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Research Update:

Alfa Transmisora de Energia S.A. Senior Secured Notes Rating Affirmed At 'BBB-'; Outlook Remains Stable

November 28, 2023

Rating Action Overview

- Alfa Transmisora de Energia S.A. has reported solid debt service coverage metrics (DSCRs) close to 1.35x, owing to higher inflation in the U.S. and Chile.
- We expect DSCRs will remain around 1.35x, slightly above our previous forecast but still in line with the rating.
- Therefore, on Nov. 28, 2023, S&P Global Ratings affirmed its 'BBB-' issue-level rating.
- The stable outlook incorporates our expectation that Alfa will be able to maintain high availability of the transmission lines without incurring penalties, posting stable and predictable DSCRs of about 1.35x.

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Project Description And Key Credit Factors

Alfa Transmisora de Energía S.A. (formerly known as Alfa Desarrollo SpA) is jointly owned by Celeo Redes Chile Expansion SpA and APG Energy & Infra Investments Chile Expansion SpA. In 2021, Celeo and APG acquired Colbun Transmisión S.A.'s assets through a newly created company, Alfa Transmisora, which is the issuer of the senior secured notes. Alfa Transmisora now owns all the operating assets of Colbun Transmision:

- National assets (regulated): seven transmission lines totaling 335 kilometers (km) and six substations;
- Zonal assets (regulated): six transmission lines totaling 70 km and two substations; and
- Dedicated assets (nonregulated): 16 transmission lines with a total length of 494 km and 19 substations.

Currently, these assets have a market share 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 the electricity demand in the country.

Key strengths

- Stable and predictable cash flows, given favorable regulatory framework in Chile and the company's revenues from availability, preventing volume risk.
- Adequate structural protections that include a six-month debt service reserve account (DSRA), a three-month operations and maintenance (O&M) reserve account backed by 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 U.S. dollars and indexed to U.S. and Chilean inflation, assuming a guaranteed posttax return, while debt will be issued in U.S. dollars, representing a natural hedge.

Key risks

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

Rating Action Rationale

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

From a financial perspective, the performance of the project during 2023 surpassed our estimates, mainly because of higher-than-anticipated inflation in the U.S. and Chile, which is a main driver of revenues adjustments. The latter strengthened the EBITDA margin to about 90%. Our updated base-case scenario incorporates new macroeconomic conditions, including inflation in Chile in 2023 higher than in our previous base case (7.7% versus 5.5%) that resulted in a minimum DSCR of 1.36x.

In terms of capital investments, Alfa won a bid to construct expansion projects under the Chilean Ministry of Energy's Decree 231. The projects, which are currently under construction on time and within budget, should become operational by 2025.

We will continue monitoring the assets' performance. We could raise the debt rating on Alfa if the DSCR is consistently close or above 1.40x and investments through 2025 remain on track.

As the tariff increased by more than the company expected, Alfa's cash flows were higher, and in order to comply with the purchase agreement signed with Colbun, the purchase price of transmission lines was raised. In February 2023, a panel of experts finalized the regulated rate review process. The Comision Nacional de Energia published the Definitive Technical Report, establishing the new tariffs for the upcoming years.

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 1.35x, and we expect that investments will continue to be executed on time and within budget. Therefore, we expect Alfa's cash flows 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 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.

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

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 1.36x and 1.44x, respectively, during the notes' term thanks to relatively low operating complexity, a business model based on availability, and currently higher inflation, which affects the cumulated adjustment in the long term.

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 Chile's inflation affects the project's revenue and rates, and Chile's inflation influences most of operating costs.

- We expect U.S. inflation to be 4.1% in 2023, 2.4% in 2024, 2.1% in 2025 and 2026, and 2.0% afterward. We expect Chile's inflation to be 7.7% in 2023, 3.5% in 2024, 3.1% in 2025, and 3.0% afterward. (See "Economic Outlook U.S. Q1 2024: Cooling Off But Not Breaking" and "Economic Outlook Emerging Markets Q1 2024: Challenging Global Conditions Will Constrain Growth," published on Nov. 27, 2023.)
- The starting point for VATTs (annual transmission value per section) in 2023 is about $30 million for the regulated revenue (both national and zonal) and close to $55 million for the dedicated revenue. We assume that for the hydro plants generally, the haircut would be 3%, while for coal plants, like the one that Santa Maria transmission line connects to the system, it's 15%. 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 the Chilean national transmission system has redundancies in place to prevent a blackout.

Key metrics

- We expect the project to post a minimum DSCR of 1.36x and median DSCR of 1.44x during the notes' term, and 1.49x and 1.54x, respectively, 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 a haircut that will be double of that in our base-case scenario. Exceptions are Angostura, the rates of which have already 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 revenues) for half of the portfolio in the regulated market.
- Given that notes have 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.

- Our base-case scenario assumes that this contract will be renewed with a haircut of 15% as it turns regulated. However, 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 has a significant impact under our downside.
- 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-**
Operations phase (senior debt)	
Asset class operating stability:	3
Operations phase business assessment:	4
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. Colbun was the former owner of transmission and substation assets that Alfa acquired. The project has dedicated contracts with Colbun's power plants, and these contracts represent about 30% of the project's total revenue. Because of the size of these contracts, Alfa won't have a rating higher than 'BBB' due to its counterparty limitation. Currently, we don't believe this is affecting the project's credit quality.

Due to the simplicity of the operations, 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: 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 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.