Research Update:

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

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Rating Action Overview

- As a result of the release of the final technical report (FTR) related to the tariff period 2020-2023 and the lower revenue acknowledged by the regulator on the expansion works on transmission line Alto Jahuel's second circuit, we expect a new minimum debt service coverage ratio (DSCR) for Chilean transmission firm Celeo Redes Operacion Chile S.A. (CROCH) in 2022 of 1.19x, versus our previous expectation of 1.2x in 2030. Operational performance in terms of availability remains in line with our expectations.
- On April 4, 2022, S&P Global Ratings affirmed its 'BBB' issue-level rating on CROCH's senior secured notes.
- The stable outlook reflects our view of stable cash flow in the next 12-24 months, resulting in a DSCR at 1.19x in 2022 and then bouncing to above 1.20x in 2023 and beyond 1.3x afterward.

Project Description And Key Credit Factors

CROCH operates two trunk transmission lines in Chile's power grid. The assets benefit from perpetual concessions granted by the Ministry of Energy in which revenues aren't subject to any demand risk and aren't 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 has been operating 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 2037.

Based on the concession contracts, CROCH receives fixed revenue based on its availability, providing predictable revenue flow with no exposure to market risk. Rates are in place for a

20-year period since the commencement of operations (COD) for AJTE circuit 1 and CHATE lines, whereas the regulator revises rates for AJTE circuit 2 every four years. The latter represents about 20% of total revenues.

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 decrease in the long term, given its direct effect 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 and the remuneration on AJTE circuit 2 results in a new minimum DSCR this year. 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) redid the study, delaying rate revisions by more than two years. Therefore, assets continued to earn previous rates, and more importantly it prevented the project from collecting the revenues related to expansion works on the second circuit, which the regulator requested. The project was supposed to receive the revenues on the expansion works--which correspond to the remuneration for an additional structure built on preexisting assets--following the implementation of the 2020-2023 tariff rate, but due to the delay it now won't receive them until the official decree is published, likely later this year.

We now incorporate our updated expectations based on the final technical report released by the Comision Nacional de Energia (CNE) in early March 2022. These relate to the downward revision of the rate applicable for 2020-2023 (about 13% on average for the system), and to the lower-than-expected remuneration for the AJTE 2C expansion works. In addition, we capture the revenues related to the optic fiber contract signed in 2021. Overall, this results in a new minimum DSCR of 1.19x in 2022.

As of this report's date, with the FTR already available, we expect the official decree is likely to be published in the third quarter of 2022. This should definitively settle the 2020-2023 tariff rate period. We expect the DSCR to recover and remain above 1.30x from 2024 onward.

The lengthy regulatory delays resulted in unexpected changes in 2021 and 2022 for CROCH. We've seen that the delays around the tariff setting process for 2020-2023 resulted in unexpected swings in DSCRs (please see "Chilean Electricity Transmission Firm Celeo Redes Operacion Chile 'BBB' Debt Rating Affirmed, Outlook Still Stable," published Feb. 25, 2021). Even though the FTR indicates that the end of the process is close, we don't view these delays as positive. Still, we expect the delay to remain a one-time event that was also somewhat affected by the pandemic.

We maintain our view of the Chilean regulatory framework for the transmission lines as robust and predictable. We also consider the context of Chile's energy matrix decarbonization and the current administration's focus on that goal. However, if the regulator incurs further delays for the upcoming 2024-2027 tariff period, our view of the regulatory framework may weaken.

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 2021, the project performed in line with our expectations, with availability levels above the minimum regulatory requirement of 99.85% and no regulatory penalties. We expect this trend to continue. CROCH serviced its debt in a timely manner, while its reserve accounts (six-month debt service reserve account [DSRA] and three-month O&M reserve account) remain fully funded.

Liquidity

We assess the project's liquidity as neutral because the project has sufficient cash sources (cash on hand, available liquidity reserves, and forecasted cash flows available for debt service -CFADS-) to cover forecasted debt service payments over the next 12 months by at least 1x. 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. In addition, even if further delays occur in 2022, preventing the project from receiving compensation for the expansion of AJTE's second circuit, we don't expect a DSCR below 1x or the use of the reserve accounts this year.

Outlook

The stable outlook reflects our view of stable cash flow during the next 12-24 months, resulting in a DSCR of 1.19x in 2022, then bouncing to above 1.2x in 2023, and beyond that thereafter. We base this on our view of the unusual one-time delay related to the 2020-2023 tariff period and consider Celeo Redes' long-term concession contracts at fixed prices for most of its assets 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 we expect, for instance, if annual U.S. inflation decreases substantially in the next few years or if costs or income taxes are higher than projected, resulting in a minimum DSCR below 1.15x and an average DSCR below 1.35x while the project's downside resilience diminishes. We could also lower our rating if there are further, recurrent regulatory delays in the next tariff period, which could weaken our view of the regulatory framework

Upside scenario

Although unlikely, we could upgrade Celeo Redes if its resilience to a downside-case scenario increases while it maintains a 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 per our article, "Economic Outlook Latin America Q2 2022: Conflict Abroad Amplifies Domestic Risks," published on March 28, 2022. We expect Chile's year-end consumer price index (CPI) of 6.3% in 2022, 3.3% in 2023, and 3.0% afterward; U.S. CPI of 6.0% in 2022, 2.7% in 2023, 2.2% in 2024, and 2.0% afterward; with average exchange rate of Chilean peso (CLP) 815 per $1 in 2022 and CLP820 per $1 in 2023 and 2024.
- Fixed rates adjusted to inflation in Chile and/or the U.S., depending on the asset. We assume circuit 2 receives the pending regulatory approvals in the second half of 2022. 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%. The calculation of the new rate incorporates an after-tax return of 8%, the transmission lines' depreciable period of 50 years, and the relevant macroeconomic variables.
- We consider the revenues from the optic fiber agreement in place, which is within the scope of the project's business. This service contract has been approved by the regulatory body and the collection will take place in 2022 and 2023 for $4.8 million.
- The project will 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 the solid track record of the transmission lines and the operator.

Key metrics

We expect a minimum DSCR of 1.19x in 2022 and an average DSCR of 1.46x during the notes' term.

Downside Case

Assumptions

- We stress U.S. inflation because it 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.
- We don't stress foreign exchange rate due to the natural hedge in place (the share of dollar-denominated versus local currency-denominated debt mimics the share of dollar/local currency revenues) and the active cash management that results in an extremely low intra-month exposure.
- After the initial regulated period, we apply a 10% haircut on the base case annual tariff revenue to capture a lower after-tax return (7%). We also keep a two-month delay in payment from the largest generator for a five-year period starting in 2022.

- Operational expenses 12% higher than in our base-case scenario.
- Penalties of about $1.8 million for five years starting from the weakest phase of the project due to unavailability (3%).

Key metrics

We expect a minimum DSCR of 0.97x and average DSCR above 1.00x during the notes' term. The project would cover any potential shortfall through the reserve accounts.

Rating Score Snapshot

Operations phase SACP (senior debt)

- Operations phase business assessment: 3
- Preliminary SACP: bb+
- Downside impact on preliminary SACP: +1 notch
- 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: Key Credit Factors For Power Project Financings, Sept. 16, 2014

- Criteria | Corporates | Project Finance: Project Finance Framework Methodology, 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