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CREDIT OPINION
24 April 2018

Update

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RATINGS

Companhia de Saneamento do Parana - SANEPAR

Domicile	Curitiba, Parana, Brazil
Long Term Rating	Ba2
Type	LT Corporate Family Ratings
Outlook	Stable

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.

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Companhia de Saneamento do Parana - SANEPAR

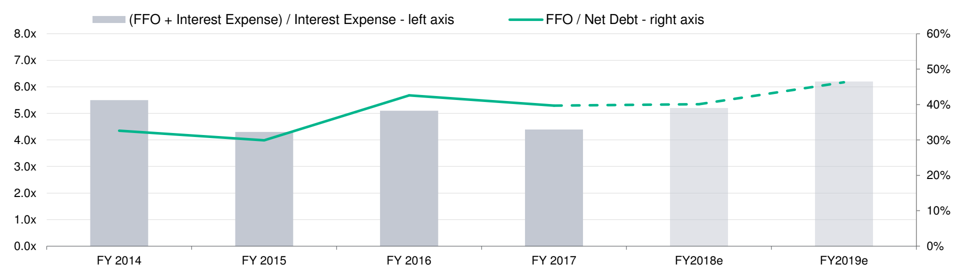
Update following Ba2/Aa2.br rating affirmation, outlook changed to stable from negative

Summary

Companhia de Saneamento do Parana - SANEPAR's (Sanepar, Ba2/Aa2.br stable) credit profile reflects the company's (1) attractive concession area and long-term nature of contracts; (2) strong credit metrics for the category, as illustrated by its funds from operations (FFO)/net debt of 40% and FFO interest coverage of 4.4x as of the year ended December 31, 2017; (3) shift to an improved, although untested, regulatory framework following its first tariff review.

The credit profile is constrained by (1) the company's sizable capital spending program, which will continue to weigh on its cash flow generation; and (2) Brazil's credit quality, with a sovereign bond rating of Ba2 stable.

Exhibit 1
Credit metrics to remain strong



Source: Moody's Financial Metrics™

Credit strengths

» Attractive concession area with long-term contracts

» Strong credit metrics for the rating category

» Improved, although still untested, regulatory framework

Credit challenges

» Sizable capital spending program to continue to strain cash flow generation in 2018

» Tail risks stemming from political intervention into tariffs related to the deferred portion to be applied in the eight years following the 2017 review

Rating outlook

The stable outlook reflects the stable outlook on Brazil's government bond rating and our view that Sanepar's creditworthiness is highly dependent on the credit quality of the sovereign.

Factors that could lead to an upgrade

An upgrade of Brazil's sovereign bond rating, together with the consistent application of a transparent and predictable regulatory framework, and sustained improvements in Sanepar's credit metrics, such that FFO interest coverage and FFO/net debt remain above 6.0x and 45%, respectively, could lead to an upgrade of the ratings.

Factors that could lead to a downgrade

The perception of a material change in the regulatory framework under which Sanepar operates or a disruptive political interference in the normal course of its business could lead to negative pressure on its ratings. A sustained deterioration in the company's credit metrics, such that FFO/net debt declines below 35% and FFO interest coverage moves toward 4.0x, or a deterioration in Brazil's sovereign credit quality could also lead to a downgrade.

Key indicators

Exhibit 2

Companhia de Saneamento do Parana - SANEPAR

	12/31/2013	12/31/2014	12/31/2015	12/31/2016	12/31/2017
FFO Interest Coverage	8.2x	5.5x	4.3x	5.1x	4.4x
Debt / Capitalisation	35.5%	38.6%	40.3%	40.4%	39.4%
FFO / Net Debt	43.0%	32.6%	29.9%	42.6%	39.7%
RCF / Net Debt	31.6%	26.9%	22.7%	35.0%	29.7%

All ratios are calculated using Moody's standard adjustments.
Source: Moody's Financial Metrics™

Profile

Headquartered in Curitiba in the State of Parana (Ba2/Aa2.br stable), Brazil, Companhia de Saneamento do Parana - SANEPAR was founded in 1963. As of December 31, 2017, Sanepar had more than 3.1 million water connections and more than two million sewage connections to provide treatment and distribution of water to more than 10 million consumers and sewage services to 346 municipalities. Of these municipalities, 345 are in the state of Parana and one municipality in the state of Santa Catarina, representing around 86% of the total municipalities in the state of Parana.

Sanepar is controlled by the State of Parana, which owns 60.1% of the company's voting shares, and the remaining portion is in free float. The company also has preferred shares that are spread out among the Government of Singapore (Aaa stable) (3.4%), Bank of Nova Scotia (A1 negative) (2.7%), SPX Falcon (2.0%), municipalities (0.7%) and other holders of listed shares (91.2%).

On December 31, 2017, Sanepar reported net sales of BRL3.9 billion and a net profit of BRL686 million.

Detailed credit considerations

Baseline Credit Assessment (BCA)

The State of Parana controls Sanepar by holding 60.1% of its voting shares. Consequently, Sanepar is considered a government-related issuer (GRI) in accordance with our Government-Related Issuers (GRIs) rating methodology. Our methodology for GRIs incorporates the company's standalone credit risk profile or BCA, as well as the likelihood that the government will provide support to the company to help meet its debt obligations if and when needed.

Sanepar's BCA of ba2 reflects the following factors:

Attractive concession area with long-term contracts

Sanepar benefits from its monopolistic rights to provide water and sewage services, through long-term public concessions in attractive areas, which represent 86% of the total municipalities in Parana, in the south of Brazil. Parana is the fifth-largest state in Brazil by GDP, with a large and diversified economic base, and GDP per capita above the country's average.

Of Sanepar's total concession contracts, 78.6% expire after 2028 and only 4.1% were in the renewal negotiation process as of December 2017. The long-term nature of these contracts sustains the predictability of cash flow generation. The company has a positive track record in renewal-relevant concessions owing to its strong presence in the region. In addition, the company's contract base is quite diversified, with its largest client, the municipality of Curitiba, accounting for less than 25% of total gross revenue, followed by the municipality of Londrina (7.2%), the concession of which the company renewed for a period of 30 years in June 2016.

Through substantial investments in the expansion and maintenance of its network, Sanepar has reached a high level of coverage in terms of the provision of water and sewage services within its concession area compared with its national peers. The company's network covers 100% of households for water services and 70.6% for sewage collection; 100% of the collected sewage is treated.

In line with the median for its peers that we rate, the water loss rate at Sanepar is currently at 34.4% (measured as the relationship between total water produced and made available through the network, and the water that has been consumed) and remains below the national average of 36.7%.

Intensive investment program to continue to strain free cash flow generation in 2018

In recent years, Sanepar's capital spending has absorbed a large portion of its cash flow generation, equivalent to 88% of FFO in the last five years on average. Such high capital spending led the company to report negative free cash flow (FCF) of BRL439 million, BRL310 million and BRL25 million in 2014, 2015 and 2016, respectively. In 2017, the company managed to post positive FCF of BRL56 million, mainly owing to the postponement of mandatory investments, which will be carried out in 2018.

Sanepar has a planned BRL5.7 billion capital spending program from 2018 through 2022 to reduce current water losses and increase its sewage services to the population in its concession area. In 2017, Sanepar advanced the expansion of the treatment unit Belem, serving the municipalities of Curitiba and Sao Jose dos Pinhais, which will triple the sewage capacity treatment at this unit. The company also plans to expand sewage collection in the coastal region of the state of Parana. Owing to its large water and sewage coverage, the company's investment program has relatively lower complexity and, therefore, lower risk of cost overrun.

While we expect Sanepar's capital spending to remain a drag on FCF generation, we note that the company has a long track record of funding its investment program through long-term funding, mostly granted by federal government-owned financial entities, such as Caixa Economica Federal (CEF, Ba2/Aa1.br stable) and Banco Nacional de Desenvolvimento Econômico e Social (BNDES, Ba2/Aa1.br stable). In 2017, funds came mainly from the company's already contracted lines, BRL100 million from CEF and BRL114 million from BNDES. Currently, the company has around BRL1.6 billion of contracted financing lines. Unlike capital market issuances, these lines ensure longer tenors and low interest costs with grace periods.

In 2017, the company's liquidity also benefited from the successful share offering completed in January 2017, which brought BRL257 million in additional funding. The company used 58% of the proceeds (around BRL150 million) toward investment in the expansion of its sewage network, while the rest covered expenses related to voluntary departure and retirement programs. Notwithstanding the intense capital spending program, in particular in 2018 (BRL1.2 billion), we expect the company's FCF to improve in the coming years, driven by continuing growth in operating performance.

Improved, although still untested, regulatory framework

On December 28, 2016, a state law (LC #202) placed Sanepar under the regulatory supervision of AGEPAR, the regulatory agency of the State of Parana, which already regulates toll road and railroad concessions in the state. On March 7, 2017, AGEPAR approved Sanepar's first tariff review, granting the company a 25.63% tariff increase over the next eight years, including an 8.53% increase in May 2017, and a 2.1% increase to be added to each annual tariff inflation adjustments over the next seven years. In April 2018, in Sanepar's first annual tariff adjustment following the tariff review, AGEPAR granted a 5.12% increase in tariff, including the 4.53% portion that was deferred.

Sanepar's first tariff revision and the new regulatory framework are positive for the company because they provide a significant tariff increase to cover costs and investments that will be recognized through its regulated asset base, and provide increased visibility into and transparency in tariff adjustments through an established tariff-setting mechanism for the recovery of future costs and investments.

The shift of regulatory supervision to AGEPAR will also provide more visibility into the tariff review process compared with the previous set-up, wherein the company was regulated through a state department, the Water Institute of Parana, and tariff adjustments were established by decrees under ultimate approval from the state governor. However, AGEPAR is relatively new in its role in the water and sewage sector, and its decisions have been relatively untested at this stage.

Solid operating performance in 2017 and strong credit metrics relative to peers

Sanepar reported strong performance in 2017. The company's revenue grew 11%, mainly driven by the 8.53% tariff adjustment applied from June 2017, and to a certain extent, by increases of 2% and 4.4% in the number of connections for water and sewage services, respectively.

At the same time, EBITDA margin increased slightly to 35.8% in 2017 from 33.7% in 2016, mainly driven by the significant revenue increase but partially offset by provisioned costs related to refinanced taxes settled with the local environmental and renewable agency (IBAMA). Given that this was a one-off event, we do not expect it to further weigh on the margins. In the first quarter of 2016, Sanepar started implementing voluntary retirement programs, and 299 employees had opt for the programs as of year-end 2017. On December 21, 2017, the board approved a new phase of execution for these programs in 2018. The generated benefits will mostly be felt in 2018-19 because currently this gain is being offset by the respective programs' cost.

Owing to the aforementioned reasons, Sanepar's cash flow generation and credit metrics in 2017 were slightly below those in 2016. From 2016 to 2017, FFO/net debt decreased to 39.7% from 42.6%, while FFO interest coverage declined to 4.4x from 5.1x. Nonetheless, these metrics are relatively solid compared with those of its peers that we rate.

We expect Sanepar to continue to report strong operating performance and credit metrics, supported by (1) the expansion of its sewage network, (2) its continuing focus on cost-saving measures through voluntary retirement and dismissal programs, and (3) the positive impact of the tariff revision announced by the regulator in February 2017. Although the unusually long period of eight years to cover new tariff increases leaves some room for politically charged decisions to grant tariff increases, we do not foresee political intervention during this process. The first portion of the deferred tariff was included in the April tariff adjustments, which somehow has shown consistency and continuity on the regulator's decision.

Ratings are constrained by Brazil's credit quality

Sanepar is controlled by the State of Parana, which holds 60.1% of the company's voting shares. Consequently, Sanepar is considered a GRI. Our rating methodology for GRIs incorporates the company's standalone credit risk profile or BCA, as well as the likelihood that the government would provide support to the company to help meet its debt obligations if and when needed. While we expect support from the State of Parana to be forthcoming, based on the strategic importance of the company's water provision and sewage services for the state’s public mission, such support does not benefit Sanepar's ratings, given that the company's standalone BCA of ba2 is higher than that of the State of Parana.

Notwithstanding the importance of potential support from the State of Parana, we believe Sanepar's credit quality is not solely dependent on that of the state government. The company's defined tariff-setting mechanism, strong standalone credit profile and track record of contained state intervention somewhat reduce the risk of disruptive influence from the controlling state government. We note, however, that state governments retain the ability to exert material influence on the direction of water companies through their control over board decisions, including executive management nomination and dividend policies, which in our view would likely limit the distance between the ratings of the company and that of the state.

Sanepar's ratings are also constrained by Brazil's sovereign bond rating, reflecting our view that the company's creditworthiness is highly dependent on Brazil's credit quality, given the influence that the Brazilian government has, for instance, on interest rate and currency fluctuations.

Liquidity analysis

We view Sanepar's liquidity as adequate. As of December 31, 2017, the company had around BRL534 million available in cash, compared with BRL563 million of debt maturities over the next 12 months.

Like most Brazilian companies, Sanepar does not have committed banking facilities to help fund any unexpected cash disbursements. However, the company has a good track record in accessing capital markets on a timely basis. In December 2016, the company raised an additional BRL257 million through a share offering, which was used to cover operational costs. In December 2017, to cover its capital spending needs, the company contracted a line of €50 million with Kreditanstalt fuer Wiederaufbau (KfW, Aaa stable), which will be fully hedged. Additionally, as of year-end 2017, Sanepar contracted a BRL1.6 billion line of credit with CEF to fund future investments.

Sanepar's debt contains maintenance financial covenants, such as net debt/EBITDA and interest coverage ratio to remain below 3.0x and above 1.5x, respectively. As of December 31, 2017, the company was comfortably in compliance with these covenants, with its net debt/EBITDA and interest coverage ratio at 1.6x and 2.3x, respectively. We expect the company to remain compliant with its financial covenants over the next 12-18 months.

Rating methodology and scorecard factors

The principal methodology used in this rating is our Regulated Water Utilities rating methodology, published in December 2015. On a 12-18-month forward-looking basis, Sanepar's rating grid model indicates an outcome of Baa3, two notches above the assigned issuer rating of Ba2. The grid-indicated outcome does not fully reflect other factors such as the constrains on Brazil's government bond rating.

Exhibit 3

Companhia de Saneamento do Parana - SANEPAR

Regulated Water Utilities Industry Grid [1][2]	Current FY 12/31/2017		Moody's 12-18 Month Forward View As of 4/16/2018 [3]	
Factor 1 : Business Profile(50%)	**Measure**	**Score**	**Measure**	**Score**
a) Stability and Predictability of Regulatory Environment	Ba	Ba	Ba	Ba
b) Asset Ownership Model	Ba	Ba	Ba	Ba
c) Cost and Investment Recovery (Sufficiency & Timeliness)	Ba	Ba	Ba	Ba
d) Revenue Risk	Ba	Ba	Ba	Ba
e) Scale and Complexity of Capital Programme & Asset Condition Risk	Ba	Ba	Ba	Ba
Factor 2 : Financial Policy (10%)				
a) Financial Policy	Baa	Baa	Baa	Baa
Factor 3 : Leverage and Coverage (40%)				
a) FFO Interest Coverage (3 Year Avg)	4.6x	A	5x - 6x	A
b) Debt / Capitalisation (3 Year Avg)	40.0%	A	35% - 40%	Aa
c) FFO / Net Debt (3 Year Avg)	37.4%	Aa	35% - 40%	Aa
d) RCF / Net Debt (3 Year Avg)	29.1%	Aa	29% - 33%	Aaa
Rating:				
Indicated Rating from Grid Factors 1-3		Baa3		Baa3
Rating Lift	**0**	**0**		
a) Indicated Rating from Grid		Baa3		Baa3
b) Actual Rating Assigned				Ba2
Government-Related Issuer	**Factor**			
a) Baseline Credit Assessment	ba2			
b) Government Local Currency Rating	Ba2			
c) Default Dependence	High			
d) Support	Moderate			

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations. [2] As of 12/31/2017. [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.

Source: Moody's Financial Metrics™

Ratings

Exhibit 4

Category	Moody's Rating
COMPANHIA DE SANEAMENTO DO PARANA - SANEPAR	
Outlook	Stable
Corporate Family Rating	Ba2
Senior Unsecured -Dom Curr	Ba2
NSR Corporate Family Rating	Aa2.br
NSR Senior Unsecured	Aa2.br

Source: Moody's Investors Service

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