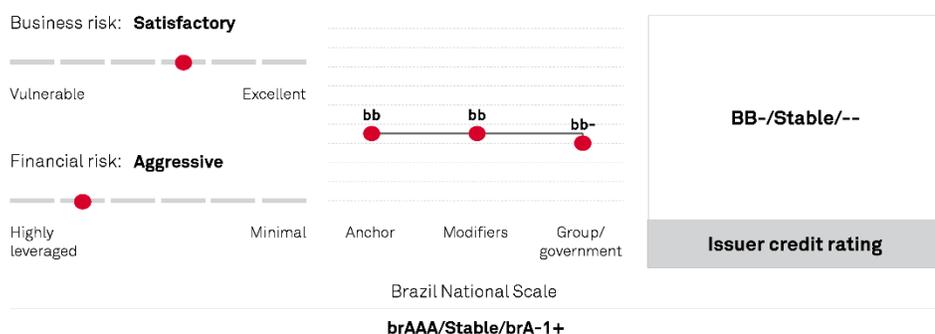


Neoenergia S.A. and subsidiaries

March 29, 2022

Ratings Score Snapshot



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Credit Highlights

Overview

Key strengths

About 85% of EBITDA comes from stable and regulated electricity activities, making operations more resilient once new transmission lines start operating.

Expanding the generation business mostly through unconventional renewables, combined with an operational hydro portfolio and a modern combined cycle gas plant, resulting in somewhat diversified operations.

Diversified customer base with residential clients representing the largest share, which protects the company during market downturns.

High standing in the domestic capital markets and good relationship with banks, which support the financing of Neoenergia's investment plan and debt refinancing.

Key risks

Potential execution risks related to a sizable investment plan mostly for regulated networks and renewables, while overhauling Neoenergia Brasilia's operations.

Neoenergia will require new debt to finance its investment plan and to refinance meaningful debt maturities, particularly in the next two years.

Rising interest rates and inflation in Brazil increase Neoenergia's interest expenses, because its debt bears floating rates indexed to the benchmark interest rate and Brazil's CPI.

Exposure to hydrology increases energy costs and working capital needs in the distribution segment.

Focus on delivery of projects, internal growth, and the turnaround of Neoenergia Brasilia in 2022. Following record investment of R\$9.4 billion in 2021, Neoenergia will increase them further this year to more than R\$10 billion for the following reasons:

- Construct unconventional renewable projects, including the 566.5 megawatt (MW) Oitis wind farm, which we expect to start operating in the first half of 2022, and the 100 MW Luzia solar park, expected in the second half of 2022.
- Expand its network, connect new clients, and improve service quality at its existing distribution companies (discos), especially Neoenergia Coelba, Neoenergia Pernambuco, and Neoenergia Cosern, given that they will have a tariff review in 2023, in which the regulator remunerates the discos' investments in their concession areas. Also, Neoenergia will continue focusing on reorganizing its distributor, Neoenergia Brasília, incorporated in March 2021.
- Continue investments in transmission lines awarded in the 2018 and 2019 auctions.

Because of the group's sizable investments, we expect Neoenergia to have free operating cash flow (FOCF) deficits in the next two years, especially in 2022. We assume the group will fund investments mostly with additional debt. As of Dec. 31, 2021, Neoenergia benefited from a cash position of R\$5.6 billion and R\$5.0 billion in available committed credit facilities to finance its investment plan.

We expect debt to EBITDA to slightly improve, funds from operations (FFO) to debt to worsen in 2022, and both metrics to improve in 2023. According to our calculations, Neoenergia's net debt to EBITDA was 4.5x and FFO to net debt 16.3% in 2021, mainly because of higher energy costs as a result of the drought and the group's high investments. We expect improving hydrology because of the better-than-expected rainfalls since mid-October 2021 are causing Brazil's main reservoirs to recover and consequently diminish the dispatch of the country's thermal plants and the cost of energy. However, macroeconomic conditions are worsening, as seen in rising inflation and interest rates. We expect the group's interest burden to increase due to higher basic interest rates in Brazil and because of Neoenergia's higher debt to fund its capital expenditures (capex). As a result, we forecast debt to EBITDA at 4.0x-4.5x and FFO to debt at 9%-12% in 2022, and improving gradually in 2023 as new assets come on stream. We forecast a more rapid strengthening of the group's credit metrics starting in 2024, although our base-case scenario excludes new projects and acquisitions.

Rapid turnaround at Neoenergia Brasilia. In 2021, Neoenergia Brasilia's EBITDA surged to R\$189 million from R\$67 million in 2020, stemming from Neoenergia's efforts to integrate operations and commercial activities. The group was able to cut about 20% of Neoenergia Brasilia's operating expenditures through a voluntary dismissal program and integration and restructuring of administrative processes. In addition, Neoenergia reduced losses at Neoenergia Brasilia by 1.3 percentage points since the acquisition by increasing inspections and converting illegal connections. The group resumed disconnecting Neoenergia Brasilia's customers who fell behind on their bills. As a result, Neoenergia Brasilia's provisions reversed to R\$69 million from a R\$46 million loss in 2020. We believe continuing overhauling Neoenergia Brasilia's operations is one of the group's priorities in 2022. This is because not only the acquired entity's quality indicators and EBITDA must converge to Agencia Nacional de Energia Elétrica's (ANEEL's) regulatory limits, but also energy losses need to be reduced. As a result, Neoenergia Brasilia should be able to represent about 5% of the group's EBITDA over the next few years.

New financial aid to distributors in Brazil will support their working capital. A new financial support package (Conta Escassez Hídrica or Water Scarcity Account) to the Brazilian distribution companies was approved by ANEEL on March 15, 2022, set by Provisory Measure 1,078/2021 and Decree 10,939/2022. Similar to the Covid Account financial package, which supported the liquidity of Brazilian distributors in the first year of the pandemic, The Water Scarcity Account is an off-balance financing program put in place by the regulator and the Brazilian government with the aim to compensate the spike in energy costs caused by the drought in mid-2021. In a first stage, the Brazilian distributors are entitled to receive R\$ 5.3 billion during the second quarter of 2022, provided by a pool of banks, to be amortized in 54 months starting on each distributor's tariff cycle in 2023. As a result, it will also contribute to attenuate the increase in tariffs to final consumers, as the loan's proceeds and costs will be passed on to tariffs gradually. Later this year, depending on hydrology conditions during the year, the discos would receive a second instalment related to this financial aid, although the later wasn't approved by ANEEL yet. The amount attributable to Neoenergia's discos, which we estimate between R\$ 300 million – R\$ 400 million related to the portion approved by ANEEL, will support the group's working capital management, given that Neoenergia registered a balance of about R\$1.7 billion on its regulatory account in 2021.

Outlook

The stable outlook on Neoenergia for the next 12 months is based on our view that after peaking in 2021–2023, its debt to EBITDA will drop below 4.0x and funds from operations (FFO) to debt rise above 15% starting in 2024, while the group maintains adequate liquidity. The outlook on Neoenergia also mirrors that on the sovereign rating on Brazil and incorporates our view that the group, as a regulated utility, could be subject to government intervention in a hypothetical sovereign default scenario.

Downside scenario

We could downgrade Neoenergia in the next 12 months if a similar action occurs on Brazil. We could also lower the global and national scale ratings on Neoenergia if its controlling shareholder, **Iberdrola S.A.** (BBB+/Stable/A-2), has fewer incentives to provide support to its Brazilian operations, combined with a deterioration in its credit metrics. The latter scenario would consist of FFO to debt below 9% and debt to EBITDA above 5.5x, which could result from lower electricity consumption, worsening of hydrology conditions that raise energy costs, rising inflation, larger-than-expected capex, and high dividend payouts. The ratings on the subsidiaries, Coelba, Celpe, Cosern, and Elektro, will move in tandem with that on Neoenergia in case of a negative rating action.

Upside scenario

Currently, the sovereign rating on Brazil caps the one on Neoenergia. Therefore, we would raise the rating on the group if we upgrade the sovereign. On a stand-alone basis, we could revise the stand-alone credit profile (SACP) upward if Neoenergia posts adjusted debt to EBITDA of about 3.0x and FFO to debt above 20% thanks from increasing cash flows, as Neoenergia is ramping up new assets, and interest rates in Brazil fall. Under this scenario, we would also expect the group to generate positive free operating cash flows, enabling it to finance its investment plan with its own cash. The national scale rating are already at the highest level possible. An upgrade on Neoenergia would result in a similar action on its subsidiaries.

Our Base-Case Scenario

Assumptions

- Consolidated energy demand to increase above GDP growth rate, about 3%, in 2022, because Neoenergia will benefit from Neoenergia Brasilia's full year of operations. At each disco level, we forecast volumes increasing slightly above Brazil's GDP, given the group's efforts and investments to connect new clients. Our GDP growth forecast is 0.4% in 2022, 1.7% in 2023, and 2.0% in 2024, while we assume energy volumes to increase 0.5%-1.0% at each concession area in 2022, and in line with GDP growth starting in 2023. Our macroeconomic assumptions follow the recently published "Economic Outlook Latin America Q2 2022: Conflict Abroad Amplifies Domestic Risks", published on March 28, 2022.
- Rate adjustments to be in line with inflation of the previous year—about 10.0% in 2022, 8.9% in 2023, and 4.1% in 2024. For 2022, despite the spike in interest rates to which the discos' contracts are adjusted, we expect Neoenergia's discos to partly compensate for the tariff increase by returning tax credits to consumers.
- A gradual reduction in total energy costs starting in 2022, assuming improving hydrology.
- A conservative generation scaling factor of 80% in 2022 and increasing to 85%-90% in the next couple of years. However, because regulated contracts have about 90% of their output protected, we don't expect higher electricity costs for hydro generators to hurt the group's metrics.
- Availability levels of wind plants at about 97% and utilization rates at 45%-50% annually.
- Investments between R\$10.0 billion – R\$10.5 billion in 2022, R\$7.0 billion – R\$7.5 billion in 2023, and falling to R\$5.0 billion – R\$5.5 billion in subsequent years, following the completion of renewable projects and transmission lines. The large portion of these investments to be financed through new debt.
- Year-end basic interest rates of 13.25% in 2022, 8.5% in 2023, and 7.5% in 2024, affecting the group's interest expenses and FFO, especially in 2022.
- A conservative dividend policy, distributing the minimum required by law, which is equivalent to 25% of previous year's net income.

Neoenergia S.A. And Subsidiaries

- Our adjusted debt figures include pension-related liabilities of about R\$1.2 billion, while our adjusted EBITDA excludes the effects of variations in the distribution concession's financial assets and the IFRS 15 accounting in the transmission segment.

Key metrics

Neoenergia S.A.--Key Metrics*

Mil. \$	2020a	2021a	2022f	2023f	2024f
Energy distributed (GWh)	57,026	64,848	66,500-67,000	67,500-68,000	69,000-69,500
Revenue	26,331	33,756	34,000-35,000	37,000-38,000	40,000-41,000
EBITDA	6,664	7,047	8,900-9,400	10,000-10,500	11,500-12,000
EBITDA margin (%)	25.3	20.9	26-27	27-28	29-30
FFO	5,160	5,208	3,500-4,000	4,300-4,800	6,500-7,000
Capex	4,732	7,635	10,000-10,500	7,000-7,500	5,000-5,500
Free operating cash flow (FOCF)	(1,189)	(7,503)	(6,500) - (6,000)	(3,000) - (2,500)	1,000-1,500
Debt to EBITDA (x)	3.0	4.5	4.0-4.5	4.0-4.5	3.5-4.0
FFO to debt (%)	26.2	16.3	9.0-12.0	10.0-13.0	14.0-16.0
FOCF to debt (%)	(6.0)	(23.5)	(18) - (15)	(8) - (5)	1-4
EBITDA interest coverage (x)	4.5	2.7	2.0-2.5	2.2-2.7	3.0-3.5
FFO cash interest coverage (x)	6.4	5.1	1.8-2.3	1.9-2.4	2.8-3.3

*All figures adjusted by S&P Global Ratings. a--Actual. e--Estimate. f--Forecast.

Base-case projections

New debt to finance the investment plan and for liability management. We forecast that Neoenergia will post a FOCF deficit in the next two years because of its sizable investments. In our forecast, we assume that the group will finance its investments with additional debt and will refinance the debt amortizations in the next two years. Neoenergia has more than R\$5 billion in available committed facilities, illustrating its ability to obtain financing for its investments and its good relationship with banks. EBITDA margins will rise due to our expectation of lower energy costs as hydrology keeps improving, while the group's new transmission lines and wind and solar power plants come on stream.

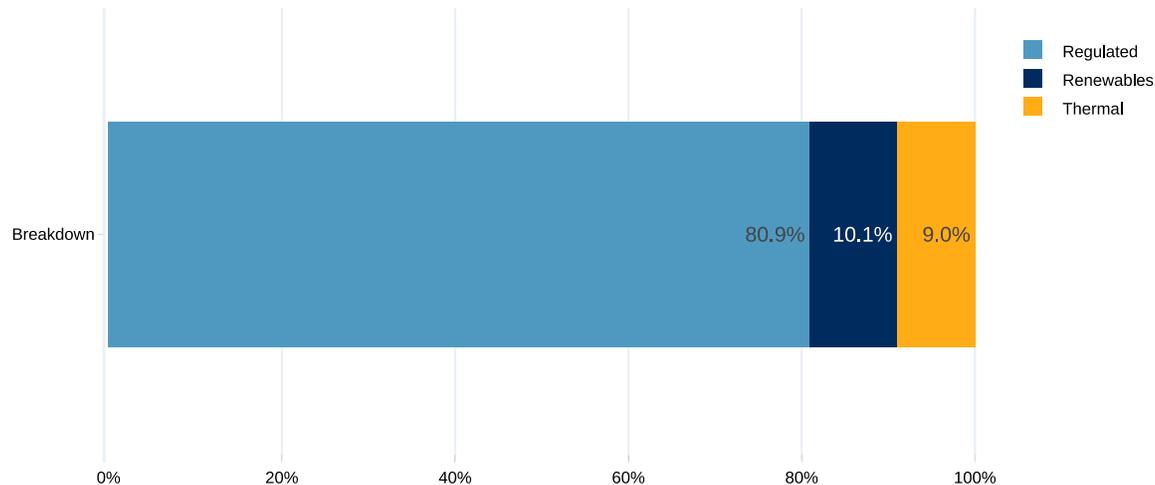
Company Description

Neoenergia is an integrated energy company operating in a wide range of electricity-related businesses: distribution, transmission, generation, and trading activities. It operates solely in Brazil, primarily in the northeastern region. Neoenergia has about 15.7 million clients in the distribution segment through its five distribution companies and a consolidated regulatory asset base of about R\$31.5 billion. In addition, Neoenergia has 2,333 kilometers (km) of transmission lines and 11 substations in operation, totaling permitted annual revenues (RAP) of about R\$410 million in the 2020-2021 cycle. Neoenergia is investing in seven additional transmission projects that will add about R\$716 million of RAP to the group's revenue base in the next couple of years. The group has 4,513 MW of installed capacity through hydro, thermal, and wind power plants, including the stakes in the jointly controlled 1,819 MW Teles Pires

Neoenergia S.A. And Subsidiaries

hydropower plant and the 10% stake in the 11,233 MW Belo Monte hydro plant, although the latter was reported as an asset held for sale. In addition, Neoenergia is constructing wind and solar parks that will add about 716 MW of installed capacity in 2022.

EBITDA Breakdown in 2021



Source: S&P Global Ratings.
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Iberdrola controls a 51.04% stake in Neoenergia. Caixa de Previdência dos Funcionários do Banco do Brasil (Previ; not rated) holds 30.29% of the group, and the remaining 18.67% is free floating. Iberdrola is the second-largest power generator and distributor in Spain, as well as the leader in renewables, and it has operations in the U.K. through Scottish Power, in Latin America through Iberdrola Renovables, and in the U.S. through Avangrid.

Peer Comparisons

We selected the following companies as peers for Neoenergia:

- CPFL Energia, which is also one of the largest private players in the Brazilian electric sector;
- Iberdrola; and
- Enel Americas, which operates across Latin America, but Brazil is its largest market.

We believe Neoenergia compares well with CPFL in terms of size and geographic concentration, given that both entities only operate in Brazil. Given Neoenergia's currently higher level of investments, its credit metrics are slightly weaker than those of CPFL, which explains our view of Neoenergia's financial risk profile as aggressive. Enel Americas, and especially Iberdrola, are better positioned because they operate in various regulatory jurisdictions. Neoenergia's parent has a network operations in countries with well-established, stable, and predictable regulatory regimes.

Neoenergia S.A.-- Peer Comparisons

	Neoenergia S.A.	CPFL Energia S.A.	Iberdrola S.A.	Enel Americas S.A.
Foreign currency issuer credit rating	BB-/Stable/--	--	BBB+/Stable/--	BBB-/Stable/--

Neoennergia S.A.-- Peer Comparisons

Local currency issuer credit rating	BB-/Stable/--	--	BBB+/Stable/--	BBB-/Stable/--
National scale rating	brAAA/Stable/--	brAAA/Stable/--	--	--
Period	Annual	LTM	Annual	Annual
Period ending	2021-12-31	2021-12-31	2021-12-31	2021-12-31
Mil.	R\$	R\$	R\$	R\$
Revenue	33,756	34,733	247,851	90,216
EBITDA	7,047	7,889	70,159	23,473
Funds from operations (FFO)	5,208	5,732	58,665	17,364
Interest expense	2,627	1,436	10,319	3,474
Cash interest paid	1,265	691	6,223	2,093
Operating cash flow (OCF)	132	3,823	44,544	12,729
Capital expenditure	7,635	3,564	45,503	16,670
Free operating cash flow (FOCF)	(7,503)	258	(960)	(3,941)
Discretionary cash flow (DCF)	(8,211)	(4,040)	(18,341)	(9,308)
Cash and short-term investments	5,617	2,786	25,632	9,518
Gross available cash	5,617	2,786	25,632	9,518
Debt	31,925	24,356	287,357	31,355
Equity	24,238	16,806	329,511	83,741
EBITDA margin (%)	20.9	22.7	28.3	26.0
Return on capital (%)	9.9	19.6	8.0	17.0
EBITDA interest coverage (x)	2.7	5.5	6.8	6.8
FFO cash interest coverage (x)	5.1	9.3	10.4	9.3
Debt/EBITDA (x)	4.5	3.1	4.0	1.3
FFO/debt (%)	16.3	23.5	20.7	55.4
Cash flow from operations/debt (%)	0.4	15.7	15.7	40.6
FOCF/debt (%)	(23.5)	1.1	(0.3)	(12.6)
DCF/debt (%)	(25.7)	(16.6)	(6.5)	(29.7)

Business Risk

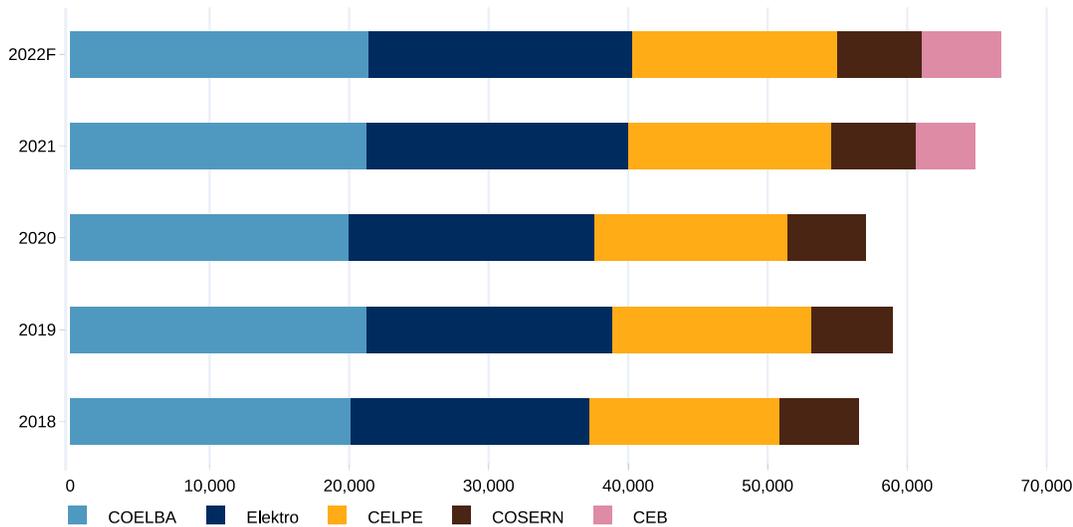
Most of Neoennergia's cash flows come from regulated activities. One of Neoennergia's business strengths is that electric power distribution and transmission activities represent 80%-85% of the group's EBITDA, offering a high degree of cash flow predictability. This is particularly so for transmission lines, given that their revenues are based on their availability to the system; therefore, they're not exposed to volume risk. With the startup of new renewable projects and transmission lines in the next few years, we expect the regulated segment (distribution and transmission) to generate about 85% of the group's EBITDA, while the generation segment will contribute the remaining 15%. We view the regulatory framework in Brazil as favorable, with a track record of fully respected contracts among industry players. Given that the discos currently operate under a model of pass-through costs, along with the remuneration of their investments, they receive rate readjustments every three to five years (depending on the concession contract). Rate readjustments allow the companies to pass through to the clients the electricity costs incurred, and general and administrative-related expenses, which are pegged to inflation. Neoennergia's highly regulated distribution business serves three of the country's largest states in terms of GDP in northeastern Brazil and part of the states of São Paulo, the country's most populous and wealthiest

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state, and Mato Grosso do Sul. Recently, the group acquired the concession that serves the densely populated Federal District. Although electricity consumption across Neoenergia's concession areas has historically increased above Brazil's consumption and that of the northeastern region, the country's weak economy over the past few years has hurt the group's operations.

Electricity Consumption (GWh)

Neoenergia's distribution companies - captive and free markets



F: Forecast

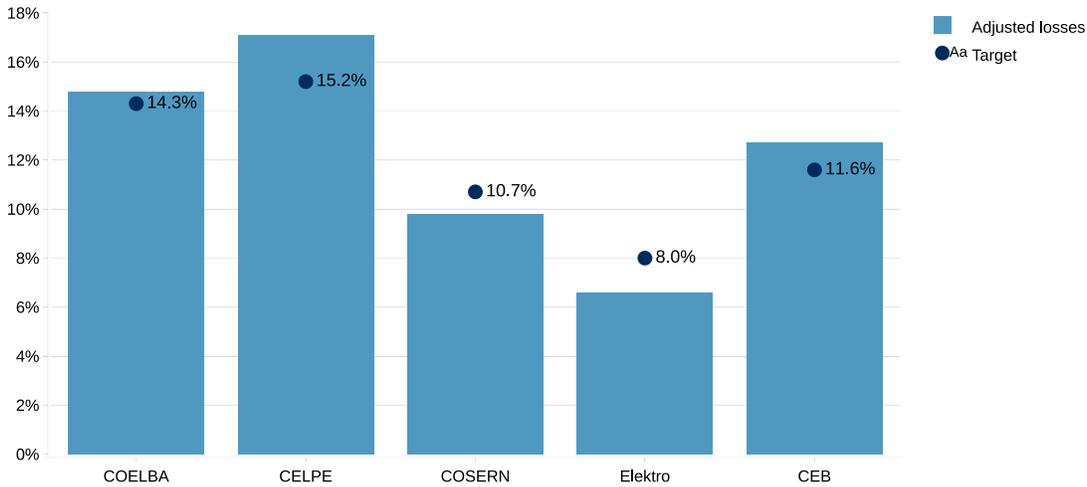
Source: S&P Global Ratings.

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Investments to improve operating efficiency. Neoenergia has been investing consistently to improve the service quality at its five concession areas, lowering average duration and frequency of service interruption (DEC and FEC, respectively), both of which are in compliance with the regulatory standards. The exception is Neoenergia Brasilia, although the latter has started improve quality indicators and cut energy losses since its acquisition. In addition, Neoenergia Coelba and Neoenergia Pernambuco still have higher electricity losses than the regulatory level not covered through tariffs, denting their profitability.

Adjusted Electricity Losses

As of Dec. 31, 2021



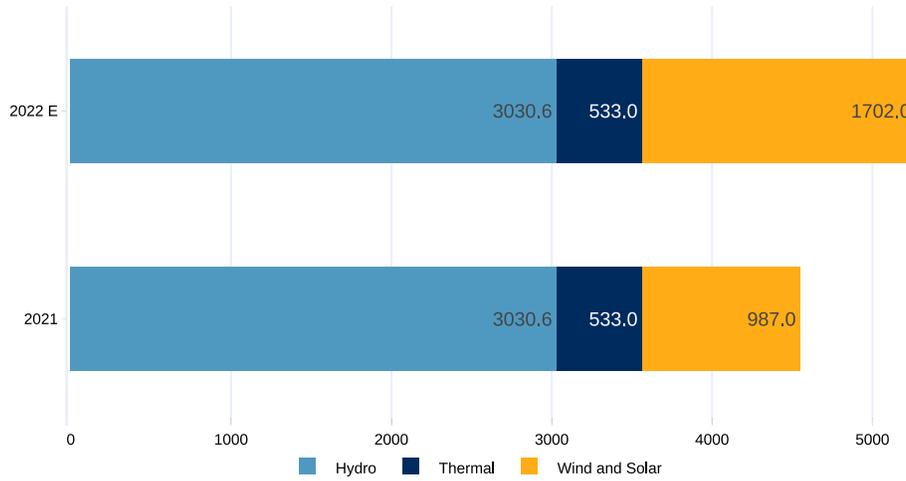
Source: S&P Global Ratings.
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In order to reduce energy losses, the group has been increasing inspections, replacing obsolete power meters, and regularizing illegal connections. In addition, the group has been implementing various measures to help its customers cover their electricity bills, including moratoriums on payments and disconnecting services for persistently delinquent clients.

Long-term contracts in the generation segment strengthen cash flow stability. Aside from Neoenergia's natural gas combined cycle thermal plant, Termopernambuco S.A. (Termope), and wind farms with long-term contracts in the free and regulated markets, the group's portfolio currently consists of hydro plants. This helps mitigate the volatile conditions inherent to this segment. Neoenergia has also been incorporating non-conventional renewable assets, mostly wind farms, into its portfolio. This is in line with Iberdrola's global strategy to maintain its leading position in renewable energy generation. Neoenergia completed the Chafariz wind farm, which added 471 MW to the group's installed capacity, reaching 4.5 gigawatts (GW) in 2021, including 10% of Belo Monte's hydro dam capacity, which Neoenergia now reports as an asset held for sale. In 2022, the group will add new capacity with the start-up of 566 MW Oitis wind project and 100 MW Luzia solar project.

Generation Installed Capacity

Megawatts (MW)



E: Estimated
 Source: S&P Global Ratings.
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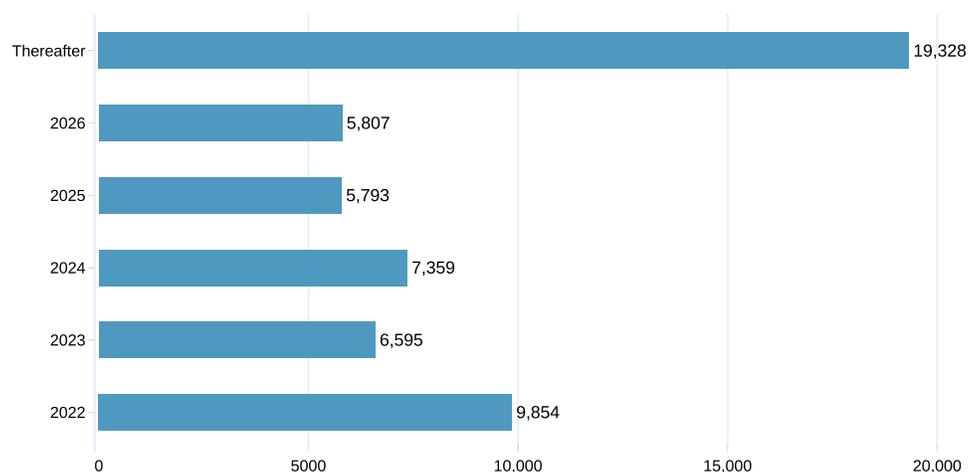
Financial Risk

Our assessment of Neoenergia's financial risk profile incorporates the group's sizable capex plan and the required additional debt to finance it. As a result, we expect negative FOCF in the next two years, especially in 2022. In addition, our analysis incorporates the group's plans to distribute minimum mandatory dividends of 25% of previous year's net income. Consequently, we expect Neoenergia's leverage, measured by net debt to EBITDA, to be 4.0x-4.5x for the next two years, down from 4.5x in 2021, which the drought partly caused to rise. The increasing basic interest rates in the country will raise the group's interest expenses, which are mostly linked to interbank deposit rates (CDI). That will reduce Neoenergia's FFO to net debt to the 9%-12% range in 2022 from 16.3% in 2021.

Debt maturities

Debt Amortization Profile

(Mil. R\$)



Source: Neoenergia's 2021 results presentation
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Neoenergia S.A.--Financial Summary

Period ending	Dec-31-2016	Dec-31-2017	Dec-31-2018	Dec-31-2019	Dec-31-2020	Dec-31-2021
Reporting period	2016a	2017a	2018a	2019a	2020a	2021a
Display currency (mil.)	R\$	R\$	R\$	R\$	R\$	R\$
Revenues	13,433	17,320	21,981	23,525	26,331	33,756
EBITDA	3,361	2,568	4,067	4,810	6,664	7,047
Funds from operations (FFO)	2,181	1,118	2,534	3,215	5,160	5,208
Interest expense	1,075	1,114	1,295	1,330	1,484	2,627
Cash interest paid	1,016	1,276	1,276	1,270	948	1,265
Operating cash flow (OCF)	1,106	694	1,328	3,410	3,543	132
Capital expenditure	2,707	3,807	4,143	4,309	4,732	7,635
Free operating cash flow (FOCF)	(1,602)	(3,113)	(2,815)	(899)	(1,189)	(7,503)
Discretionary cash flow (DCF)	(1,660)	(3,134)	(3,349)	(1,596)	(1,656)	(8,211)
Cash and short-term investments	1,394	3,873	3,955	4,066	5,076	5,617
Gross available cash	1,394	3,873	3,955	4,066	5,076	5,617
Debt	11,577	14,492	16,919	18,141	19,730	31,925
Common equity	9,220	15,608	17,577	19,259	21,509	24,238
Adjusted ratios						
EBITDA margin (%)	25.0	14.8	18.5	20.4	25.3	20.9
Return on capital (%)	14.4	6.9	10.0	10.2	13.0	9.9
EBITDA interest coverage (x)	3.1	2.3	3.1	3.6	4.5	2.7

Neoenergia S.A.--Financial Summary

FFO cash interest coverage (x)	3.1	1.9	3.0	3.5	6.4	5.1
Debt/EBITDA (x)	3.4	5.6	4.2	3.8	3.0	4.5
FFO/debt (%)	18.8	7.7	15.0	17.7	26.2	16.3
OCF/debt (%)	9.6	4.8	7.9	18.8	18.0	0.4
FOCF/debt (%)	(13.8)	(21.5)	(16.6)	(5.0)	(6.0)	(23.5)
DCF/debt (%)	(14.3)	(21.6)	(19.8)	(8.8)	(8.4)	(25.7)

Reconciliation Of Neoenergia S.A. Reported Amounts With S&P Global Adjusted Amounts (Mil. R\$)

Financial year	Debt	Shareholder equity	Revenue	EBITDA	Operating income	Interest expense	S&PGR adjusted EBITDA	Operating cash flow	Dividends	Capital expenditure
Dec-31-2021										
Company reported amounts	38,623	23,886	43,165	10,338	7,872	2,627	7,047	132	708	7,635
Cash taxes paid	-	-	-	-	-	-	(574)	-	-	-
Cash interest paid	-	-	-	-	-	-	(1,265)	-	-	-
Accessible cash and liquid investments	(5,617)	-	-	-	-	-	-	-	-	-
Dividends from equity investments	-	-	-	46	-	-	-	-	-	-
Income (expense) of unconsolid. cos.	-	-	-	(68)	-	-	-	-	-	-
Nonoperating income (expense)	-	-	-	-	250	-	-	-	-	-
Noncontrolling/minority interest	-	352	-	-	-	-	-	-	-	-
Debt: Workers comp/self insurance	789	-	-	-	-	-	-	-	-	-
Debt: Derivatives	(1,870)	-	-	-	-	-	-	-	-	-
Revenue: other	-	-	(9,409)	(9,409)	(9,409)	-	-	-	-	-
COGS: other nonoperating nonrecurring items	-	-	-	6,362	6,362	-	-	-	-	-

Reconciliation Of Neoenergia S.A. Reported Amounts With S&P Global Adjusted Amounts (Mil. R\$)

	Debt	Shareholder equity	Revenue	EBITDA	Operating income	Interest expense	S&PGR adjusted EBITDA	Operating cash flow	Dividends	Capital expenditure
EBITDA: other	-	-	-	(222)	(222)	-	-	-	-	-
D&A: other	-	-	-	-	(26)	-	-	-	-	-
Working capital: Taxes	-	-	-	-	-	-	-	574	-	-
Working capital: other	-	-	-	-	-	-	-	1,265	-	-
OCF: Taxes	-	-	-	-	-	-	-	(574)	-	-
OCF: other	-	-	-	-	-	-	-	(1,265)	-	-
Total adjustments	(6,698)	352	(9,409)	(3,291)	(3,045)	0	(1,839)	0	0	0
S&P Global Ratings adjusted	Debt	Equity	Revenue	EBITDA	EBIT	Interest expense	Funds from Operations	Operating cash flow	Dividends	Capital expenditure
	31,925	24,238	33,756	7,047	4,827	2,627	5,208	132	708	7,635

Liquidity

We assess Neoenergia's liquidity as adequate because we expect its sources of cash to exceed uses by more than 1.1x in the next 12 months, even if EBITDA were to fall 10%. Neoenergia has meaningful debt maturities in 2022 and 2023, of about R\$7.9 billion and R\$7.6 billion, respectively, in addition to its sizable capex plan of about R\$17 billion in the next two years. We believe the group's cash position and expected cash generation, in addition to about R\$5 billion in committed facilities, are enough to cover its debt maturities and to finance part of its investments in 2022. In our view, the group has a solid relationship with banks and standing in capital markets. In addition, we believe that Neoenergia has flexibility to postpone dividend payments and investments in case of stressful conditions.

Principal liquidity sources

- Cash and cash equivalents of R\$5.6 billion as of Dec. 31, 2021.
- Expected cash flows of about R\$4.6 billion in 2022.
- Committed credit lines of about R\$5 billion available to finance the investments.
- Proceeds from new loans and issuances secured during the first quarter of 2022 of about R\$1.5 billion.

Principal liquidity uses

- Debt amortization of about R\$7.9 billion in 2022.
- Investments of about R\$10 billion in 2022.
- Intra-year working capital requirements of about R\$1 billion annually.
- Minimum dividend distributions of about R\$1 billion in 2022.

Covenant Analysis

Compliance expectations

We expect Neoenergia to comply with the required financial covenants under its bank loans and debentures, even if forecasted EBITDA were to fall 10% from our base-case scenario.

Requirements

Its main covenants, measured either quarterly, semiannually, or annually:

- Net debt to EBITDA of up to 4.0x; and
- EBITDA to interest of at least 2.0x.

The subsidiaries are also subject to the same financial covenants, measured on a consolidated basis, with a few exceptions, such as Neoenergia Elektro, which has the following covenants:

- Net debt to EBITDA of up to 3.0x; and
- EBITDA interest coverage of at least 2.5x.

Neoenergia COELBA and Neoenergia COSERN have the same financial covenant as the group, including:

- Net debt to EBITDA of up to 4.0x.

Although the covenants for Neoenergia Elektro are more restrictive, we believe the subsidiary has greater flexibility because it has less debt than the group. In addition, these ratio calculations differ from our methodology because they consider the variations in the concession’s financial asset as part of the distribution companies' EBITDA. In addition, at the consolidated level, we adjust our figures by the effects of IFRS 15 in the transmission segment, by taking off any construction margin in the pre-operating period.

Environmental, Social, And Governance

ESG Credit Indicators

E-1	E-2	E-3	E-4	E-5	S-1	S-2	S-3	S-4	S-5	G-1	G-2	G-3	G-4	G-5
- Climate transition risks					- N/A					- N/A				

N/A—Not applicable. ESG credit indicators provide additional disclosure and transparency at the entity level and reflect S&P Global Ratings’ opinion of the influence that environmental, social, and governance factors have on our credit rating analysis. They are not a sustainability rating or an S&P Global Ratings ESG Evaluation. The extent of the influence of these factors is reflected on an alphanumeric 1-5 scale where 1 = positive, 2 = neutral, 3 = moderately negative, 4 = negative, and 5 = very negative. For more information, see our commentary “ESG Credit Indicator Definitions And Applications,” published Oct. 13, 2021.

ESG factors have an overall neutral influence on our credit rating analysis of Neoenergia. It operates mainly distribution and transmission networks (roughly 85% of the group's EBITDA) mostly in northeastern Brazil, where close to 20% of residential clients are low income. In line with other integrated energy groups in Brazil, such as CPFL Energia and Companhia Energetica de Minas Gerais – CEMIG, we consider that Neoenergia is well positioned for energy transition. This is because roughly 87% of its installed capacity is renewable if we consider the additional renewable capacity coming onstream in 2022 and disregarding Neoenergia’s 10% stake in Belo Monte, given that this asset is now reported as held for sale. In addition, although Neoenergia has a stake in Termope, a gas-powered thermoelectric plant, its share of the group’s total installed capacity is small, while natural gas is a relatively clean fossil fuel. In addition, Termope serves as energy reserve to support Brazil’s energy matrix, which is skewed towards hydro.

Group Influence

We consider the Brazilian operations as strategically important to Iberdrola's strategy to expand its regulated activities (electricity distribution and transmission) in high-growth markets, as well as in the renewable segment. However, Neoenergia represents just about 15% of the parent's consolidated EBITDA, and that's likely to remain the case. Finally, we expect Neoenergia to continue operating as a stand-alone entity and not rely on the parent's direct financial support. We believe Neoenergia Coelba, Neoenergia Pernambuco, Neoenergia Cosern, and Neoenergia Elektro are the group's most important subsidiaries because they're electricity

distributors, generating more than 75% of Neoenergia's cash flows. In addition, although these subsidiaries are required by law to be separate from the group for regulatory purposes, we consider that Neoenergia adopts an integrated financial strategy towards all of its subsidiaries.

Rating Above The Sovereign

Neoenergia--through its subsidiaries in the electric power distribution, transmission, and generation segments--operates in a heavily regulated industry. It is regulated at the federal level through ANEEL. We believe that in a sovereign stress scenario, the government could interfere in the electric utility sector, given its ability to determine the guidelines for the segment. Therefore, we believe that a default of Brazil would provide incentives for the government to intervene in the sector's companies, including Neoenergia, which could hamper its ability to repay debt. Therefore, given that Neoenergia is a regulated utility, we limit our ratings on it and its subsidiaries to those on Brazil.

Issue Ratings--Subordination Risk Analysis

Capital structure

As of Dec. 31, 2021, Neoenergia's gross debt totaled R\$38.6 billion, consisting of debentures (42%) and bank loans (58%) from several financial institutions. Out of the total amount, 14% is at the holding level and the remaining 86% is at the subsidiaries' level. We rate several of Neoenergia and its subsidiaries' debt instruments on the national scale. Please see the table below.

Debt-Level Ratings			
Issue	Amount	Maturity	Rating
Neoenergia S.A.			
6th debentures issuance	R\$802.7 million	Jun-29	brAA+
Companhia de Eletricidade do Estado da Bahia (Neoenergia Coelba)			
10th debentures issuance	R\$1.2 billion	Apr-23	brAAA
12th debentures issuance	R\$700 million	Apr-26	brAAA
13th debentures issuance	R\$800 million	Dec-31	brAAA
1st commercial notes issuance	R\$800 million	Dec-28	brAAA
Companhia Energetica de Pernambuco (Neoenergia Pernambuco)			
8th debentures issuance	R\$500 million	Feb-23	brAAA
10th debentures issuance	R\$500 million	Apr-26	brAAA
11th debentures issuance	R\$500 million	Dec-35	brAAA
1st commercial notes issuance	R\$500 million	Dec-28	brAAA
Companhia Energetica do Rio Grande do Norte (Neoenergia Cosern)			
7th debentures issuance	R\$370 million	Oct-24	brAAA
1st commercial notes issuance	R\$200 million	Dec-28	brAAA
Elektro Redes S.A. (Neoenergia Elektro)			
7th debentures issuance	R\$638.7 million	May-25	brAAA
9th debentures issuance	R\$700 million	May-28	brAAA
10th debentures issuance	R\$650 million	Oct-31	brAAA
Calango 6 Energia Renovavel S.A.			
1st debentures issuance	R\$43.5 million	Jun-28	brAA+
Lagoa 1 Energia Renovavel S.A.			
1st debentures issuance	R\$46.2 million	Mar-29	brAA+
NC Energia S.A.			

1st debentures issuance	R\$31.6 million	Dec-25	brAA+
Termope			
7th debentures issuance	R\$300 million	Aug-22	brAA+

Analytical conclusions

The 'brAAA' issue-level ratings on Neoenergia Coelba, Neoenergia Pernambuco, Neoenergia Cosern, and Neoenergia Elektro are in line with their issuer credit ratings because these entities are the group's main operating companies and they finance themselves mostly through unsecured debt at their level. The 'brAA+' issue-level rating on Neoenergia's debt is a notch lower than the issuer credit rating because more than 85% of the consolidated debt is at the operating subsidiaries' level, indicating a structural subordination of the holding's obligations. Finally, the 'brAA+' issue-level ratings on Calango 6, Lagoa 1, NC Energia, and Termope reflect these issuances' reliance on Neoenergia's guarantees (credit substitution). As such, we treat these debt instruments as the group's obligation; therefore, subordinated to its other obligations.

Rating Component Scores

Foreign currency issuer credit rating	BB-/Stable/--
Local currency issuer credit rating	BB-/Stable/--
Business risk	Satisfactory
Country risk	Moderately High
Industry risk	Low
Competitive position	Satisfactory
Financial risk	Aggressive
Cash flow/leverage	Aggressive
Anchor	bb
Diversification/portfolio effect	Neutral (no impact)
Capital structure	Neutral (no impact)
Financial policy	Neutral (no impact)
Liquidity	Adequate (no impact)
Management and governance	Fair (no impact)
Comparable rating analysis	Neutral (no impact)
Stand-alone credit profile	bb
Group credit profile	bbb+
Entity status within group	Strategically important (no impact)
Rating above the sovereign	-1 notch from SACP

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- General Criteria: Methodology For National And Regional Scale Credit Ratings, June 25, 2018
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- Criteria | Corporates | General: Recovery Rating Criteria For Speculative-Grade Corporate Issuers, Dec. 7, 2016
- General Criteria: Guarantee Criteria, Oct. 21, 2016
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015

Neoenergia S.A. And Subsidiaries

- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | Industrials: Key Credit Factors For The Unregulated Power And Gas Industry, March 28, 2014
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria | Corporates | Utilities: Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings Detail (as of March 29, 2022)*

Neoenergia S.A.

Issuer Credit Rating

BB-/Stable/--

Brazil National Scale

brAAA/Stable/brA-1+

Issuer Credit Ratings History

07-Apr-2020

BB-/Stable/--

12-Dec-2019

BB-/Positive/--

12-Jan-2018

BB-/Stable/--

16-Aug-2017

BB/Negative/--

23-May-2017

BB/Watch Neg/--

11-Jul-2018

Brazil National Scale

brAAA/Stable/brA-1+

12-Jan-2018

brAA-/Stable/brA-1+

16-Aug-2017

brAA-/Negative/brA-1+

23-May-2017

brAA-/Watch Neg/brA-1

Related Entities

Companhia de Eletricidade do Estado da Bahia

Issuer Credit Rating

BB-/Stable/--

Brazil National Scale

brAAA/Stable/--

Senior Unsecured

Brazil National Scale

brAAA

Companhia Energetica de Pernambuco (CELPE)

Issuer Credit Rating

BB-/Stable/--

Brazil National Scale

brAAA/Stable/--

Senior Unsecured

Brazil National Scale

brAAA

Companhia Energetica do Rio Grande do Norte

Issuer Credit Rating

BB-/Stable/--

Brazil National Scale

brAAA/Stable/--

Ratings Detail (as of March 29, 2022)*

Senior Unsecured

Brazil National Scale brAAA

Elektro Redes S.A.

Issuer Credit Rating

Brazil National Scale brAAA/Stable/--

Senior Unsecured

Brazil National Scale brAAA

*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. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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