

ISSUER COMMENT

Duke Paranapanema Will Benefit from Its Acquisition by China Three Gorges

From [Credit Outlook](#)

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On 10 October, [Duke Energy Corporation](#) (Baa1 negative) announced that it reached an agreement to sell its operations in Brazil through the disposal of [Duke Energy International Geração Paranapanema S.A.](#) (Duke Paranapanema, Ba2 negative) to [China Three Gorges Corporation](#) (CTG, Aa3 negative) for an enterprise value of \$1.2 billion. The amount is around 4.5x EBITDA based on Duke Paranapanema's EBITDA for the 12 months that ended 30 June 2016. The transaction is credit positive for Duke Paranapanema and is subject to regulatory approvals in Brazil and China.

Duke Paranapanema would benefit from CTG's solid experience in large scale hydroprojects (CTG is the world's largest hydropower operator). With the acquisition of Duke Paranapanema, CTG would become the second-largest hydropower operator in Brazil with an installed capacity of 8.27 GW, which is almost 6% of the country's installed capacity.

Duke Paranapanema would also benefit from CTG's ample and lower-cost funding sources. CTG did not disclose its financing for the acquisition but we believe that it could refinance the company's capital structure under better conditions if it so chooses. A lower interest burden would help Duke Paranapanema improve its funds from operations interest-coverage metrics, which for the 12 months that ended in June 2016, was 4.5x, compared with 6.4x for CTG. Most of Duke Paranapanema's debentures are callable upon premium payment.

CTG's credit quality will not be affected by the sale, given that the acquisition is equivalent to less than 1.5% of the group's assets. We expect that CTG will partially debt fund the acquisition, letting the operating cash flows from the acquired assets offset the incremental debt-service. The deal leverages CTG's expertise in hydropower and strengthens its growing presence in Latin America.

The deal is consistent with CTG's strategy to expand in renewable energy overseas and follows recent acquisitions in the hydropower sector. CTG has been invested in Brazil since 2011, when it purchased a 21.35% stake in [EDP - Energias de Portugal, S.A.](#) (Baa3 stable). More recently in January 2016, CTG added almost 5 GW of installed capacity to its operations in Brazil with the hydroelectric power plants of Jupia and Ilha Solteira operated under a 30-year concession that it won at an auction in November 2015 for BRL13.8 billion (\$3.7 billion).

Duke Paranapanema is an electricity generation company and subsidiary of Duke Energy Corporation, which indirectly holds 99.06% of its voting capital and 95.06% of its total capital. Duke Paranapanema has installed capacity of 2,274 MW (1,125MW of physical energy) in eight hydroelectric power plants along the Paranapanema River and accounts for approximately 1.5% of Brazil's current total installed capacity. In the 12 months that ended 30 June 2016, Duke Paranapanema reported net revenues of BRL1.2 billion (\$348 million) and net profit of BRL295 million (\$80 million).

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China Three Gorges Corporation is a wholly state-owned enterprise directly under the purview of China's State-owned Assets Supervision and Administration Commission of the State Council. CTG was set up in 1993 as the owner and operator of the Three Gorges Project — along the Yangtze River — the largest hydroelectric project globally by total installed capacity. At year-end 2015, CTG had a total hydropower installed capacity of around 60GW and another 28GW planned or under construction until 2021. The company also had an installed capacity of 6GW for wind and solar power.

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