

ISSUER COMMENT

18 April 2017

[Rate this Research](#) >>

RATINGS

Companhia de Saneamento do Parana - SANEPAR

Domicile	Curitiba, Parana, Brazil
Long Term Rating	Ba3
Type	LT Corporate Family Ratings
Outlook	Stable

Source: Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

Contacts

Paco Debonnaire Analyst paco.debonnaire@moodys.com	55-11-3043-7341
Camila Yochikawa Associate Analyst camila.yochikawa@moodys.com	55-11-3043-6079
Alejandro Olivo Associate Managing Director alejandro.olivo@moodys.com	52-55-1253-5742

Sanepar's first tariff review to boost future cash flow generation profile

Companhia do Saneamento do Parana - Sanepar

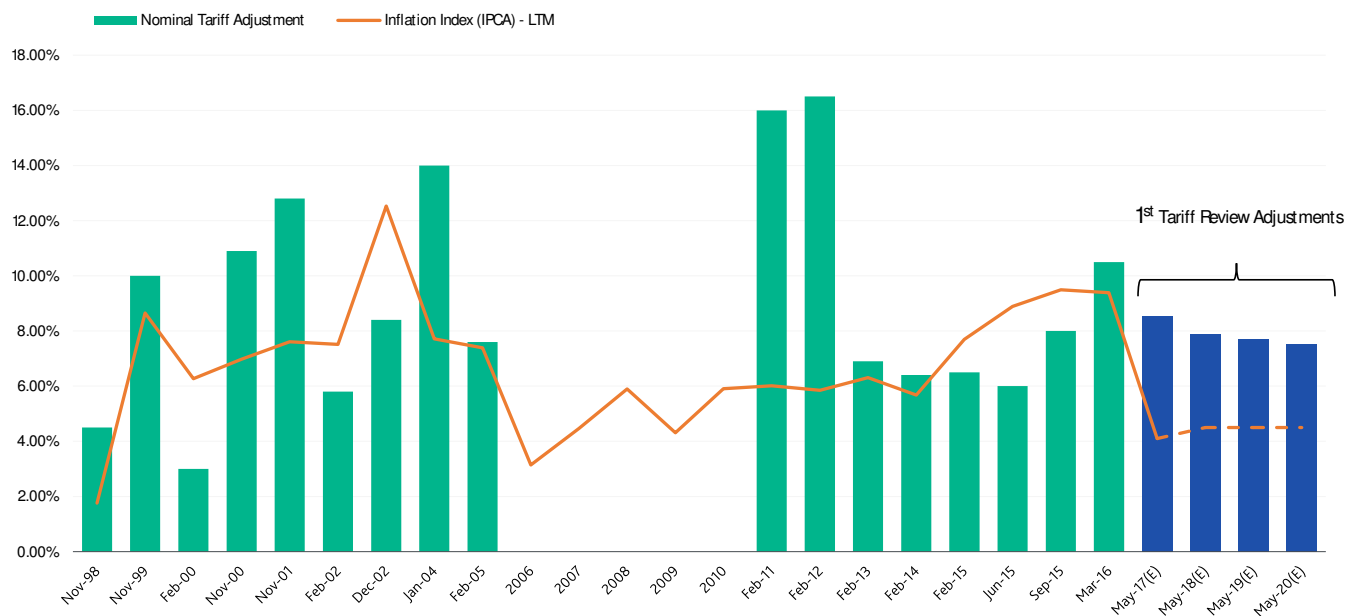
Last Wednesday Agepar, the state of Parana's regulator for infrastructure services, including water and sewage, concluded the tariff review for the [Companhia de Saneamento do Parana \(Sanepar, Ba3/A1.br stable\)](#). The review provides the company with a new tariff setting mechanism based on a transparent return on asset model that will remunerate future capital investments.

Sanepar will receive a 25.63% tariff increase over the next 8 years starting in May 2017 with a 8.53%, followed by annual increases of 2.1% in each of the following 7 years. In addition, every year from 2018 until 2024 the company will receive an incremental increase that will be based on the difference between revenues projected during the tariff review and actual revenues billed by the company. The new tariff also lowers the minimum consumption level that Sanepar can charge to its customers to 5 cubic meter (m3) down from 10 m3 previously.

The tariff review is credit positive for Sanepar because the immediate 8.53% tariff increase will support a higher free cash flow generation and will have a positive impact on the company's credit metrics. Based on the company's projections of an average year on year growth in water and sewage volumes of 1.7%, we expect Sanepar's FFO to Net debt ratio will reach a range of 35-37% in 2017, compared to around 31-33% under the previous inflation pass-through model. This compares to a ratio of 43% reported in 2016 and reflect our expectation that the company's investment program will absorb a large portion of free cash flows in 2017.

The tariff review also brings transparency and visibility to the tariff setting mechanism which will support more predictable cash flow generation for Sanepar in future. Prior to this review Sanepar's tariffs were adjusted through an inflation pass-through model which did not consider the remuneration of capital investments. Tariffs were also regulated by a department of the state of Parana which was exposed to political influence, evidenced by the absence of any tariff adjustments during the years 2006-2010 (see exhibit 1 below). In December 2016, the responsibility to regulate Sanepar's activities were transferred to Agepar, an entity financially independent from the state's governments, in charge of infrastructure activities within the state.

Exhibit 1

Not always consistent in the past, Sanepar's tariff increases will be more predictable going forward

Source: Agepar, Sanepar, Moody's estimates

Sanepar's future investments will now be partly covered by front-loaded tariff adjustments which will ease the company's free cash flow generation and liquidity profile. Sanepar has planned an ambitious BRL 4.4 billion capital expenditure program from 2017 through 2021 to reduce current water losses and increase its sewage services to the population in its concession area. 2017 will be particularly capital intensive for the company with a planned BRL 1.1 billion (around 30% of revenues, compared to BRL 0.7 billion/20% of revenues reported in 2016) in investments mainly on the expansion of the sewage treatment unit serving the municipalities of Curitiba and Sao Jose dos Pinhais and the expansion of sewage collections on the coastal region of the state of Parana.

The unusually long period of eight years covering the new tariff increase leaves some room for politically-charged decision that could affect the execution of the tariff increase. Although financially independent from the state government we do not see Agepar as completely immune from political influence towards the setting of tariff going forward. The regulator's executive board members are appointed by the state's government. We also note that unlike more experienced water regulatory agencies in the states of Sao Paulo and Minas Gerais, Agepar started to operate in 2012 to regulate the state's toll roads and therefore lacks track record in regulating the water and sewage sector.

The ratings of Sanepar are currently constrained by the ratings of the [state of Parana \(Ba3, A1.br stable\)](#) and reflects our view that the state, as majority shareholder can exert significant influence over Sanepar's strategic decisions and dividend policy, which in turn can have material impact on the company's credit profile. We also note that a significant portion of the company's revenue is driven by tariff review decisions from the regulator AGEPAR whose members are appointed by the state government.

Headquartered in Curitiba, Brazil and founded in 1963, Sanepar is a water and sewage utility company operating in the Brazilian state of Parana. As of December 31, 2016, Sanepar had more than 3 million water connections and more than 1.9 million sewage connections and provided treatment and distribution of water to more than 10 million consumers and sewage service to 345 municipalities accounting for approximately 86% of the total municipalities in the state of Paraná, and one municipality in the state of Santa Catarina (unrated). Sanepar is controlled by the state of Paraná which owns 89.8% of Sanepar's voting shares and by Domino Holdings S.A. (not rated) which owns 9.7%.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moody's.com for the most updated credit rating action information and rating history.

Moody's Related Research

[Credit Opinion: Companhia de Saneamento do Parana - SANEPAR: Update following rating outlook change to stable from negative](#)

© 2017 Moody's Corporation, Moody's Investors Service, Inc., Moody's Analytics, Inc. and/or their licensors and affiliates (collectively, "MOODY'S"). All rights reserved.

CREDIT RATINGS ISSUED BY MOODY'S INVESTORS SERVICE, INC. AND ITS RATINGS AFFILIATES ("MIS") ARE MOODY'S CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES, AND MOODY'S PUBLICATIONS MAY INCLUDE MOODY'S CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES. MOODY'S DEFINES CREDIT RISK AS THE RISK THAT AN ENTITY MAY NOT MEET ITS CONTRACTUAL, FINANCIAL OBLIGATIONS AS THEY COME DUE AND ANY ESTIMATED FINANCIAL LOSS IN THE EVENT OF DEFAULT. CREDIT RATINGS DO NOT ADDRESS ANY OTHER RISK, INCLUDING BUT NOT LIMITED TO: LIQUIDITY RISK, MARKET VALUE RISK, OR PRICE VOLATILITY. CREDIT RATINGS AND MOODY'S OPINIONS INCLUDED IN MOODY'S PUBLICATIONS ARE NOT STATEMENTS OF CURRENT OR HISTORICAL FACT. MOODY'S PUBLICATIONS MAY ALSO INCLUDE QUANTITATIVE MODEL-BASED ESTIMATES OF CREDIT RISK AND RELATED OPINIONS OR COMMENTARY PUBLISHED BY MOODY'S ANALYTICS, INC. CREDIT RATINGS AND MOODY'S PUBLICATIONS DO NOT CONSTITUTE OR PROVIDE INVESTMENT OR FINANCIAL ADVICE, AND CREDIT RATINGS AND MOODY'S PUBLICATIONS ARE NOT AND DO NOT PROVIDE RECOMMENDATIONS TO PURCHASE, SELL, OR HOLD PARTICULAR SECURITIES. NEITHER CREDIT RATINGS NOR MOODY'S PUBLICATIONS COMMENT ON THE SUITABILITY OF AN INVESTMENT FOR ANY PARTICULAR INVESTOR. MOODY'S ISSUES ITS CREDIT RATINGS AND PUBLISHES MOODY'S PUBLICATIONS WITH THE EXPECTATION AND UNDERSTANDING THAT EACH INVESTOR WILL, WITH DUE CARE, MAKE ITS OWN STUDY AND EVALUATION OF EACH SECURITY THAT IS UNDER CONSIDERATION FOR PURCHASE, HOLDING, OR SALE.

MOODY'S CREDIT RATINGS AND MOODY'S PUBLICATIONS ARE NOT INTENDED FOR USE BY RETAIL INVESTORS AND IT WOULD BE RECKLESS AND INAPPROPRIATE FOR RETAIL INVESTORS TO USE MOODY'S CREDIT RATINGS OR MOODY'S PUBLICATIONS WHEN MAKING AN INVESTMENT DECISION. IF IN DOUBT YOU SHOULD CONTACT YOUR FINANCIAL OR OTHER PROFESSIONAL ADVISER. ALL INFORMATION CONTAINED HEREIN IS PROTECTED BY LAW, INCLUDING BUT NOT LIMITED TO, COPYRIGHT LAW, AND NONE OF SUCH INFORMATION MAY BE COPIED OR OTHERWISE REPRODUCED, REPACKAGED, FURTHER TRANSMITTED, TRANSFERRED, DISSEMINATED, REDISTRIBUTED OR RESOLD, OR STORED FOR SUBSEQUENT USE FOR ANY SUCH PURPOSE, IN WHOLE OR IN PART, IN ANY FORM OR MANNER OR BY ANY MEANS WHATSOEVER, BY ANY PERSON WITHOUT MOODY'S PRIOR WRITTEN CONSENT.

All information contained herein is obtained by MOODY'S from sources believed by it to be accurate and reliable. Because of the possibility of human or mechanical error as well as other factors, however, all information contained herein is provided "AS IS" without warranty of any kind. MOODY'S adopts all necessary measures so that the information it uses in assigning a credit rating is of sufficient quality and from sources MOODY'S considers to be reliable including, when appropriate, independent third-party sources. However, MOODY'S is not an auditor and cannot in every instance independently verify or validate information received in the rating process or in preparing the Moody's publications.

To the extent permitted by law, MOODY'S and its directors, officers, employees, agents, representatives, licensors and suppliers disclaim liability to any person or entity for any indirect, special, consequential, or incidental losses or damages whatsoever arising from or in connection with the information contained herein or the use of or inability to use any such information, even if MOODY'S or any of its directors, officers, employees, agents, representatives, licensors or suppliers is advised in advance of the possibility of such losses or damages, including but not limited to: (a) any loss of present or prospective profits or (b) any loss or damage arising where the relevant financial instrument is not the subject of a particular credit rating assigned by MOODY'S.

To the extent permitted by law, MOODY'S and its directors, officers, employees, agents, representatives, licensors and suppliers disclaim liability for any direct or compensatory losses or damages caused to any person or entity, including but not limited to by any negligence (but excluding fraud, willful misconduct or any other type of liability that, for the avoidance of doubt, by law cannot be excluded) on the part of, or any contingency within or beyond the control of, MOODY'S or any of its directors, officers, employees, agents, representatives, licensors or suppliers, arising from or in connection with the information contained herein or the use of or inability to use any such information.

NO WARRANTY, EXPRESS OR IMPLIED, AS TO THE ACCURACY, TIMELINESS, COMPLETENESS, MERCHANTABILITY OR FITNESS FOR ANY PARTICULAR PURPOSE OF ANY SUCH RATING OR OTHER OPINION OR INFORMATION IS GIVEN OR MADE BY MOODY'S IN ANY FORM OR MANNER WHATSOEVER.

Moody's Investors Service, Inc., a wholly-owned credit rating agency subsidiary of Moody's Corporation ("MCO"), hereby discloses that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by Moody's Investors Service, Inc. have, prior to assignment of any rating, agreed to pay to Moody's Investors Service, Inc. for appraisal and rating services rendered by it fees ranging from \$1,500 to approximately \$2,500,000. MCO and MIS also maintain policies and procedures to address the independence of MIS's ratings and rating processes. Information regarding certain affiliations that may exist between directors of MCO and rated entities, and between entities who hold ratings from MIS and have also publicly reported to the SEC an ownership interest in MCO of more than 5%, is posted annually at www.moody.com under the heading "Investor Relations — Corporate Governance — Director and Shareholder Affiliation Policy."

Additional terms for Australia only: Any publication into Australia of this document is pursuant to the Australian Financial Services License of MOODY'S affiliate, Moody's Investors Service Pty Limited ABN 61 003 399 657AFSL 336969 and/or Moody's Analytics Australia Pty Ltd ABN 94 105 136 972 AFSL 383569 (as applicable). This document is intended to be provided only to "wholesale clients" within the meaning of section 761G of the Corporations Act 2001. By continuing to access this document from within Australia, you represent to MOODY'S that you are, or are accessing the document as a representative of, a "wholesale client" and that neither you nor the entity you represent will directly or indirectly disseminate this document or its contents to "retail clients" within the meaning of section 761G of the Corporations Act 2001. MOODY'S credit rating is an opinion as to the creditworthiness of a debt obligation of the issuer, not on the equity securities of the issuer or any form of security that is available to retail investors. It would be reckless and inappropriate for retail investors to use MOODY'S credit ratings or publications when making an investment decision. If in doubt you should contact your financial or other professional adviser.

Additional terms for Japan only: Moody's Japan K.K. ("MJJK") is a wholly-owned credit rating agency subsidiary of Moody's Group Japan G.K., which is wholly-owned by Moody's Overseas Holdings Inc., a wholly-owned subsidiary of MCO. Moody's SF Japan K.K. ("MSFJ") is a wholly-owned credit rating agency subsidiary of MJJK. MSFJ is not a Nationally Recognized Statistical Rating Organization ("NRSRO"). Therefore, credit ratings assigned by MSFJ are Non-NRSRO Credit Ratings. Non-NRSRO Credit Ratings are assigned by an entity that is not a NRSRO and, consequently, the rated obligation will not qualify for certain types of treatment under U.S. laws. MJJK and MSFJ are credit rating agencies registered with the Japan Financial Services Agency and their registration numbers are FSA Commissioner (Ratings) No. 2 and 3 respectively.

MJJK or MSFJ (as applicable) hereby disclose that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by MJJK or MSFJ (as applicable) have, prior to assignment of any rating, agreed to pay to MJJK or MSFJ (as applicable) for appraisal and rating services rendered by it fees ranging from JPY200,000 to approximately JPY350,000,000.

MJJK and MSFJ also maintain policies and procedures to address Japanese regulatory requirements.

REPORT NUMBER

1069145