Celeo Redes Operacion Chile S.A.

March 5, 2024

This report does not constitute a rating action.

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Project Description

Celeo Redes Operación Chile S.A. (CROCH) operates two trunk transmission lines in Chile's power grid. The assets benefit from perpetual concessions granted by the Ministry of Energy where revenue isn't subject to demand risk and isn't based on the utilization rate of the lines. The project's assets consist of Alto Jahuel Transmisora de Energía S.A. (AJTE) and Charrúa Transmisora de Energía S.A. (CHATE).

- AJTE is a 256-kilometer, 500-kilovolt transmission line that consists 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.
- CHATE is a single 198-kilometer circuit that began 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; this provides a predictable revenue flow with no exposure to market risk. The rates are in place for 20 years after the commercial operations dates for AJTE circuit 1 and the CHATE lines, whereas the regulator revises the rates for AJTE circuit 2 every four years. The latter represents about 20% of total revenue.

Credit Highlights

Overview

Key strengths	Key risks
A perpetual concession agreement stipulates the project's revenue based on its availability, eliminating market risk.	After a first 20-year fixed tariff period, the regulation will reset and apply a new tariff for the project’s main assets in 2035-2037.
The project's business model results in stable, predictable cash flows.	Although we see them as one-off events, delays in the 2020-2023 tariff review process hurt metrics during this period.

We expect the project to post stable, predictable metrics because of the availability-based remuneration of its assets, regardless of the utilization rate. CROCH benefits from a dollar-denominated, 20-year fixed tariff period that began when the assets started operating; the regulator will subsequently revise the tariff every four years. These assets represent about 80% of CROCH's total assets. The tariff or trunk transmission annuity value (known as VATT) includes two components: an investment value annuity that's adjusted to U.S. inflation and a reimbursement for operating expenses that's indexed to Chilean inflation and to foreign currency movements.

For expansion assets, the regulator revises the VATT every four years from the commercial operations date, following the same procedure as for CROCH’s main assets. As a result, fixed tariffs and CROCH’s availability-based business model allow the project to post predictable, stable cash flows and credit metrics. The availability payments come from the electricity system, and in our view, delays in the payment chain wouldn't hurt the project's cash flow available for debt service (CFADS).

Regulation results in a stable financial performance during the 20-year fixed tariff period; after that, tariffs will be reset every four years. In our base-case scenario, the project reaches a minimum debt service coverage ratio (DSCR) slightly above 1.20x in 2046, and it reaches a median DSCR of about 1.31x during the notes' term. The shift from our previous expectation (in 2023) for the minimum DSCR is the result of the lower sculpted amortization from 2024 onward, and the haircut that we apply to the tariff resets after 20 years. We consider U.S. and Chilean inflation to be relevant variables that could affect the project's metrics because its revenue is adjusted to them.

We also incorporate some risk of volatility in our analysis because the fixed tariff periods for AJTE and CHATE end in 2035 and 2037, respectively, and there will still be 10 years left before the total amortization of the notes in 2047. This will expose the project to a regulatory tariff review for its main assets every four years. When the fixed tariff period ends, the regulator will recalculate the transmission line's remuneration, incorporating the asset's replacement value and an after-tax return on investment of about 7%.

We expect the current process for resetting tariffs to be smoother than it has been, but we remain vigilant about regulatory decisions. Delays in the tariff-setting process for 2020-2023 resulted in unexpected swings in CROCH's DSCRs in 2020-2022 (see Research Update: Chilean Electricity Transmission Firm Celeo Redes Operacion Chile 'BBB' Debt Rating Affirmed, Outlook Still Stable, Feb. 25, 2021, and Research Update: Chilean Electricity Transmission Firm Celeo Redes Operacion Chile 'BBB' Debt Rating Affirmed, Outlook Still Stable, April 4, 2022). Even though the regulator published the final tariff decree settling this process for good, we don't view these delays as positive since they created unexcepted swings in the project's metrics.

Absent unexpected regulatory hiccups, we expect CROCH to post steady cash flows and metrics through the notes' term. In our view, the higher-than-expected volatility in CROCH’s metrics in 2020-2023 was mostly a result of factors that were out of the project's control and driven by regulatory delays; they have now been overcome with the decree's publication. The 2024-2027 review process is ongoing, and we don’t expect material changes in the valuation and remuneration of the assets. The current expectation is that the decree will likely be published in 2025.

We still view 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 country’s focus on that goal. However, if CROCH's metrics become volatile again as a result of further delays from the regulator in the current 2024-2027 tariff review process, or if the regulator introduces more material changes, our view of the regulatory framework may weaken.

Outlook

The stable outlook reflects our view of CROCH's stable cash flows, which will lead to a DSCR near or above 1.30x in the next 12-24 months. Following the unusual volatility seen in the 2020-2023 tariff period and the lower sculpted amortization from 2024 onward, we now expect a minimum DSCR that is slightly above 1.20x in 2046 in light of the project's long-term concession contracts at fixed prices for most of its assets, the availability levels above the minimum regulatory requirement, and the tariff reset after the first period of 20 years.

Downside scenario

A downgrade in the next two years is possible if the project's revenue is lower than we expect, for instance, because of a substantial drop in U.S. inflation in coming years or because of higher-than-projected costs or income taxes; and resulting in a minimum DSCR below 1.15x and a median DSCR below 1.25x 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 assessment of the regulatory framework.

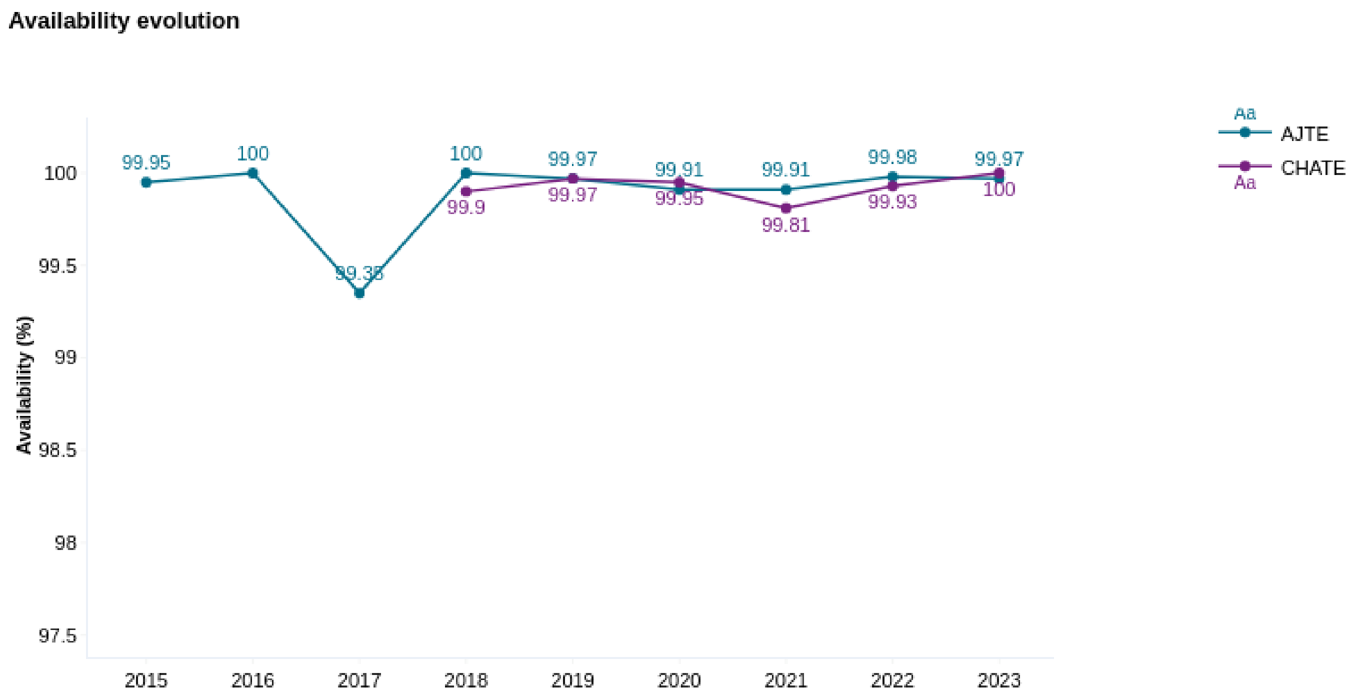
Upside scenario

Although it's unlikely at this stage, we could upgrade CROCH if its resilience to the downside-case scenario increases while it maintains a minimum DSCR above 1.30x.

Performance Update

The rating on CROCH reflects our expectation that its operating and financial performance will be stable over the next few years, supported by its availability and stable regulation. We expect a minimum DSCR of 1.21x and a median DSCR of 1.31x during the notes' term given the relatively low operating complexity, a business model based on availability, and higher inflation, which affects the cumulative inflation adjustment in the long term.

From an operational standpoint, the assets' availability in 2023 was in line with our expectations (above 99.8%), complying with established limits with no penalties, fines, or accidents reported. We expect similar operating performance going forward, which supports the predictability of the project's cash flow. Availability has remained steady since the assets began operating (see the following chart).



AJTE--Alto Jahuel Transmisora de Energía S.A. CHATE--Charrúa Transmisora de Energía S.A. Sources: Company filings and S&P Global Ratings.

From a financial standpoint, despite the project's stable operational performance, we note the bumpy road seen in 2021 and 2022. We attribute it to the regulatory delays for the 2020-2023 tariff review and to the lower remuneration from the regulator for the expansion work on AJTE circuit 2, though they were partly offset by increased revenue from the fiber optic contract and higher inflation. We already considered these factors in our February 2021 and April 2022 research updates.

With the official tariff decree finally being published in 2023, this process has concluded. We now expect steadier performance in terms of metrics in coming years (with a DSCR above 1.30x), supported by the lower sculpted amortization and no material impacts from the 2024-2027 tariff review period. We continue to view the regulatory delays as a one-off event, and we expect the upcoming 2024-2027 tariff review period to be smoother.

Base-case assumptions

- We consider key macroeconomic variables such as inflation in the U.S. and Chile, per our articles "U.S. Economic Forecast Update: A Sturdy Job Market Keeps Growth Going," published Feb. 21, 2024, and "Economic Outlook Emerging Markets Q1 2024: Challenging

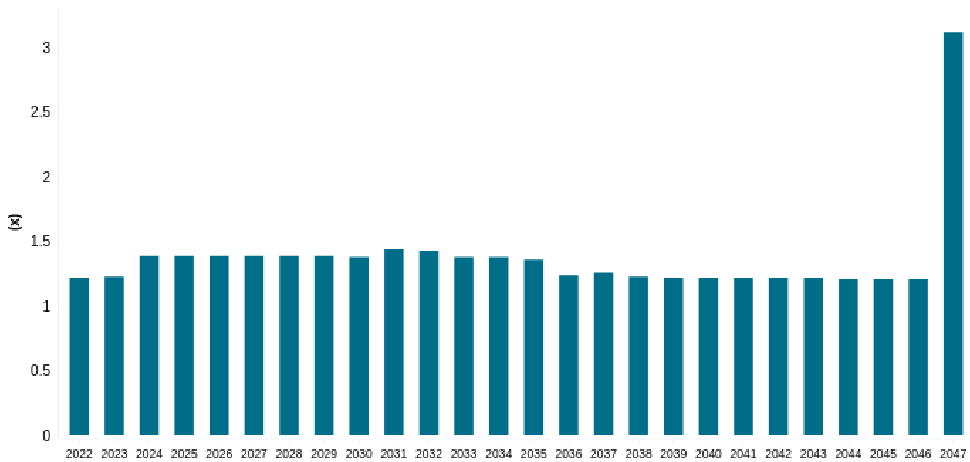
Global Conditions Will Constrain Growth," published Nov. 27, 2023. We expect Chile's year-end consumer price index (CPI) of 7.7% in 2023, 3.5% in 2024, and 3% afterward; and U.S. CPI of 4.1% in 2023, 2.8% in 2024, 2% in 2025, and 2.4 in 2026.

- Fixed rates adjusted to inflation in Chile, the U.S., or both, depending on the asset. 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 of about 7%. Our base case incorporates a haircut at the end of the 20-year fixed-rate period to accommodate potential volatility in the resetting of tariffs. We consider the revenue from the fiber optic agreement in place (approved by the regulator) as being fully collected in 2023.
- The project maintains operations and maintenance (O&M) agreements with Celeo Redes Chile Ltd. (not rated), totaling about UF47,000 per year for AJTE's two circuits and about UF31,000 per year for CHATE, adjusted to inflation in Chile. The agreements include an automatic renewal clause unless either party chooses to terminate the agreements.
- No penalties due to unavailability of the assets, given the solid track record of the transmission lines and the operator.

Key metrics

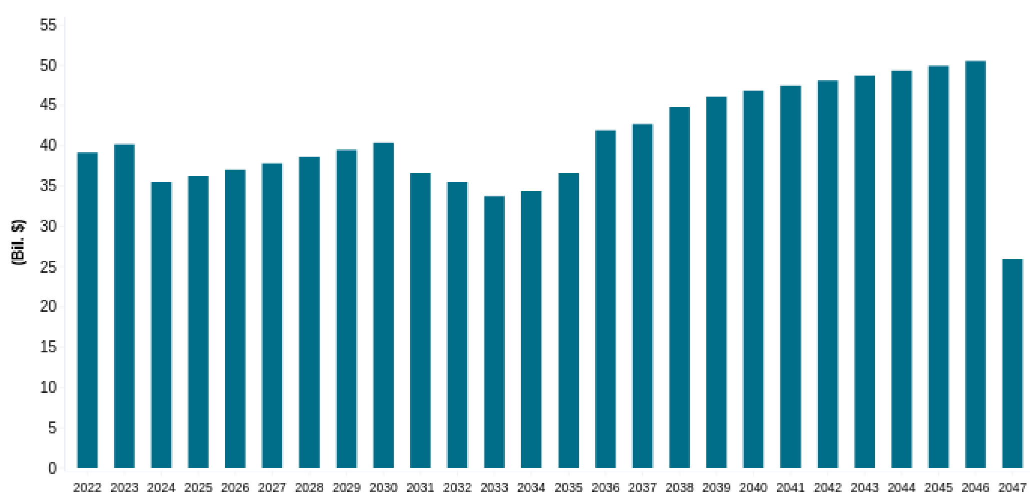
In our base case, we expect a minimum DSCR of 1.21x in 2046 and a median DSCR of 1.31x during the notes' term. The shift from our previous expectation (in 2023) for the minimum DSCR was due to the higher sculpted amortization in the 2020-2023 period, the impacts of the delays for the reset period, and the haircut applied on the reset following the first 20-year fixed-rate period.

S&P Global Ratings' base-case DSCR



Data for 2022-2023 represents actual figures. Data for 2024-2047 represents forecasts. DSCR--Debt service coverage ratio.

Celeo Redes Operación Chile S.A.--Debt repayments



Data for 2022-2023 represents actual figures. Data for 2024-2047 represents forecasts. Source: S&P Global Ratings.

Deriving the preliminary operations phase SACP

	--Minimum DSCR ranges*--				
	aa	a	bbb	bb	b
OPBA					
1-2	=> 1.75	1.75-1.20	1.20-1.10	1.10-1.05	<1.05
3-4	N/A	=> 1.40	1.40-1.175	1.175- 1.10	<1.10
5-6	N/A	=> 1.75	1.75-1.30	1.30-1.15	<1.15
7-8	N/A	=> 2.50	2.50-1.60	1.60-1.35	<1.35
9-10	N/A	=> 5.00	5.00-2.50	2.50-1.50	<1.50
11-12	N/A	N/A	N/A	=>3.00	<3.00

*DSCR ranges include values at the lower bound, but not the upper bound. For example, 1.20x-1.10x includes 1.10x, but excludes 1.20x. SACP--Stand-alone credit profile. N/A--Not applicable. DSCR--Debt service coverage ratio.

Downside-case assumptions

- We stress U.S. inflation because it has a positive effect on the project's revenue. We assume a 100-basis-point decrease in the U.S. inflation rate from our base-case scenario.
- We don't stress foreign exchange exposure because of the natural hedge in place (the share of dollar-denominated versus local currency-denominated debt mimics the share of dollar-denominated revenue versus local currency-denominated revenue) and active cash management, which results in an extremely low intramonth exposure.
- After the initial regulated period, we maintain a 10% haircut to capture potential volatility in the resetting, following the 20-year fixed-rate period. We also keep a two-month delay in the payment from the largest generator.
- Operational expenses that are 12% higher than in our base-case scenario.
- Penalties of about $2.8 million starting from the weakest phase of the project because of unavailability (3%).

Key metrics

We expect a minimum DSCR of 1.0x in 2046 and a median DSCR above 1.31x during the notes' term. Although the metrics remain generally above 1.0x, they don't provide additional upside to the ratings at this level.

Liquidity

We assess the project's liquidity as being neutral because it has sufficient cash sources (cash on hand, available liquidity reserves, and forecast CFADS) to cover expected debt service payments over the next 12 months by at least 1x. The six-month debt service reserve account and three-month O&M reserve accounts are funded with cash. In addition, there's a backwardand forward-looking distribution lock-up of 1.15x until 2035; there will be a 1.15x backward-looking lock-up and a 1.2x forward-looking lock-up after January 2036.

Rating Component Scores

Senior debt issue rating: BBB

Operations phase (senior debt)

- Asset class operating stability: 3
- Operations phase business assessment: 3

Preliminary operations phase SACP: bbb-

- Downside resiliency assessment and impact: Moderate (neutral)
- Median DSCR impact: Neutral
- Debt structure impact: Neutral
- Liquidity impact: Neutral
- Refinancing impact: Neutral
- Future value modifier impact: Positive (+1 notch)
- Holistic analysis impact: Neutral
- Structural protection impact: Neutral
- Counterparty assessment impact: No impact at this stage

Operations phase SACP: bbb

Parent linkage and external influences (senior debt)

Parent linkage: Delinked

Project SACP: bbb

- Extraordinary government support: N/A
- Sovereign rating limits: N/A
- Full credit guarantees: N/A

Related Criteria

- Criteria | Infrastructure | General: Sector-Specific Project Finance Rating Methodology, Dec. 14, 2022
- Criteria | Infrastructure | General: General Project Finance Rating Methodology, Dec. 14, 2022
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021

- Criteria | Structured Finance | General: Counterparty Risk Framework: Methodology And Assumptions, March 8, 2019
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Global Investment Criteria For Temporary Investments In Transaction Accounts, May 31, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Ratings Detail (as of March 05, 2024)*

Celeo Redes Operacion Chile S.A.	
Senior Secured	BBB/Stable
US$379 mil 5.20% nts ser A due 06/22/2047	
Foreign Currency	BBB/Stable

*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.