MOODY'S
INVESTORS SERVICE

Credit Opinion: EDP - Energias do Brasil S.A.

Global Credit Research - 26 Apr 2012

Sao Paulo, Brazil

Ratings

Category	Moody's Rating
Outlook	Stable
Issuer Rating -Dom Curr	Ba1
NSR LT Issuer Rating -Dom Curr	Aa2.br
Parent: Energias de Portugal, S.A.	
Outlook	Negative
Issuer Rating	Ba1
Senior Unsecured -Dom Curr	Ba1
Commercial Paper -Dom Curr	NP
Bandeirante Energia S.A.	
Outlook	Stable
Issuer Rating -Dom Curr	Baa3
Subordinate -Dom Curr	Ba1
NSR LT Issuer Rating -Dom Curr	Aa1.br
NSR Subordinate -Dom Curr	Aa2.br
Espirito Santo Centrais Eletricas - ESCELSA	
Outlook	Stable
Issuer Rating -Dom Curr	Baa3
Subordinate -Dom Curr	Ba1
NSR LT Issuer Rating -Dom Curr	Aa1.br
NSR Subordinate -Dom Curr	Aa2.br

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Key Indicators

[1]**EDP - Energias do Brasil S.A.**

ACTUALS	**2011**	**2010**	**2009**	**2008**	**2007**
(CFO Pre-W/C + Interest) / Interest Expense	**5.6x**	**5.6x**	**5.1x**	**3.9x**	**4.2x**
(CFO Pre-W/C) / Debt	**30.9%**	**32.6%**	**32.3%**	**36.2%**	**40.0%**
(CFO Pre-W/C - Dividends) / Debt	**19.6%**	**23.7%**	**24.7%**	**29.3%**	**34.1%**
Debt / Book Capitalization	**38.0%**	**37.5%**	**37.3%**	**38.4%**	**38.9%**

[1] All ratios calculated in accordance with the Regulated Electric and Gas Utilities Rating Methodology using Moody's standard adjustments.

Note: For definitions of Moody's most common ratio terms please see the accompanying *User's Guide*.

Opinion

Rating Drivers

- Solid credit metrics

- The level of support of its parent company, EDP - Energias de Portugal

- Resilient access to the local capital and banking markets

- Lower cash generation for the distribution business due to third tariff review

- Relatively sizeable capital expenditure program

Corporate Profile

Headquartered in São Paulo, Brazil, EDP - Energias do Brasil S.A. (EDB) is a holding company controlled by EDP - Energias de Portugal (EDP, Ba1; negative outlook) with activities in generation, distribution and commercialization of electricity. In 2011, EDB`s power distribution business represented 47.3% of the consolidated EBITDA, the power generation business represented 50.5% and the commercialization of energy represented the remaining 2.2%. The two distribution subsidiaries, Bandeirante and Escelsa, distributed, together 24,544 GWh in 2011 (approximately 5.7% of the electricity consumed in the Brazilian electricity integrated system). The generation business totaled 1,828 MW of installed capacity at year-end 2011 which accounted for approximately 1.6% of the country's electricity installed capacity. EDB reported consolidated net revenues of BRL5.4 billion (USD3.2 billion) and net profit of BRL491 million (USD293 million) in 2011.

Recent Developments

On February 16, 2012, Moody's downgraded Energias de Portugal SA (EDP), its finance subsidiary EDP Finance BV (EDP Finance) and its Spanish subsidiary, Hidroelectrica del Cantabrico (HC Energia) to Ba1 from Baa3. Moody's has also downgraded the rating of EDP and EDP Finance's EMTN programme to (P)Ba1 from (P)Baa3. Concurrently, Moody's downgraded the short-term ratings of EDP, EDP Finance and HC Energia to Not-Prime from Prime-3. The assigned outlook on all affected ratings was negative.

These announcements followed Moody's decision to downgrade the Republic of Portugal's sovereign rating to Ba3 with a negative outlook from Ba2 with a negative outlook, as announced on 13 February 2012.

On December 22, 2011, China Three Gorges acquired 21.4% of the capital of EDP Portugal for 2.7 billion Euros.

In July 2011, EDB's parent EDP Portugal sold 13.8% of the voting shares of EDB for BRL 811 million, reducing its participation in the company to 51% from 64.8%.

On July 08, 2011 Moody's downgraded the senior unsecured ratings of EDP - Energias de Portugal SA, its finance subsidiary EDP Finance BV ("EDP Finance") and its Spanish subsidiary, Hidroelectrica del Cantabrico ("HC Energia") to Baa3 from Baa1. Moody's has also downgraded the rating of EDP's and EDP Finance's Euro Medium Term Note programme to (P)Baa3 from (P)Baa1. The outlook assigned to the ratings was negative.

This rating action concluded the review initiated on 6 April 2011 and followed the earlier downgrade of the rating of the government of the Republic of Portugal ("RoP") to Ba2 with a negative outlook from Baa1, on review for downgrade.

On June 16, 2011, EDP-Energias do Brasil S.A. (EDB; Ba1,stable) announced the acquisition of the exploitation rights of the 373MW Santo Antonio do Jari hydropower plant (214.5 of assured energy) for an estimated amount of around BRL 1.4 billion, which included the price to be paid to the previous shareholders and capital expenditures.

SUMMARY RATING RATIONALE

EDB's rating reflects the group's overall investment grade credit metrics, resilient access to the local capital and banking markets, conservative management and the relatively stable cash flows from the distribution business of its operating subsidiaries Bandeirante and Escelsa. The ratings are constrained by the relatively high 50% dividend pay-out ratio at the level of the parent company , a fairly sizeable capital expenditure program and the inherent risks associated with the completion of the 720MW Pecem I thermoelectric power plant project.

EDB's Ba1 issuer rating is one notch lower than the Baa3 Issuer Rating of its subsidiaries, Bandeirante, Escelsa and Energest, to reflect the potential structural subordination of its debt to the existing debt at the level of its operating subsidiaries.

DETAILED RATING CONSIDERATIONS

SOLID CREDIT METRICS

EDB has posted healthy profitability and stable cash generation on a consolidated basis in the past four years. This is evidenced by the CFO Pre WC over debt ratio which has steadily remained above the 30% level during this period. Likewise, interest coverage has also been at very healthy levels for the company' rating category at around 5.4x in the same period.

In 2011, the company's consolidated cash flow remained virtually flat as measured by FFO of BRL 1,387 million slightly up from BRL 1,357 million in 2010. The company's consolidated cash flow has been boosted by the generation segment, which has increased its participation in net sales and EBITDA. Conversely, the distribution segment has somewhat impaired the company's operating margins and cash flow last year. This was largely attributed to the lower-than- expected performance of one of its distribution subsidiaries, Escelsa, which posted lower operating margins and cash flow.

Escelsa's lower cash flow stemmed largely from the combination of two extraordinary events, consisting of the migration of industrial consumers to the free market and lower than expected volume consumption for most of the consumers categories. Volume sales in the regulated market grew by just 2.4% in 2011, below management expectations of around a 5% annual volume growth. The increase of manageable operating costs, mainly consisting of labor and third party costs, by BRL 44 million, also contributed to the lower operating profit in 2011.

In 2011, the lower than expected consumption of electricity and the migration of consumers to the free market forced Escelsa to sell the excess contracted electricity in the spot market at much lower tariffs than previous years. In 2011, Escelsa sold 529 thousand MW/h at an average tariff of BRL 31.5 compared to 410.4 thousand MW/h of energy sold at an average tariff of BRL 103 in 2010, which resulted in around BRL 30 million in net revenue losses and a reduction in FFO by approximately BRL 23 million .

In 2011, Escelsa posted FFO of BRL 250 million or 18% of EDB's consolidated FFO down from FFO of BRL 323 million or 24% of EDB's consolidated FFO in 2010.

Going forward, Escelsa is bound to post growing cash generation through August 2013 when its electricity tariffs will be subject to the regulator's periodic tariff review.

Conversely, the other EDB distribution subsidiary, Bandeirante, which has posted strong cash flows over the past four years is forecast to suffer a dramatic reduction in cash generation over the next couple of years due to the expected lower tariffs from the third tariff review to be implemented in October 2012 with effects retroactive to October 2011. We expect that Bandeirante's lower CFO will be partly offset by a dramatic reduction in the distribution of upstream dividends.

FINANCIAL LEVERAGE TO INCREASE

Moody's expects that EDB will continue to post healthy consolidated cash generation over the medium term horizon. This stems from the growing contribution of the generation businesses with their stable and higher operating margins, which are expected to grow from being 50.4% of the group's cash generation as measured by EBITDA in 2011 to around 58% within the next couple of years.

Nevertheless, we expect a moderate increase of debt in 2012 driven by fairly sizeable capital expenditures of around BRL 1 billion this year, lower contributions from the distribution business along with the continued distribution of significant dividends during this period. We expect that the lower cash generation from Bandeirante will not be offset by the forecasted growing cash flow from Escelsa this year.

Moody's projections indicate a increase in leverage as measured by the CFO pre-W/C to debt ratio, which we estimate will still remain strong for the rating category but now at a lower level around the mid twenties, while the debt to capitalization ratio is expected to average 40% within the next couple of years. The lower cash generation of the distribution segment is expected to be partly offset by the growing cash generation from the generation segment.

COMPLETION RISK OF PECEM PROJECT REMAINS A MAJOR CHALLENGE

The Pecem I thermoelectric power plant, which has been jointly constructed with the local group MPX Energia S.A (unrated by Moody's) represents a major challenge to EDB because of the technical risks associated with the completion of this sizeable project, which could cost as much as BRL 3.2 billion including approximately BRL 300 million of capitalized interest.

The thermoelectric power plant, which was scheduled to come on stream in January 2012, has been delayed because of a couple of strikes from the employees working in the construction site of the thermo plant, unexpected delay in the authorization to start operations along with a particularly wet season in the region, which caused some interruption in the construction works.

The Pecém project is expected not to be much affected as the company's shareholders obtained a formal approval from the regulator to extend the project start date. The regulator agreed that the two turbines could start operating up to July 23, 2012. While there is no assurance the company will succeed, its management is working to make sure the two turbines will be operating within the deadline date agreed with the regulator.

A mitigating factor for covering potential losses stemming from not beginning operations within the agreed deadline date with the regulator is the execution of the guarantee package signed with the EPC, which consists of retained cash owed to the EPC (amount not disclosed) and banking letters of credit (amount not disclosed). According to management, the project level already reached the 98% level of completion and it is relatively in line with the company's project plan. The successful implementation of the Pecém project is likely to reduce the overall business risk of EDB by virtually eliminating the completion and operational risks of the project, enhancing cash generation and improving the group's capital structure.

The major downside risks to this forecast is that any delay in beginning operations, which is not formally approved by the regulator, would force the company to acquire electricity in the market to fulfill its contractual obligations under the PPA agreement. Given a relatively and unusual unexpected dry season over the past weeks, the prices of energy in the spot market are very high at around BRL 190 per MW/h. We will closely monitor the evolvement of the completion of the Pecém project to evaluate the potential impact that a further delay in start operations might have in EDB's cash flow if any.

EVOLVING BRAZILIAN REGULATORY ENVIRONMENT

A major important factor constraining the ratings has been the Brazilian regulatory framework, which has a history of being unpredictable but has undergone substantial change over the past several years. The electricity regulatory model implemented in 2004 has mitigated the uncertainties brought about by constant changes in the Brazilian regulatory framework over the past two decades. This model provides a more supportive environment for acceptable rates of return since the current rules for electric utilities are transparent and technically driven, thus increasing predictability of return on invested capital.

Nonetheless, we still believe there is a lower assurance of timely recovery of costs and investments in Brazil since the new framework has not yet experienced a prolonged period of high inflation, exchange rate devaluation or electricity rationing. Potential future electricity shortages due to a relatively tight reserve margin, limited independence of the regulator and minimal jurisprudence backing the new regulatory framework were also taken into consideration in our evaluation of this factor.

LEVEL OF SUPPORT OF EDP PORTUGAL

The ratings assigned for the EDB group also factor in the ownership of its parent company, EDP Portugal (Ba1; negative outlook). While EDP does not guarantee EDB's debt, the Portuguese parent expects that its subsidiaries will remain financially self sustainable, as stated in its published policies. Moody's believes that the Brazilian operations of EDP play an important role in the group's growth strategy. The recent rating downgrades and changing the outlook to negative could potentially limit the ability of EDP Portugal to eventually step in to support its subsidiaries with a material undertaking in case of financial distress.

In this context, we believe that ownership by EDP does not support a one notch of uplift of the rating on the global scale. EDB's Ba1 issuer rating is largely based on EDB's overall investment grade characteristics on a consolidated basis supported by the steady improvement in credit metrics achieved in the past four years and continued conservative financial management.

Moody's believes that EDP Portugal will continue to support the activities of EDB by preserving the current strong capital structure of its Brazilian subsidiary; however, Moody's will continue to monitor the evolvement of the creditworthiness of EDP Portugal and the potential impact that any further rating deterioration could have on the financial strength of EDB.

We have firm grounds to believe that the Brazilian subsidiaries, mainly the distribution companies, are to a large extent insulated from any potential credit deterioration of their ultimate parent company. This results from regulatory oversight and existing financial covenants embedded in most of the debt contracts, which prevent those subsidiaries from increasing their leverage over a certain agreed limit.

Structural Considerations

EDB's issuer rating is one notch lower than the operating subsidiaries' issuer ratings to reflect the structural subordination of any eventual debt at the holding company level to that of the operating companies where debt levels are expected to increase in the near term as a result of current investment plans. Lenders to operating subsidiaries generally have claims on cash flow that are superior to those of the holding company creditors, which can also restrict the financial flexibility of the holding company.

Liquidity

We deem the liquidity standing of EDB on a consolidated basis as very adequate. At December 31, 2011, EDB reported a sizeable consolidated cash position of BRL 896 million, which comfortably covers short- term debt of BRL 660 million. This strong cash position along with estimated CFO of around BRL1.2 billion will support EDB's planned capital expenditures of around BRL1 billion and dividends of approximately BRL500 million for 2012. We forecast that EDB will need to raise around BRL 700 million not just to meet its cash needs in 2012 but also to maintain its current strong cash position.

Additionally, based upon management's provided information, EDB has around BRL 900 million pre-approved long-term loans from the BNDES, of which just BRL 300 million has been used, and 90 million Euros from EIB, with just 30 million Euros used so far. These resources aim at supporting the capital expenditure program of EDB's operating subsidiaries. Given its proven resilient access to the local banking and capital markets EDB could also access these markets to complement its borrowing needs.

Corporate Governance

EDB has corporate governance practices that are above the average of Latin American issuers. EDB is a publicly listed company with shares traded on the Novo Mercado of Bovespa. While its shares are only traded on the Sao Paulo stock exchange, the company undertook several steps beyond what is legally required to adapt the US Sarbanes-Oxley act as part of its commitment of practicing superior standards of corporate governance

EDB's Board of Directors is made up of eight members, of which four are considered independent (two appointed by minority shareholders). The board relies on three support committees: Audit, Sustainability and Corporate Governance, and Compensation. The Audit and the Sustainability Committees are permanent in nature and are comprised of three members where at least one is independent. There is also a Fiscal Council composed of three members and three alternates elected for a maximum term of one year; however, it is non-permanent and convened only when requested by shareholders.

Rating Outlook

The stable outlook reflects Moody's expectation that EDB will continue to prudently manage capital expenditures and the distribution of dividends in tandem with its cash flow and funding capacity and efficiently handle its liquidity position so that RCF remains above 12% of total debt on a consistent basis.

What Could Change the Rating - Up

The rating or the outlook could be upgraded as a result of greater clarity as to the successful completion of the

Pecem project. This should be followed by an improvement in credit metrics so that retained cash flow to total debt exceeds 25% and interest coverage is higher than 4.5x on a sustainable basis along with Moody's expectation that EDP Portugal will not undertake any actions to materially alter the current capital structure of EDB.

What Could Change the Rating - Down

A downgrade could be triggered by a fall in the RCF over debt ratio below 10% and interest coverage below 3.5x for a prolonged period. Deterioration in the level of supportiveness of the Brazilian regulatory environment for regulated utilities could also prompt a negative rating action.

Rating Factors

EDP - Energias do Brasil S.A.

Regulated Electric and Gas Utilities	Current 12/31/2011		Moody's 12 - 18 month Forward View	
Factor 1: Regulatory Framework (25%)	**Measure**	**Score**	[1]**Measure**	**Score**
a) Regulatory Framework (25%)		Ba		Ba
Factor 2: Ability to Recover Costs and Earn Returns (25%)		Ba		Ba
Factor 3: Diversification (10%)				
a) Market Position (10%)		Baa		Baa
b) Generation and Fuel Diversity (0%)		Baa		Baa
Factor 4: Financial Strength, Liquidity & Financial Metrics (40%) [2]				
a) Liquidity (10%)		Baa		Baa
b) CFO pre-WC + Interest / Interest (7.5%) (3yr Avg)	5.5x	A	3.5x - 3.8x	Baa
c) CFO pre-WC / Debt (7.5%) (3yr Avg)	31.9%	Aa	21.8% - 23.6%	A
d) CFO pre-WC - Dividends / Debt (7.5%) (3yr Avg)	22.6%	A	12.6%	Baa
e) Debt / Capitalization or Debt / RAV (7.5%) (3yr Avg)	37.6%	A	39.4% - 40.7%	A
Rating:				
a) Methodology Implied Issuer Rating		Baa2		Baa3
b) Actual Issuer Rating [3]				Ba1

[1] 12 - 18 month Moody's forecast [2] 3-year historical average [3] Reflects the structural subordination of holding company