

# MOODY'S

## INVESTORS SERVICE

### Credit Opinion: Concessionaria de Rodovias do Interior Paulista

Global Credit Research - 14 Dec 2015

Sao Paulo, Brazil

#### Ratings

Category	Moody's Rating
Outlook	Rating(s) Under Review
Issuer Rating -Dom Curr	*Baa3
Senior Unsecured -Dom Curr	*Baa3
NSR Senior Unsecured	*Aa1.br
NSR LT Issuer Rating	*Aa1.br

\* Placed under review for possible downgrade on December 10, 2015

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#### Key Indicators

[1]Concessionaria de Rodovias do Interior Paulista	9/30/2015(L)	12/31/2014	12/31/2013	12/31/2012
Cash Interest Coverage	2.7x	3.7x	5.1x	4.3x
FFO / Debt	22.0%	20.6%	27.0%	36.7%
Moody's Debt Service Coverage Ratio	2.0x	1.6x	1.9x	2.7x
RCF / Capex	1.7x	1.7x	3.4x	5.1x
Concession Life Coverage Ratio	2.9x	2.4x	2.8x	4.2x

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations. Source: Moody's Financial Metrics

Note: For definitions of Moody's most common ratio terms please see the accompanying [User's Guide](#).

#### Opinion

##### Rating Drivers

- Strong asset features in a historically economically robust service area
- Track record of high dividend distributions
- Expected higher leverage to fund capital expenditures at Arteris' federal concessions
- Relatively tight liquidity profile

- Perceived deterioration of the legal and regulatory framework

## **Corporate Profile**

Concessionaria de Rodovias do Interior Paulista S.A. ("Intervias" or the "Company") is an operating subsidiary of Arteris S.A. (Arteris, not rated). Arteris (f/k/a OHL Brasil S.A.) is a holding company with approximately 3,250 kilometers of operating toll roads under concession in Brazil consisting of four concessions in the state of Sao Paulo (Baa3, rating under review) and five federal concessions in the states of Sao Paulo, Minas Gerais, Rio de Janeiro, Parana and Santa Catarina. Combined tolled traffic was 726 million equivalent vehicles in FY 2014 (717 million in FY 2013). In the LTM June 2015, Intervias reported net sales of BRL357 million, EBITDA of BRL341 million and net profit of BRL126 million using Moody's standard adjustments.

Intervias has a 28-year concession to operate the toll road services of seven small adjacent roads in the interior of the state of Sao Paulo, which was granted by the State of Sao Paulo under a single concession in 2000, which leaves 13 years remaining.

Intervias is indirectly controlled by Abertis Infraestructuras S.A. (Abertis, not rated) and by Brookfield Brazil Motorways Holdings SRL, (Brookfield Brazil, not rated) through their respective ownerships of 51% and 49% in Participes en Brasil S.L. (Participes, not rated), which owns 69.3% of Arteris. Abertis, a company listed on the Spanish stock exchange for more than 25 years, having been included in the IBEX 35 since its creation. It operates in two sectors in 12 countries: highway concessions and telecommunications infrastructure with public private partnership contracts and highway concessions worldwide.

Brookfield Brazil Motorways Holdings SRL is indirectly controlled by Brookfield Asset Management Inc., a company listed on the NYSE and the Toronto Stock Exchange, with more than US\$200 billion in assets under management. Brookfield Asset Management has been operating in Brazil since 1899, with a direct or indirect presence in about half of the Brazilian states with revenues of \$1.8 billion (10% of the group's total sales) and assets of \$11.8 billion (9% of the group's total assets). In Brazil, it operates primarily in the real estate, renewable energy, infrastructure and private equity segments.

## **Recent Developments**

On December 10, 2015, Moody's placed Intervias' ratings under review for possible downgrade.

On December 09, 2015, Moody's placed Brazil's government bond rating under review for possible downgrade.

On August 12, 2015, Moody's affirmed Intervias' issuer rating at Baa3 on the global scale and Aa1.br on the national scale. At the same time, Moody's affirmed the ratings on BRL600 million in Brazilian debentures due in 2018 at Baa3 and Aa1.br on the global and national scale, respectively. The ratings on BRL375 million in Brazilian debentures were also affirmed at Baa3 on the global scale and Aa1.br on the national scale. Outlook was changed to negative from stable for all ratings.

On August 11, 2015, Moody's downgraded Brazil's government bond rating to Baa3 from Baa2 and changed the outlook on the rating to stable from negative.

In July 2015, Intervias' tariff adjustment, which is provided annually pursuant to the concession contract according to the official IGP-M inflation index to the period July 1st 2014 up to June 30, 2015 of 4.11%.

On March 2, 2015 Brazil's President Dilma Rousseff approved Law 13.103 ("Lei dos Caminhoneiros"), which: (i) suspended the idle axles charge for unloaded trucks; (ii) defined the overload weight increase to 10% from 5%, which may result in more maintenance costs for the toll roads; (iii) created more "resting/supporting" areas for trucks/truck drivers; (iv) exonerated truckers from penalties from the last two years related to overload-weight.

On June 30, 2014, Intervias had a 4.67% tariff adjustment approved to the period July 1st, 2013 up to June 30, 2014, 1.62% lower than the inflation rate for the period. Intervias filed a lawsuit against the regulator Artesp to receive the full index amount provided in the concession contract which is the IPC-A of 6.37% for the period. Artesp says the lower percentage is to counterbalance the benefits Intervias had with the 50% reduction of the variable concession fees payable to Artesp to 1.5% from the previous 3.0% of gross toll revenues and by the change of idle truck axles since July 28, 2013.

On September 03, 2013, Moody's America Latina (Moody's) assigned the Baa3 rating on the global scale (domestic currency), and Aa1.br National Scale Rating (NSR) to the 5-year BRL600 million senior, unsecured, non-convertible debentures (the "Third Issuance"), issued by Intervias. The proceeds of the Third Issuance were

used to prepay the outstanding amount (BRL304.5 million) of the First and Second Issuances maturing in 2015 as well as for general corporate purposes, including CAPEX and dividend distributions. The issuance took place in the fourth quarter of 2013.

On June 24, 2013, the Governor of the State of Sao Paulo suspended the annual tariff adjustment for toll road concessionaires. Toll tariffs, which were scheduled to be adjusted for inflation on July 1st, were frozen for one year, until July 1, 2014. The Governor's decision followed intense public protests against tariff increases (later revoked) in the public transportation system in the city of Sao Paulo.

In August 2012, Abertis and OHL Concesiones S.A. (OHL, Ba2, negative) reached an agreement through which Abertis incorporated 100% of the shares of Participes, previously owned by OHL. As a result, Intervias became indirectly controlled by Abertis and by Brookfield through their respective ownerships of 51% and 49% in Participes. The transaction involved (i) the exchange of 100% of Participes' capital stock for 10% of Abertis' capital stock, (ii) the assumption, by Abertis, of approximately R\$1.2 billion in intercompany loans between OHL and Participes, and (iii) the payment of EUR 10.7 million. In order to consummate the purchase, Abertis formalized an agreement with the Canadian fund Brookfield for the joint acquisition of Participes. All government approvals were received and the transaction was finalized in December 2012, which allowed Abertis to become the global leader in highway management.

### **Rating Rationale**

The Baa3/Aa1.br issuer ratings reflect Intervias' high asset quality, relatively limited competition from alternative routes along with the inherent mature nature of this concession, as evidenced by the strong asset features of its road system located in a well-developed and economically diversified region in the State of Sao Paulo, Brazil (Baa3, rating under review).

The rating under review mainly reflects the constraint of the sovereign rating given the domestic nature of Intervias' operations. Additionally, the rating incorporates expected upcoming increases in leverage as a result of maintenance of high dividend distributions to the holding company to help finance large capital expenditure programs at Arteris' federal concessions, planned contract amendments, further potential political interference from the Government of the State of Sao Paulo, as well as the possible invalidation of the company's concession amendment granted to the company in 2006, extending its concession to January 2028 from February 2020.

Covenants included in the debentures limit intercompany loans and leverage which is limited to a maximum net debt of 3.5x annual EBITDA minus fixed concession payments while also requiring cash coverage of short term debt obligations to be equal to or higher than 1.2x. These covenants are relatively loose given that the net debt to EBITDA ratio was 2.4x in the LTM September 2015 while the cash coverage of short-term debt was higher than 5.0x, according to the definition of the covenants.

### **DETAILED RATING CONSIDERATIONS**

#### **Asset Type and Service Area**

Intervias has a 28-year concession to operate the toll road services of seven small adjacent roads in the interior of the state of Sao Paulo, which the state regulatory agency Artesp granted under a single concession in February, 2000. The seven roads consist of 376 kilometers and 9 toll plazas.

From 2009 through 2013, the Company's tolled traffic presented an annual average growth rate of 5.33%, which is almost three times Brazil's GDP growth during the same period. In 2014, tolled traffic increased by 2.2% reaching 66.9 million equivalent vehicles as compared 2013 volume of 65.5 million equivalent vehicles. In the first nine months of 2015, traffic decreased 3.3% when compared to the same period of 2014 as a result of the negative GDP, increasing unemployment, higher inflation which combined resulted in lower income. Comparing the 3Q2015 with the 2Q2015 traffic increased 5.8% while comparing 3Q2015 with 3Q2014 traffic decreased 1.9%.

Intervias' assets have operated historically within a small but economically robust service area. The mature and essential nature of the concession is evidenced by its strong operating performance. Alternative routes in the region are either charging the same tariff per km, or not tolled at all, but with inferior service quality. Therefore, we expect limited competition over the remaining life of the concession. The region covered by the concession includes nineteen cities with an estimated population of around 1.7 million people.

The economic base of this service area is somewhat diversified with agricultural businesses and educational services. Some of the largest public universities - ESALQ, UFScar and Unesp - are located in Piracicaba, Araras, Sao Carlos and Rio Claro. In Sao Carlos, there is also a concentration of high technology industries, such as the

site for the maintenance of AIRBUS turbines. The primary agricultural product of the region has been sugar cane for ethanol. The robustness of the service area is also supported by traffic related to the transportation of industrialized products to and from the North of the state of Sao Paulo and the South of the state of Minas Gerais. This contributes to a higher diversification of traffic in the region. Despite a relatively strong economic base, a higher rating on this sub-factor is limited by uncertainty about the demographic trends over time.

As Brazil's largest state, Sao Paulo has a population of about 40 million and contributes more than one-third of the country's GDP. The State's economic base is highly diversified, reflecting its role as the country's industrial engine. Wealth levels are relatively high compared to the national average, and the State's economic performance has outpaced Brazil's in recent years. We estimate the GDP per capita in the service area of Intervias is currently about USD10,000, which is among the highest in Latin America. Historically, Brazil has had a dynamic market oriented economy characterized by a diversified export base; however, according to Moody's forecast, Brazil's overall GDP growth will be in the range of 3% negative in 2015.

#### Traffic Profile and Performance Trends

Intervias has a strong track record of tolled traffic over its fifteen-year history with an additional 13 years to explore the concession. The user profile consists largely of freight vehicles, the behavior of which is more volatile than commuter traffic mainly at times of economic contraction. Heavy truck usage has historically represented 63% of the road traffic in terms of equivalent vehicles and is a result of the active economic activity in the region including both industrial production and agribusiness.

Commercial vehicles tend to correlate highly in their activity with GDP performance, but while the commercial traffic in the region grew 31.0% from 2009 to 2014, Brazil's GDP increased only 16.9% in the same period, reflecting the strong performance of the local economy. In the first nine months of 2015, toll traffic more closely followed GDP and decreased 3.3% if compared to the same period of 2014. In the first nine months of 2015, commercial traffic dropped 5.4% while light vehicle traffic increased 0.5%. According to our forecast, traffic should reduce about 4% during 2015 and 2% in 2016 as the country will continue to suffer from negative GDP growth, high inflation and increasing unemployment.

#### Concession and Regulatory Framework

Although we have historically considered the regulatory environment for toll road concessions in Brazil, and specifically in the State of Sao Paulo where the company has its concession, as stable and supportive of privately-managed concessions, recent actions by both the Brazilian Federal Government as well as the State of São Paulo and its transportation regulatory agency - ARTESP, have changed our opinion about the quality and the predictability of the sector legal and regulatory environment in the country.

The most recent example of, in our opinion, the sector's deteriorating regulatory environment has taken place in the State of Sao Paulo. Although ARTESP has historically been generally supportive of toll road concessionaires, as demonstrated by prior amendments to the company's concession contract executed between Intervias and ARTESP in 2006 which restored the economic/financial equilibrium of the concession contract to compensate for additional investments and tax charges that had not been contemplated in the concession contract that was signed when the concession was granted. There is an action the court contesting the Amendment 16/2006 which had rebalanced the aforementioned agreement in favor of the company's concession through an extension of the concession from February 2020 to January 2027. Intervias, in response, filed an appeal against ARTESP's action, which in the case of the company is in the first instance.

The scope of required investments is typically addressed in the concession agreements. Compensation for additional investments or changes in the business circumstances are generally subject to negotiation, which has occurred successfully with several concessions in the State of Sao Paulo. The regulator may change the terms of the concession contracts, as long as it provides conditions to restore or maintain the economic and financial equilibrium of the original concession contract.

Another example of political interference occurred in 2013 when toll road tariffs were frozen in the State of São Paulo. Until 2013, toll tariffs were adjusted annually in July by inflation according to the general price index (IGP-M). In June 2013; however, the Sao Paulo State Governor announced the suspension of the annual tariff adjustments until July 2014, allegedly as a result of protests and civil unrest that took place in the State of Sao Paulo in response to the announced tariff adjustments (later revoked) of the public means of transportation.

In order to preserve the financial-economic equilibrium of the concession contracts of the SP toll road concessionaires, the main compensatory measures announced by the State Governor were: (i) a 50% reduction

of the variable concession fees, payable to the State regulatory agency - ARTESP, to 1.5% from current 3.0% of gross toll revenues; (ii) idle truck axles would begin to be charged; and (iii) reduction or exemption of the fixed concession payments to the granting authority for those concessionaires that do not have delays in scheduled construction works defined in their respective concession contracts.

Although the decision to restore the economic/financial equilibrium of the affected concessions signaled ARTESP's support of toll road framework in the State of SP, in July 2014 the Sao Paulo State Government did not authorize the full-inflation tariff adjustment, as contemplated in the concession contracts, which led several concessionaires to file lawsuits against the regulator. Furthermore, in March 2015, the Federal Government enacted Law 13,103, which suspended the charge for idle axles for unloaded trucks that had been authorized by the State Government in 2013, and, at the same time, increased the overload weight limit to 10% from 5%, thus increasing maintenance expenses of the toll road concessionaires.

Given the aforementioned events, we have adjusted the rating of sub-factor 3b, "Protection Provided by the Concession and Regulatory Framework" of our methodology "Privately Managed Toll Roads" to Ba from Baa, which reflects our perception of higher political interference and increased uncertainty as to the consistency and predictability of the concession and regulatory framework in the toll road sector in Brazil.

#### Factor 4: Financial Policy

Among Arteris' concessions in the State of Sao Paulo, Intervias stands out as the one with the most significant planned CAPEX other than maintenance such as: (i) duplication of approximately 25 kilometers in the region Araras / Rio Claro from 2017 to 2018; (ii) duplication of about 21 kilometers in the region Limeira / Engenho Coelho started in 2014 and expected to be concluded in 2015; (iii) duplication of about 16 kilometers in the region of Limeira from 2017 to 2018; (iv) deployment of a contour in Mogi started in 2014 and planned to be concluded 2015; and (v) a smaller deployment of third lanes and overpass and underpass in the roads. CAPEX from 2015 to 2019 will consume an average of approximately BRL100 million per year and should be financed by the Company's current cash position (BRL262 million), cash generation and additional debt issuance.

Revised estimates from Arteris indicate a significant additional amount of CAPEX (BRL4 billion) will be spent between 2015 and 2018, mostly related to its five federal concessions, which had their respective concession contracts amended given delays due to environmental licensing, project redesign, and land expropriations.

Nevertheless, the negative economic impact resulting from said delays has been relatively minor to date. The financing for this CAPEX is expected to come from a combination of dividends and intercompany loans from the state owned concessions and new debenture issuances as well as additional financing from BNDES.

Currently, the group has about BRL300 million of long term credit lines (up to 15 years) approved by BNDES to finance its planned CAPEX. Although Arteris' access to the capital markets and to the BNDES has been resilient, significant additional investments could lead to a deterioration in liquidity and further borrowing needs when access to the capital markets are less favorable.

Consequently, the ratings of Intervias are constrained by the significant cash needs of Arteris, the parent company, which is forecasted to require sizeable dividends as well as increased leverage in order to help fund the ongoing and new CAPEX investments at the federal toll road concessions. Consequently, the rating for the Financial Policy factor is Ba to reflect this expected aggressive financial strategy. However, the following financial covenants embedded in the BRL600 million Debentures issued in September 2013 and in the BRL375 million Debentures issued in October 2014 limit the Company's re-leveraging capability, a financing mechanism which we believe will be pursued by the Company to raise funds to on-lend to the parent company in the form of related-party debt: 1) Net Debt-to-EBITDA less fixed concession payments equal to or less than 3.5x. 2) Debt Service Coverage Ratio equal to or higher than 1.2x. It is our understanding that these intercompany loans will be repaid from financings to be undertaken at the federal concessions or at the parent level at a later date.

Given Intervias' EBITDA of BRL350 million per year on average over the next five years and capital expenditures of approximately BRL170 million per year, our forecast shows overall credit metrics remaining adequate for the rating category even if Intervias continues to maintain a dividend pay-out in the range of 95%.

#### Factor 5: Coverage and Leverage

Intervias' credit metrics are adequate for the rating category. Average Funds From Operations (FFO)-to-Debt ratio from 2013 to the LTM September 2015 was 24.1% while the average Cash Interest Coverage ratio was 3.9x in the same period. RCF to Capex was 2.4x in the same period despite of the high dividend distributions to its holding

company parent to finance the high CAPEX demanded by the five Federal toll roads concessions controlled by Arteris.

Intervias' leverage as measured by the Net-Debt-to-EBITDA ratio increased from 1.4x in 2013 to 2.3x in the LTM September 2015 as the company increased its debt position through the issuance of a 5-year BRL600 million debentures of which BRL304.5 million was used to prepay the outstanding amount of the First and Second Debentures Issuances while the remaining portion was transferred to its parent via dividends and intercompany loans to finance the CAPEX of the federal concessions. Additionally, in October 2014 the company issued a BRL375 million 5-year debenture, resources which were mostly transferred to Arteris in 2015. We believe the transfer of intercompany loans will cease as the limit amount of BRL300 million included in the indenture of the debentures was totally reached with the additional intercompany loan of BRL300 million made in the first semester of 2015.

As a result, net debt increased from BRL394 million as of December 31, 2013 to BRL809 million as of September 30, 2015. Intervias has BRL32 million of fixed concession liabilities to be paid during the remaining life of the concession. For comparative purposes with other rated toll roads, we have adjusted Intervias' debt to include the present value of these concession liabilities, as per Moody's standard adjustments for operating leases.

The major risks for the company not achieving these ratios in the financial projections are traffic volume and tariff adjustments falling below our expectation because of further material delays in carrying out the planned capital expenditures and suspension or delays in implementing expected tariff adjustments. Another risk is the company raises additional debt to transfer further resources to its holding company parent.

## Liquidity

Intervias has an adequate liquidity position in light of its cash position of BRL262 million as of September 30, 2015 and the company's favorable debt profile represented by its BRL600 million debentures which will be repaid in three installments in September 2016, 2017 and 2018 and the BRL375 million debentures that will be repaid in three installments in October 2017, 2018 and 2019.

Intervias' strong cash flow has allowed the accumulation of cash over the years while the debenture issuances have clearly provided the company with a better debt profile. We expect that free cash flow will remain negative over the next years due to the aggressive dividend pay-out and high volume of CAPEX at least up to 2017 period when the company has the highest volume of CAPEX to be made.

## FORWARD LOOKING PERSPECTIVE

We used the following assumptions in our base-case, forward-looking perspective, which, according to Moody's Privately Managed Toll Roads methodology, covers the five-year period from 2015 to 2019:

1. Our base case assumes the continued re-leveraging of the Company as we expect the maintenance of high dividend payments, in line with management's assumptions as well as the Company's track record. In addition, we have assumed marginally higher CAPEX (with a 5% cost overrun). About 70% of the capital investments are related to expansion CAPEX, as per the concession contract while 30% is related to maintenance CAPEX. In our five-year forward-looking perspective (2015 to 2019) we project BRL820 million of total CAPEX (maintenance and expansion).
2. Tariffs will continue to be adjusted by inflation from 2016 to 2019.
3. The Company's traffic volume will grow less than Brazil's GDP, from 2015-2019 due to the mature nature of the concession. We are being slightly more conservative than the company, mainly as a result of a more challenging macroeconomic scenario.
3. The reduction of the variable concession fee to 1.5% from 3.0% will continue over the projected period, as will the non-charging of trucks' idle axles.
4. We are assuming an average pay-out ratio of 95% from 2015 to 2019. Average maintenance CAPEX of BRL50 million per year from 2015-2019). The forecasted CAPEX increases up to 2017 and reduces going forward with average CAPEX of BRL110 million per year, which is in line with the company's forecast. As a result, we expect that the RCF/CAPEX ratio will stay at around 0.7x on average in the next five years.
5. Covenants: Our projections indicate that Intervias will continue to meet the Net Debt / EBITDA ratio of 3.5x, which will gradually increase from 2.3x in the LTM September 2015 to 2.7x in 2019. As to the Debt Service

Coverage Ratio, it will continue to remain much higher than the 1.2x required by the debentures as it was 28.0x in 2014 and 22.7x in the LTM September 2015.

## Rating Outlook

The ratings of Intervias are currently under review. The review will conclude upon conclusion of the review for downgrade on Brazil's government bond ratings.

## Drivers of Rating Change

In light of the review for downgrade, a rating upgrade is unlikely in the near term. A downgrade on Brazil's government bond ratings could result in a downgrade of the assigned ratings. A rapid deterioration in the company's credit metrics could also prompt a rating downgrade.

## Rating Factors

### Concessionaria de Rodovias do Interior Paulista

Privately Managed Toll Roads Industry Grid [1][2]	Current LTM 9/30/2015		[3]Moody's 12-18 Month Forward ViewAs of 12/14/2015	
	Measure	Score	Measure	Score
<b>Factor 1 : Asset Type and Service Area (25%)</b>				
a) Asset Type	Baa	Baa	Baa	Baa
b) Competing Routes	Aa	Aa	Aa	Aa
c) Economic Resilience of Service Area	Baa	Baa	Baa	Baa
<b>Factor 2 : Traffic Profile and Performance Trends (15%)</b>				
a) Traffic Profile	Ba	Ba	Ba	Ba
b) Track Record and Stability of Tolloed Traffic	A	A	A	A
c) Traffic Density	Baa	Baa	Baa	Baa
<b>Factor 3 : Concession and Regulatory Framework (10%)</b>				
a)Ability and Willingness to Increase Tariffs	Baa	Baa	Baa	Baa
b) Protection Provided by the Concession and Regulatory Framework	Ba	Ba	Ba	Ba
<b>Factor 4 : Financial Policy (10%)</b>				
a) Financial Policy	Ba	Ba	Ba	Ba
<b>Factor 5 : Coverage and Leverage (40%)</b>				
a) Cash Interest Coverage	2.7x	Baa	2.2x	Ba
b) FFO / Debt	22.0%	A	15.5%	A
c) Moody's Debt Service Coverage Ratio	2.0x	Baa	1.5x	Ba
d) RCF / CAPEX	1.7x	A	0.3x	B
e) Concession Life Coverage Ratio	2.9x	Baa	2.9x	Baa
<b>Rating:</b>				
Indicated Rating from Grid Factors 1-5		Baa2		Ba1
Rating Lift				
a) Indicated Rating from Grid		Baa2		Ba1
b) Actual Rating Assigned		Baa3		Baa3

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations. [2] As of 9/30/2015(L); Source: Moody's Financial Metrics [3] This represents Moody's forward view; not the view of the issuer; and unless noted in the text, does not incorporate significant acquisitions and divestitures.

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