

Research Update:

Alfa Transmisora de Energia S.A. 'BBB-' Debt Rating Affirmed On Proposed Notes; Outlook Remains Stable

June 25, 2024

Rating Action Overview

- Alfa Transmisora de Energia S.A. intends to issue up to \$131 million equivalent in the Chilean local market, denominated in Unidades de Fomento (UF; Chile's inflation-indexed currency) to finance the acquisition of Transquillota and a payment to Colbun after the tariff review process.
- We now expect a minimum debt service coverage ratio (DSCR) of close to 1.30x, slightly below our previous forecast but still in line with the rating.
- Therefore, on June 25, 2024, S&P Global Ratings affirmed its 'BBB-' issue-level rating on Alfa Transmisora's senior secured notes.
- The stable outlook incorporates our expectation that the project will maintain high availability of its transmission lines without major events that would result in penalties, leading into a minimum DSCR in the 1.30x area.

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Project Description And Key Credit Factors

Alfa Transmisora is jointly owned by Celeo Redes Chile Expansion SpA and APG Energy & Infra Investments Chile Expansion SpA. In 2021, Celeo and APG acquired Colbun Transmision S.A.'s assets through the newly created Alfa Transmisora, which now owns all the operating assets of Colbun Transmision:

- National assets (regulated): seven transmission lines totaling 374 kilometers (km) and seven substations;
- Zonal assets (regulated): six transmission lines totaling 96 km and two substations; and
- Dedicated assets (nonregulated): 16 transmission lines totaling 462 km and 21 substations.

Currently, these assets have a market share of close to 5% in Chile. These lines are located across five regions that are home to 74% of Chile's population, generate close to 65% of the country's GDP, and account for 57% of electricity demand in the country.

Key strengths

- Stable and predictable cash flow, given favorable regulatory framework in Chile and the company's revenue from availability, preventing volume risk.
- Adequate structural protections that include a six-month debt service reserve account, a three-month operations and maintenance (O&M) reserve account backed by a letter of credit, and a prefunded interest reserve account during the notes' term.
- Transmission lines with low operational complexity and commercially proven technology.
- No currency mismatch, given that regulated tariffs are in dollars and indexed to U.S. and Chilean inflation, assuming a guaranteed post-tax return, and almost 27% of total cash flow is denominated in UF, representing a natural hedge.

Key risks

- Recontracting risk. While regulated revenue (about 40% of total revenue in 2024) isn't exposed to market risk, many dedicated contracts will come due before the notes mature in 2051, exposing the project to price volatility. The largest contracts are with Angostura and Santa Maria, which will be reclassified as national assets in 2039 and 2040, respectively.
- Counterparty dependence. Unlike other transmission lines in Chile, which generate most or all cash flow from regulated revenue, the project earns most of its revenue from dedicated contracts with third parties. The largest counterparty is Colbun, from which the project generates about 30% of total revenue. Therefore, the rating on Colbun could cap our rating on Alfa's notes. The other counterparties each represent less than 10% of total revenue, so we don't believe they influence the project's credit quality.

Rating Action Rationale

Alfa will raise up to \$131 million equivalent in UFs. Alfa Transmisora will use part of the proceeds to purchase Transmisora Electrica de Quillota Ltda. (Transquillota), a small transmission line that will represent around 4% of the project's total revenue. The project will also use a portion of the funds to pay Colbun S.A. (BBB/Stable/--) a purchase price adjustment to reflect higher future cash flow, as determined by the tariff review process.

The new debt will rank pari passu with the existing senior bond and share the same collateral and protections, including the reserve account and distribution test. Like the existing bond, the UF tranche will have a 40% balloon at its legal maturity in 2051. For analytical purposes, and although we do not rate the new debt, we included the notes in our calculations to reflect that they are all senior secured and equally ranked.

To comply with the purchase agreement signed with Colbun, the purchase price of the transmission lines was raised. A report from the Comision Nacional de Energia caused the regulated tariff (VATT) of the companies to increase by more than originally expected, resulting in higher revenue and a purchase price adjustment to the original sellers (Colbun for Colbun Transmission and Colbun and Enel for Transquillota).

With the acquisition of Transquillota, Alfa's portfolio will increase to 932 km of national, zonal, and dedicated transmission lines and 29 substations. Transquillota is in the Region V of Chile,

approximately 80 km northwest of Santiago, and consists of the 220-kilovolt (kV) San Luis substation and the approximately 8-km, 220-kV double circuit San Luis – Quillota transmission line.

Transquillota connects the San Luis substation with the 220-kV Quillota substation, owned by Enel Generacion Chile S.A. (BBB/Stable/--). Transquillota also owns two bays in the Quillota substation, which allow the interconnection of the transmission line.

Transquillota began commercial operations in 1998 along with the San Isidro I and II power plants. Because Transquillota was originally built to interconnect those power plants, it was classified as a dedicated transmission line and received tolling revenue from Colbun and Enel (the previous owners). However, in 2020, Transquillota was reclassified as a national, regulated transmission line and changed its remuneration scheme.

Despite the additional debt and slightly lower DSCR forecast, we believe the project is still in line with our existing expectations and the current rating. We analyze Alfa's operational phase in two stages. The first one ends in 2051, the legal maturity of the notes. The second stage (refinancing) starts in 2052 and ends in 2059, when the refinanced amount would be fully paid.

Our base-case scenario for the first phase assumes a minimum DSCR of 1.30x in 2029 and a median DSCR of 1.41x. We believe these metrics remain consistent with our previous analysis (a minimum DSCR of 1.35x); therefore, including the new debt and new asset doesn't materially affect our assessment of the project's credit quality.

Finally, we continue to notch down the operations phase stand-alone credit profile by one to 'bbb-'. This view reflects some weakness versus other rated projects in the region, mainly from higher debt, cash flow volatility from the recontracting of the dedicated lines, and refinancing risk (not linked to the new debt but to the overall characteristics of the transaction).

Outlook

The stable outlook incorporates our expectation that the project will be able to maintain high availability of its transmission lines without major events that would result in penalties. We forecast a minimum DSCR around 1.30x, and we expect that investments will continue to be executed on time and within budget. Therefore, we expect Alfa's cash flow will remain stable and predictable, enabling the project to execute the planned investments that the Chilean regulator has requested to improve the system's robustness.

Downside scenario

In the next two years, we could lower the rating if the project posts a minimum DSCR of 1.175x or lower, which could result from significant lower inflation adjustments over the contracts (either Chilean or U.S. inflation), higher operating expenses, or investments above the budget.

Although unlikely in the next 12 months, if we were to downgrade Colbun to 'BB+' or lower, the rating on the project would move in tandem, given that Colbun is Alfa Transmisora's largest individual offtaker. We would also lower the rating on the project if there were a higher dependency from another third-party contract.

Upside scenario

We could revise our outlook to positive or raise our rating in the next 24 months if the project's

DSCR is consistently above 1.40x because of higher Chilean or U.S. inflation, greater cost savings, or future investments that are lower than we expect. In addition, if contracts maturing throughout the notes' term are renewed under better terms than in our base-case scenario, we could raise the rating.

Performance Update

The project's operating performance and investments remain in line with our expectations. Availability levels during the last few years were in line with our expectations at more than 97% for all transmission lines, with no reported incidents.

The project performed better than we expected financially during 2023, mainly because of higher-than-anticipated inflation in the U.S. and Chile, which is a main driver of revenue adjustments. The latter strengthened the EBITDA margin to about 90%.

In terms of capital investments, Alfa won a bid to construct expansion projects. The projects, which are currently on time and within budget, should become operational by 2025. Those projects will continue to be financed with internally generated funds, and we don't think they'll increase the transaction's operational risk--therefore, we did not assign a construction phase stand-alone credit profile.

We continue to expect solid operating and financial performance in the next few years thanks to the project's availability and stable regulation. We expect a minimum and median DSCR of about 1.30x and 1.41x, respectively, during the notes' term, thanks to relatively low operating complexity; a business model based on availability; and currently higher inflation, which affects the long-term cumulative adjustments.

Base Case

Assumptions

- In our view, the most relevant macroeconomic variables for this project are U.S. and Chilean inflation and the exchange rate between the Chilean peso and the dollar. U.S. and Chilean inflation affects the project's revenue and rates, and Chile's inflation influences most operating costs.
- We expect U.S. inflation to be 2.8% in 2024, 2.0% in 2025, 2.4% in 2026 and 2.1% afterward (see "Credit Conditions North America Q2 2024: Soft Landing, Lurking Risks", published March 27, 2024).
- We expect Chile's inflation to be 3.7% in 2024, 3.2% in 2025 and 3.0% afterward (see "Economic Outlook Emerging Markets Q3 2024: Growth On Track, Policy Risks Rising", published June 24, 2024).
- The starting point for VATTs (annual transmission value per section) in 2023 is about \$30 million for regulated revenue (both national and zonal) and close to \$55 million for dedicated revenue. We assume the haircut would be 3% for the hydro plants generally and 15% for coal plants, like the one that the Santa Maria transmission line connects to the system. The contracts with other counterparties have a haircut of 5%-10%.
- Operating expenses comprise O&M costs, as well as commercial and administrative expenses, adjusted annually to Chile's inflation.

- Our base-case scenario doesn't assume that the assets would face penalties throughout the notes' term. We believe Chile's national transmission system has redundancies in place to prevent a blackout.

Key metrics

- Minimum DSCR of 1.30x and median DSCR of 1.41x during the first phase.
- Minimum SCR of 1.26x and median DSCR of 1.31x in the refinancing period.

Downside Case

Assumptions

- We stressed U.S. and Chilean inflation. Given that inflation in both countries has a positive effect on the project's revenue, we assumed a 100-basis-point decrease from rates in our base-case scenario in the year with the lowest DSCRs.
- We assumed that contracts renewed throughout the notes' term will face haircuts of double those in our base-case scenario. Exceptions are Angostura, the rates of which have already been set, and Santa Maria, for which we assume no renewal in the downside case.
- Operating expenses are 12% higher than in our base-case scenario.
- Penalties are equivalent to 1% of the project's revenue. This would result from maximum penalties (5% of the asset's revenue) for half of the portfolio in the regulated market.
- Given the notes have a fixed interest rate, any changes in floating rates wouldn't affect the interest payments. During the refinancing period, we assumed the interest rate will be 200 basis points higher than in our base-case scenario, which is equivalent to 9%.

Key metrics

- The most vulnerable phase of the project's life will start in 2040, given the 2039 expiration of Santa Maria-Charrua's contract.
- Under the downside-case scenario and because this asset is linked to a coal-fired generation unit, we assume the cancellation of this contract, which would have significant consequences.
- The DSCRs are close to 1.1x during the notes' term, and the cash sweep mechanism from 2043 to 2051 aims to amortize about 10% of principal.

Rating Score Snapshot

Senior debt issue rating	BBB-
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Operations phase (senior debt)	
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Asset class operating stability:	3
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Operations phase business assessment:	4
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Senior debt issue rating	BBB-
Preliminary operations phase SACP	bbb
Downside resiliency assessment and impact:	Moderate
Median DSCR impact:	Neutral
Debt structure impact:	Neutral
Liquidity impact:	Neutral
Refinancing impact:	Neutral
Future value modifier impact:	N/A
Holistic analysis impact:	Negative (-1 notch)
Structural protection impact:	Neutral
Counterparty assessment impact:	BBB
Operations phase SACP	bbb-
Parent linkage and external influences (senior debt)	
Parent linkage:	Delinked
Project SACP:	bbb-

DSCR--Debt service coverage ratio. ICR--Issuer credit rating

Operations counterparties

The project has exposure to Chile-based generation company Colbun, which is the former owner of the transmission and substation assets that Alfa acquired. The project has dedicated contracts with Colbun's power plants, which represent about 30% of the project's total revenue. Because of the size of these contracts, the counterparty limitation keeps our rating on Alfa's debt no higher than 'BBB'.

The project also has dedicated contracts with Anglo American PLC (BBB/Stable/A-2), Empresas CMPC S.A. (BBB/Stable/--) and Corporacion Nacional del Cobre de Chile (BBB+/Stable/--). These counterparties are the most relevant players in Chile and the largest contributors. Currently, we don't believe this affects the project's credit quality.

Due to the simplicity of the operations and the fact that price and conditions are market based, we consider O&M operators of transmission lines to be replaceable. In addition, the project has a three-month O&M reserve account, and many players in the market are available to replace the O&M provider if needed.

Related Criteria

- Criteria | Infrastructure | General: General Project Finance Rating Methodology, Dec. 14, 2022
- Criteria | Infrastructure | General: Sector-Specific 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 List

Ratings Affirmed

Alfa Transmisora de Energia S.A.

Senior Secured BBB-/Stable

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.spglobal.com/ratings for further information. Complete ratings information is available to RatingsDirect subscribers at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.spglobal.com/ratings.

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