



## RATING ACTION COMMENTARY

# Fitch Affirms Transportadora Associada de Gas at 'BB'; Outlook Stable

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Fitch Ratings - Austin - 19 Jul 2023: Fitch Ratings has affirmed Transportadora Associada de Gás S.A.'s (TAG) Long-Term Foreign Currency (FC) Issuer Default Rating (IDR) at 'BB', Local Currency (LC) IDR at 'BBB-', and Long-Term National Scale Rating at 'AAA(bra)'. The Rating Outlook is Stable.

TAG's FC IDR is capped by Brazil's Country Ceiling of 'BB', as its operations are entirely in Brazil; but TAG's LC IDR reflects its solid business model, supported by long-term contracts with no volumetric risk and the low risk profile of the gas transportation industry in Brazil, which provides healthy protection of company revenues, and thus, high margins with strong and stable operating cash flows. Fitch expects TAG to sustain its robust credit profile, given high FCF and sharp deleveraging capacity. Fitch projects for TAG's leverage to continue declining over the forecast period despite relevant dividends distributions and increased capex spend over the next three years.

## KEY RATING DRIVERS

**Declining Leverage Despite Re-Contracting Risk:** TAG's operating cash generation is sound and supported by four, inflation-indexed, long-term gas transportation agreements (GTA) with Petroleo Brasileiro S.A. (Petrobras; BB-/Stable), with the closest maturity in 2025, and over 30 extraordinary contracts with 12 shippers (as of YE 2022). TAG has 100% of its transportation network capacity contracted, which excludes volumetric exposure despite a utilization rate of around 60% on average, with peak periods reaching approximately 90% of capacity utilization. Part of the company's tariff is also U.S. dollar-linked, indexed to the U.S. PPI, and updated annually.

TAG is not subject to any demand exposure until the expiration of its first contract, which accounts for approximately 24% of its total revenues. While TAG may face re-contracting risk in 2026, the company has already boosted its commercial efforts to increase the number of shippers tied to that pipeline. Even with an assumed 30% decline

in revenues from that contract, leverage is expected to continue declining, with debt-to-EBITDA of 1.1x by 2026.

**Strategic Asset for Brazil:** TAG operates a strategic pipeline network for the country's infrastructure in the northern, northeastern and southeastern regions of Brazil. Gas distributors in those regions rely on TAG's infrastructure to receive natural gas. The infrastructure is also important as it connects the southeast gas transportation network, which is crucial for industry operational flexibility, particularly after pending industry regulatory updates.

**Solid Cash Flow from Operations:** TAG's EBITDA grew to BRL7.1 billion in 2022 and is expected to grow to BRL7.5 billion by 2026 with margins averaging 87% over the forecast period. Fitch's base case scenario considers annual cash flow from operations (CFO) at BRL5.0 billion to 5.2 billion in the next four years, which is sufficient to support the forecasted annual average capex of BRL770 million and relevant dividends of around BRL1.7 billion. Average annual FCF is projected at BRL2.7 billion between 2023 and 2026.

**Guarantee Structure Mitigates Petrobras Concentration Risk:** TAG is exposed to concentration risk with Petrobras as the single counterparty to the legacy GTAs. The guarantee structure mitigates this risk as the receivables from Petrobras' gas distributors and thermal power plant clients must equate to at least 120% of the monthly payment to TAG. The credit profile of the gas distributors is robust, which also helps mitigate default and concentration risk. The possibility of gas supply discontinuity by Petrobras to its customers (gas distributors) is reduced, since there are limited alternatives for Petrobras to sell gas to other buyers.

**Neutral Regulatory Changes:** Fitch estimates a greater opening of the gas market in Brazil due to Petrobras' asset sales in the industry and recent regulatory changes that stimulate gas supply competition. The existing transportation contracts between TAG and Petrobras remain unchanged, and TAG's business model continues to be solid. The potential reduction of gas prices to the final consumer should increase gas consumption and production in Brazil in the coming years and strengthen the relevance and capacity use of TAG's assets.

## DERIVATION SUMMARY

TAG's sound business profile with robust and stable cash flows is very similar to that of other Fitch-rated midstream companies in the LatAm region such as the Brazilian electric power transmission company Transmissora Alianca de Energia Eletrica S.AA (Taesa; BB/Stable), the gas transportation company, Transportadora de Gas

Internacional S.A. E.S.P.'s (TGI; BBB/Stable), based in Chile, and Transportadora de Gas del Peru S.A. (TGP; BBB+/Stable), based in Peru.

All of them have low business risk profiles, predictable revenues and robust cash flow generation, with limited demand risk exposure given revenue based on available infrastructure capacity under long-term contracts. These are characteristics of both power transmission and gas transportation companies in regulated industries. These companies also present strong credit metrics.

The main difference between the IDRs of Brazilian-owned companies, TAG and Taesa, and their regional peers is the revenue-generating country and assets' geographic location. Although TGP and TGI are in investment-grade countries, TAG's and Taesa's ratings are negatively affected by Brazil's Country Ceiling of 'BB' and its operating environment.

## **KEY ASSUMPTIONS**

Fitch's Key Assumptions Within Our Rating Case for the Issuer:

--Revenues based on contracted amounts and adjusted annually by inflation with part of the tariffs linked to exchange rate indices, according to GTAs;

--A 3% decline in total revenues in 2026 following expiration of Malha Nordeste GTA;

--Operating and maintenance costs before depreciation and amortization representing 16% of net revenues in 2023 with a reduction to 12% in 2024 due to cost savings related to termination of Transpetro contract;

--Average capex of BRL770 million between 2023 and 2026;

--Dividend distribution at an annual average of BRL1.7 billion over the 2023 to 2026 period;

--Tax benefit use until 2023, with full tax payments assumed thereafter.

## **RATING SENSITIVITIES**

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--Positive rating actions are limited by Brazil's Country Ceiling of 'BB' and sovereign rating of 'BB-';

--An upgrade to the National Long-Term Rating does not apply as it is at the top of the national scale.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--A downgrade of Brazil's Country Ceiling;

--A persistent weakening of Petrobras' receivables guarantee structure with clients that deposit into a collection account;

--A sustained increase in the leverage ratio above 3.5x;

--Failure to recontract expiring capacity from Malha Nordeste GTA.

--Regulatory or contractual changes affecting the fundamentals of the gas transportation industry or TAG's business model.

## **BEST/WORST CASE RATING SCENARIO**

International scale credit ratings of Non-Financial Corporate issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit <https://www.fitchratings.com/site/re/10111579>.

## **LIQUIDITY AND DEBT STRUCTURE**

Manageable Liquidity: TAG's liquidity profile is expected to lead to moderate to weak ratios, as measured by cash/short term debt. This is mitigated by its sound and resilient CFO, which supports its strong debt and capital markets access to various sources of financing. TAG's cash and marketable securities position was BRL688 million as of Dec. 31, 2022, low relative to BRL3.7 billion of debt coming due in 2023. TAG has a manageable debt amortization schedule and a committed credit line of BRL500 million with Banco Bradesco S.A. to support temporary foreign exchange (FX) mismatches between its annual tariff adjustment and U.S.-dollar-denominated debt's semi-annual amortization.

TAG's total debt was BRL19 billion at YE 2022, consisting of debentures totaling BRL8.9 billion and a BRL10 billion U.S. dollar facility. The company has a natural hedge for its FX exposure as two of its GTAs include tariff adjustments linked to U.S. dollar variation and the U.S. PPI. The company is subject to net debt/EBITDA financial covenants below 3.5x after accounting for around BRL1.5 billion-BRL1.9 billion of parent credit guarantees, which cover six months of debt amortization.

## ISSUER PROFILE

The Transportadora Associada de Gás (TAG) operates in the natural gas transportation and storage segment in Brazil, owning the most extensive network of high-pressure gas pipelines totaling around 4,500 kilometres (km) or roughly 47% of the country's total gas transport network in the north, northeast and southeast regions of the country. TAG's total transportation capacity of 75 million m<sup>3</sup>/day is fully contracted with Petroleo Brasileiro S.A. (Petrobras) through four long-term gas transportation agreements (GTAs).

TAG's network passes through almost 200 municipalities in ten Brazilian states, covering 3,700 km along the northeastern/southeastern coast (states of Ceará, Rio Grande do Norte, Paraíba, Pernambuco, Alagoas, Sergipe, Bahia, Espírito Santo and Rio de Janeiro) and another 800 km connecting the oil region from Urucu to the city of Manaus, in the Amazon.

Engie group and the Canadian institutional investor Caisse de Dépôt et Placement du Québec (CDPQ) have owned TAG since April 2019 when the SPE Aliança Transportadora de Gás Participações SA (Aliança), made the winning bid for a 90% stake in the total amount (enterprise value) of BRL33.5 billion. The sale was completed in June of the same year funded through: Aliança's capital injection (BRL10.1 billion), a debenture issuance (BRL14 billion) and a USD Loan Facility (BRL9.4 billion/USD2.5 billion). Subsequently, TAG carried out the reverse incorporation of Aliança in order to unify assets and liabilities, meeting the requirements of the financing contracts.

In July of 2020, TAG became the country's first 100% privately owned gas carrier when its shareholders acquired, for the amount of BRL1.0 billion, the remaining 10% share resulting in ENGIE's total shareholding of TAG at 65% (of which 32.5% belongs to ENGIE Brasil Energia and 32.5% to GDF International; CDPQ retains the remaining 35%). Despite its strong ownership structure, TAG's assessment is based on its SCP given that the company runs independently from its shareholders with control shared as defined by shareholders agreement.




## REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

## ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit [www.fitchratings.com/esg](http://www.fitchratings.com/esg).

## RATING ACTIONS

ENTITY / DEBT 	RATING 	PRIOR 
Transportadora Associada de Gas S.A. - TAG	LT IDR	BB Rating Outlook Stable
	Affirmed	BB Rating Outlook Stable
	LC LT IDR	BBB- Rating Outlook Stable
	Affirmed	BBB- Rating Outlook Stable
	Natl LT	AAA(bra) Rating Outlook Stable
	AAA(bra) Rating Outlook Stable	
	Affirmed	

[VIEW ADDITIONAL RATING DETAILS](#)

## FITCH RATINGS ANALYSTS

**Julieta Seebach**

Director

Primary Rating Analyst

+1 512 215 3743

[julie.seebach@fitchratings.com](mailto:julie.seebach@fitchratings.com)

Fitch Ratings, Inc.

2600 Via Fortuna, Suite 330 Austin, TX 78746

**Gustavo Mueller**

Director

Secondary Rating Analyst

+55 21 4503 2632

gustavo.mueller@fitchratings.com

**Saverio Minervini**

Senior Director

Committee Chairperson

+1 212 908 0364

saverio.minervini@fitchratings.com

**MEDIA CONTACTS****Elizabeth Fogerty**

New York

+1 212 908 0526

elizabeth.fogerty@thefitchgroup.com

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**APPLICABLE CRITERIA**[National Scale Rating Criteria \(pub. 22 Dec 2020\)](#)[Corporate Rating Criteria \(pub. 28 Oct 2022\) \(including rating assumption sensitivity\)](#)[Exposure Draft: Climate Vulnerability in Corporate Ratings Criteria \(pub. 09 Jun 2023\) \(including rating assumption sensitivity\)](#)**APPLICABLE MODELS**

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Corporate Monitoring &amp; Forecasting Model (COMFORT Model), v8.1.0 (1)

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### Solicitation Status

### Endorsement Policy

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Transportadora Associada de Gas S.A. - TAG

EU Endorsed, UK Endorsed

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