FITCH ASSIGNS 'BB' AND 'AA(BRA)' RATING TO ENTREVIAS' 2ND DEBENTURE ISSUANCE

Fitch Ratings-Sao Paulo-13 March 2018: Fitch Ratings has assigned long-term ratings of 'BB' and 'AA(bra)' to the second issuance of debentures of Entrevias Concessionaria de Rodovias S.A. (Entrevias) in the amount of BRL1.0 billion due in 2030. The Rating Outlook is Stable.

The total amount of the issuance is BRL1.0 billion, in line with Fitch scenarios. The upfront equity injected was BRL31 million higher and the final interest rate of IPCA+7.75% was slightly lower than initially expected.

KEY RATING DRIVERS

Summary: Entrevias' ratings reflect the operational profile of the concessionaire, with heavy vehicles representing close to 60% of the traffic in both sections. The North Section of the toll road, which crosses Ribeirao Preto (SP), has a proven traffic base and should represent two thirds of total traffic. This stretch presents a relatively moderate volatility. The South Section, a more recent stretch, is crucial for region's agricultural production flow. The concession agreement provides for annual tariff increases that track inflation. The senior debt structure is also indexed to inflation, has six months reserve account and restriction on cash distribution up to 2024, period of higher investments when the issuer has debt service coverage ratios (DSCR) below one, providing adequate liquidity, in line with the rating category.

The Stable Outlook reflects Entrevias' strong ability to absorb a demand shock. The concessionaire is able to withstand a 32% traffic decrease in 2024, before defaulting on its debt service, in Fitch's base case.

Volume Strongly Linked to Economy [Volume Risk - Midrange]

Entrevias' concession is divided in two sections: North and South. The North Section, which crosses Ribeirao Preto, is under management of Vianorte S.A. (Vianorte, not rated) until March 2018 and has a long traffic track record. Fitch estimates this stretch to represent two thirds of total traffic, according to independent engineer report. The South Section, which crosses Marilia, connects the states of Sao Paulo and Parana, and it is crucial for agricultural production flow. Heavy vehicles represent close to 60% of the traffic in both sections. Brazilian logistics network narrows competition between toll roads, therefore, the price elasticity is moderate. Fitch expects Entrevias' volume to perform in line with the overall economic outlook given the high percentage of heavy vehicles in both sections.

Tariffs Adjusted By Inflation [Price Risk - Midrange]

The concession agreement presents a mechanism that allows inflation pass-through annually, and tariffs on the North Section, under management of Vianorte since 1998, have been readjusted accordingly without great effect on volumes. The regulatory framework is well-defined and provides for enforceable contracts. Political measures that impacted tariff readjustments have been offset by other mechanisms to preserve the financial/economic balance of the contract.

Extensive Capex Plan in the Next Years [Infrastructure Development/Renewal - Midrange]

Entrevias is expected to undertake a heavy capex plan in order to comply with recently signed concession agreement and to accommodate medium-term traffic forecasts in the South Section of the road, in the region of Marilia. Although the company has a well-developed infrastructure and renewal plan, it does not have an EPC agreement signed with a major construction company. However, the construction work is simple, making it easier to replace the contractor in case it is needed. The concession framework provides for adequate recovery of expenditure via the mechanisms defined in the concession contract to preserve its financial/economic balance.

Adequate Debt Structure [Debt Structure - Midrange]

The debentures are senior and indexed to inflation, which is the same index used to readjust tariffs, providing a natural hedge to the debt. The structure benefits from a six-month debt service reserve account (DSRA). The amortization profile is back-loaded and the convent related to dividend distribution is not viewed as a strong protection as it includes equity in its calculation. This weak feature is partially mitigated by the cash distribution restriction until 2024.

Financial Profile

Entrevias has low leverage, measure by net debt/EBITDA, with a peak of 2.2x in 2024. It presents an average DSCR of 0.9x during the debenture tenor in Fitch's rating case. However, the deficit in cash generation has mitigated the existence of significant retained cash balances in the concessionaire up to 2024 (period of higher investments), by an LLCR of 1.6x and by the long tail of the concession, that only matures in 2047, leading to a PLCR of 3.0x in Fitch's rating case.

PEER GROUP

There are no projects with characteristics similar to those of Entrevias that have a public rating by Fitch.

RATING SENSITIVITIES

Future developments that may, individually or collectively, lead to Positive Rating Action:

--Traffic growth that increases cash balance significantly above Fitch's base case in a sustained fashion.

Future developments that may, individually or collectively, lead to Negative Rating Action:

--Traffic growth does not meet Fitch's rating case, reducing the project's liquidity in BRL60 million in an accumulated basis in the following years;
--Sustained two-digit deviations in capex above Fitch's base case.

TRANSACTION SUMMARY

Entrevias' second debentures issuance has the amount of BRL1.0 billion with a 2030 final maturity and an interest rate of IPCA+7.75%, paid annually. The principal amortization schedule is customized, with 89% of principal due between 2026 and 2030. The debt structure benefits from a DSRA of six months and a clauses that provides for cash to be retained within the concessionaire until the 2024. DSCR calculations used to test for the distribution of dividends include capital contribution and must be greater than 1.2x. There are also limitations on additional indebtedness up to BRL30 million and through the leverage covenant, measured by net debt/EBITDA, which should be lower than 3.75x.

The second issuance will be used to pay the second installment of the fixed grant of BRL416 million (data-base of April 2017), and the remainder will be allocated to the investment plan of the concessionaire.

Fitch Cases

Fitch's base and rating cases assumptions reflect the macroeconomic projections of GDP, inflation and interest rates updated according to the Global Economic Outlook report published by the agency on Dec. 4, 2017.

The main assumptions of Fitch's base case include:

--Traffic growth of 1.2x GDP growth;
--Tariff readjustments according to the inflation of the period;
--Investments of BRL2.57 billion between 2017-2026, in nominal terms.

The main assumptions of Fitch's rating case include:

--Traffic growth of 1.0x GDP growth;
--Investments of BRL2.72 billion between 2017-2026, in nominal terms.

In Fitch's base case, average DSCR is 1.2x, considering the full debenture tenor, and maximum leverage (net debt/EBITDA) is 2.1x in 2025, taking into account the years of full operation, which takes place from 2019. LLCR reaches 1.9x and PLCR, 3.5x.

In Fitch's rating case, average DSCR is 0.9x, also considering the full debenture tenor, and maximum leverage (net debt/EBITDA) is 2.2x in 2024, taking into account the years of full operation, which takes place from 2019. LLCR reaches 1.6x and PLCR, 3.0x.

Asset Description

Entrevias is an SPV that owns the concession rights to explore, to invest and maintain 570km of roads in the State of Sao Paulo, divided in seven highway stretches that connect the north of the state of Parana and the southeast of the state of Minas Gerais. The concession was granted by the State Government of Sao Paulo, mediated by Agencia Reguladora de Servicos Publicos Delegados de Transporte do Estado de Sao Paulo (ARTESP), in 2017 for a period of 30 years (maturity in June 2047).

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Fitch used financial information available until Dec. 31, 2017 for its analysis.

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Applicable Criteria
Rating Criteria for Infrastructure and Project Finance (pub. 24 Aug 2017)
https://www.fitchratings.com/site/re/902689
Toll Roads, Bridges and Tunnels Rating Criteria (pub. 22 Feb 2018)
https://www.fitchratings.com/site/re/10021263