 1.8% in 2024-2026;

--Cemig D's non-manageable costs fully passed through tariffs;

--Cemig GT's average sales price of BRL243/MWh in 2023-2024, with annual energy sales of 4.8GWh per year;

--Average annual consolidated capex of BRL6.2 billion during 2023-2026;

--Dividend payout of 50% of net income.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--Neutral to positive FCF;

--Consolidated net adjusted leverage below 3.0x on a sustainable basis;

--EBITDA interest coverage above 4.5x on a sustainable basis.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--Consolidated net adjusted leverage higher than 4.0x on a sustainable basis;

--EBITDA interest coverage below 3.0x on a sustainable basis;

--Short-term debt exceeding cash;

--Significant operational issues in its mains subsidiaries Cemig D and Cemig GT;

--Loss or costly renewal of generation concessions, depending on the financial structure.

LIQUIDITY AND DEBT STRUCTURE

Sound Liquidity: Cemig group should continue with broad access to financing sources and gradually reduce its debt maturity concentration in 2024. Liquidity strengthened in 2023, benefiting from positive operating results and the debenture issuance of BRL2.0 billion at Cemig D level, due in 2026. At the end of June 2023, cash and equivalents were BRL3.7 billion, compared with short-term debt of BRL1.1 billion. Cash inflow from the asset sale of BRL421 million, concluded in October 2023, also reinforces the group's liquidity. On June 30, 2023, Cemig group's total adjusted debt amounted to BRL15 billion, including off-balance-sheet debt of BRL3.4 billion, with the balance mainly consisting of debentures of BRL8.1 billion and Cemig GT's Eurobonds of BRL3.7 billion.

ISSUER PROFILE

Cemig is the holding of one of the largest integrated power utility groups in Brazil. The group operates in the distribution segment through Cemig D and in generation and transmission mainly through Cemig GT. Cemig is controlled by State of Minas Gerais.

SUMMARY OF FINANCIAL ADJUSTMENTS

Revenues and EBITDA do not incorporate construction revenues and construction costs.

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.

ESG CONSIDERATIONS

Companhia Energetica de Minas Gerais (CEMIG) has an ESG Relevance Score of '4' for Governance Structure due to the inherent governance risks that arise with a dominant state shareholder, which has a negative impact on the credit profile, and is relevant to the ratings in conjunction with other factors.

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
Cemig Geracao e Transmissao S.A.	LT IDR	BB Rating Outlook Stable	Affirmed	BB Rating Outlook Stable
	LC LT IDR	BB Rating Outlook Stable	Affirmed	BB Rating Outlook Stable
	Natl LT	AA+(bra) Rating Outlook Stable	Affirmed	AA+ (bra) Rating Outlook Stable
senior unsecured	LT	BB	Affirmed	BB
senior unsecured	Natl LT	AA+(bra)	Affirmed	AA+(bra)
Cemig Distribuicao S.A.	LT IDR	BB Rating Outlook Stable	Affirmed	BB Rating Outlook Stable
	LC LT IDR	BB Rating Outlook Stable	Affirmed	BB Rating Outlook Stable

	Natl LT	AA+(bra) Rating Outlook Stable	Affirmed	AA+ (bra) Rating Outlook Stable
senior unsecured	Natl LT	AA+(bra)	Affirmed	AA+(bra)
Companhia Energetica de Minas Gerais (CEMIG)	LT IDR	BB Rating Outlook Stable	Affirmed	BB Rating Outlook Stable

VIEW ADDITIONAL RATING DETAILS

FITCH RATINGS ANALYSTS

Wellington Senter
Director
Primary Rating Analyst
+55 21 4503 2606
wellington.senter@fitchratings.com
Fitch Ratings Brasil Ltda.
Av. Barão de Tefé, 27 – Sala 601 Saúde Rio de Janeiro, RJ 20220-460

Lucas Rios, CFA
Associate Director
Secondary Rating Analyst
+55 11 4504 2205
lucas.rios@fitchratings.com

Saverio Minervini
Senior Director
Committee Chairperson
+1 212 908 0364
saverio.minervini@fitchratings.com

MEDIA CONTACTS

Elizabeth Fogerty
New York

+1 212 908 0526
elizabeth.fogerty@thefitchgroup.com

Additional information is available on www.fitchratings.com

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APPLICABLE CRITERIA

Government-Related Entities Rating Criteria (pub. 30 Sep 2020)

National Scale Rating Criteria (pub. 22 Dec 2020)

Corporate Rating Criteria (pub. 28 Oct 2022) (including rating assumption sensitivity)

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

Climate Vulnerability in Corporate Ratings Criteria (pub. 21 Jul 2023) (including rating assumption sensitivity)

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

ENDORSEMENT STATUS

Cemig Distribuicao S.A.	EU Endorsed, UK Endorsed
Cemig Geracao e Transmissao S.A.	EU Endorsed, UK Endorsed
Companhia Energetica de Minas Gerais (CEMIG)	EU Endorsed, UK Endorsed

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