MOODY'S
INVESTORS SERVICE

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

Global Credit Research - 04 Aug 2014

*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 | Positive |
| Issuer Rating | Ba1 |
| Senior Unsecured -Dom Curr | Ba1 |
| Commercial Paper -Dom Curr | NP |
| **Espirito Santo Centrais Eletricas - ESCELSA** | |
| Outlook | Stable |
| Issuer Rating -Dom Curr | Baa3 |
| NSR LT Issuer Rating -Dom Curr | Aa1.br |
| **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 |

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## Key Indicators

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

| **ACTUALS** | **2013** | **2012** | **2011** | **2010** | **2009** |
|---|---|---|---|---|---|
| (CFO Pre-W/C + Interest) / Interest Expense | **4.5x** | **4.9x** | **4.3x** | **5.6x** | **5.1x** |
| (CFO Pre-W/C) / Debt | **31.8%** | **27.1%** | **28.7%** | **32.6%** | **32.3%** |
| (CFO Pre-W/C - Dividends) / Debt | **18.5%** | **14.1%** | **17.4%** | **23.7%** | **24.7%** |
| Debt / Book Capitalization | **39.2%** | **37.8%** | **38.3%** | **37.5%** | **37.3%** |

[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

- Adequate credit metrics

- Weaker liquidity at the levels of both the holding company and distribution subsidiaries

- Resilient access to the local capital and banking markets

- Turnaround of the PECEM thermal project

- Relatively high capital expenditures and payment of dividends

- Hydrological Risk

### Corporate Profile

Headquartered in Sao Paulo, Brazil, EDP - Energias do Brasil S.A. (EDB) is a holding company controlled by EDP - Energias de Portugal (EDP, Ba1; positive outlook) with activities in generation, distribution and commercialization of electricity. In 2013, EDB`s power distribution business represented 44.7% of the consolidated EBITDA, the power generation business represented 51.4% and the commercialization of energy represented the remaining 3.9%. The two distribution subsidiaries, Bandeirante and Escelsa, distributed in aggregate 25,907 GWh in 2013 (approximately 5.3% of the electricity consumed in the Brazilian electricity integrated system). The generation business consists of 2,195MW of installed capacity at year-end 2013 which accounted for approximately 1.8% of the country's electricity installed capacity. EDB reported consolidated net revenues of BRL6,771 billion (USD3,134 billion), which does not include BRL325.7 million of construction revenues (USD 150 million) and a net profit of BRL376 million (USD174million) in 2013.

### Recent Developments

On July 30, 2014, Moody's affirmed the Ba1, (P) Ba1 and non-prime ratings of EDP - Energias de Portugal S.A. (EDP), EDP Finance B.V. and Hidroelectrica del Cantabrico SA. The outlook was changed to positive from negative.

On June 27, 2014, the parent holding company EDB announced that it had received from CWE Brasil (unrated), controlled by China Three Gorges (A1 stable), BRL 420.6 million related to the sale of its 50% participation in two major power projects as described in our issuer comment published on December 12, 2013.

In the first half of 2014, EDB's distribution subsidiaries Bandeirante and Escelsa raised BRL 709 million in the local banking market to strengthen their cash position and lengthen their debt profile.

In the first four months of 2014, Bandeirante received BRL 204 million from the Brazilian Electricity Clearing House CCEE to compensate for the increased costs incurred acquiring dispatched thermal power energy.

In 2013, Bandeirante received BRL 355.6 million from the sector's regulatory charge CDE (Energy Development Account).

In the first four months of 2014, Escelsa received BRL 387 million, of which BRL 356 million came from CCEE and BRL 31 million from CDE to compensate for higher costs incurred with the acquisition of energy either because of higher thermal power costs or higher energy costs as a result of the company's involuntary exposure to the spot market due to mandated curtailments of hydro generation.

In 2013, Escelsa received BRL 239.1 million from CDE to compensate for higher costs for the same reasons as above described.

On February 13, 2014, EDB announced it had divested 50% of its 66.7% stake in the Sao Manoel power plant project to CWEI Brasil, a subsidiary of China Three Gorges Corporation (A1 stable).

On December 16, 2013, EDB won an energy auction coordinated by the regulator ANEEL to construct and operate the 700 MW Sao Manoel Hydro power plant (409.5 MW of physical energy) in the state of Mato Grosso scheduled to start operating in May 2018. The project's cost was estimated at BRL 2.7 billion.

On December 12, 2013, EDB announced the sale of a 50% share in two major hydro projects for BRL 870 million to CWE Brasil. The 50% share divestitures were related to the 373.4 MW Santo Antonio de Jari and the 219 MW Cachoeira do Caldeirao power plant projects.

On June 5, 2013, Moody's America Latina Ltda (Moody's) affirmed the ratings of Energias do Brasil S.A. (EDB, Ba1; Aa2.br), Bandeirante Energia S.A (Bandeirante, Baa3; Aa1.br), Espirito Santo Centrais Eletricas S.A. (Escelsa, Baa3; Aa1.br) and Energest S.A. (Energest, Baa3; Aa1.br). The outlook for all ratings remained stable.

On May 10, 2013, PECEM's second turbine started operating. The PECEM thermal project was originally planned to start operating in January 2012 but after several unexpected events the company reached an agreement with the regulator to start full operations in July 2012 without any penalty. Nevertheless, as a result of the start-up delays, PECEM was forced to acquire energy in the spot market at very high prices from July 2012 until the second turbine commenced operations.

On April 11, 2013, EDB issued 3-year BRL 500 million debentures in the local market, which were fully acquired by a local Brazilian bank. These debentures will be amortized in two equal installments in April 2015 and April 2016.

On March 7, 2013, the Federal Government published decree law # 7,945 with the following objectives:

1) Use of financial resources from the sector's regulatory charge CDE (Energy Development Account) to fund distribution companies for additional costs incurred with the acquisition of more expensive thermal power so as to avoid the permanent transfer of these costs to electricity tariffs.

2) Changes in the criterion to calculate PLD (spot prices) by including associated costs with the dispatch of energy out of the order of merit.

3) Costs associated with promoting energy safety are to be shared among all the electricity industry's players including generators, distributors, traders and free consumers.

## SUMMARY RATING RATIONALE

EDB's ratings reflect the group's adequate credit metrics for the rating category and the relatively stable cash flows emanating from the regulated distribution utilities and the long-term supply contracts underpinning the generation business. EDB's resilient access to the local capital and banking markets further supports the ratings. Nevertheless, the ratings are constrained by the deterioration in liquidity, potential losses from exposure to the spot market, expected sizeable capital expenditures and the historically high distribution of dividends.

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

## DETAILED RATING CONSIDERATIONS

ADEQUATE CREDIT METRICS

EDB posted healthy profitability and stable cash generation on a consolidated basis from 2009 through 2011.This is evidenced by the CFO Pre WC (CFO) over debt ratio which steadily remained above the 30% level during this period. Interest coverage was also healthy at 4.9x, which was pretty much in line with the 5.1x average in the previous three years.

In 2012, EDB presented a slight deterioration in credit metrics as measured by CFO Pre- WC of BRL 1.098 million or 27.1% over adjusted debt down from the previous BRL1,270 million three-year average or 31.2% over debt. Interest coverage was 4.9x in 2012, which was pretty much in line with the previous 5.1x three-year coverage average.

EDB's 2012 performance is not directly comparable with the previous years in light of the changes in the consolidation procedures following the new instruction from the Brazilian Securities and Exchange Commission (CVM) issued in December 2012 on new consolidation accounting procedures. Accordingly, EDB published its 2013 consolidated statements along with the restatement of its 2012 consolidated financial statements.

Based on this new accounting instruction, the proportional consolidation of a given subsidiary is no longer allowed; either the holding company consolidates 100% of its majority-owned subsidiary's operations or it recognizes its minority participation through the equity method. The main criterion to consolidate a subsidiary is effective control and influence in the company's management that the shareholder has over this subsidiary.

As a result of the new consolidation accounting procedures, EDB no longer consolidates its 50% share in PECEM but it recognizes its participation through the equity method. The major impact on the company's financial metrics was a reduction of around BRL 1.2 billion in its consolidated debt as of December 31, 2012 and an increase in EBITDA by around BRL 104 million in 2012 basically reflecting EDB's 50% share in PECEM, which had total debt of around BRL 2.4 billion as of December 31, 2012 with a posted negative EBITDA of BRL 208 million for 2012.

Had EDB not restated its 2012 financial statements, the company would have posted much weaker credit metrics as measured by CFO Pre- WC of BRL 918 million or 17.3% over adjusted debt and interest coverage of 3.4x in 2012. The deterioration in EDB's consolidated credit metrics largely stemmed from the combination of the delay in the start-up of the Pecem project and weaker than expected performance of the distribution business. In 2012, Energia Pecem posted a very poor financial performance as measured by negative EBITDA of BRL 208 million. EDB's two distribution subsidiaries Bandeirante and Escelsa also posted weaker than expected financial performances in 2012.

In line with our expectations, the third tariff review applied by the regulator in October 2012 significantly affected Bandeirante's cash flow as the review was retroactive to October 2011. Nonetheless, Bandeirante incurred additional costs acquiring more expensive thermo energy due to the drought induced hydrology restrictions, mainly in the second half of 2012. These additional costs were not recognized or covered in the company's existing tariffs. Reaching BRL 135.5 million as of December 31, 2012, these additional costs were accounted for as regulatory assets which would be included in the company's tariff adjustment in October 2013.

Increases in the cost of acquiring energy also hurt Escelsa's cash flow in 2012 which resulted in BRL 89 million in net regulatory assets which were also not recovered in the company's tariffs in 2012.

In 2013, EDB posted a relatively satisfactory performance boosted by the better than anticipated performance of its two distribution subsidiaries Bandeirante and Escelsa as evidenced by the consolidated CFO Pre-WC over debt ratio of 31.8% in 2013 up from 27.1% in 2012 and an interest coverage ratio of 4.5X in 2013, slightly down from 4.9x in 2012.

In spite of having continued to distribute relatively high dividends of BRL 549 million in 2013 and BRL 528 million in 2012, EDB's solid CFO Pre-WC helped the company to keep a robust RCF over debt ratio of 18.5% in 2013 up from 14.1% in 2012.

A major event that contributed to the company's improving credit metrics in 2013 was the company's sale of its 50% share in two major hydro power projects at the very end of last year, as previously described, which allowed the company to not consolidate its participation in these projects.

The non consolidation of these two power projects resulted in the non-recognition of around BRL 1.2 billion in net debt as of December 31, 2013 with a limited impact in cash flow metrics as both projects were in a pre-operational phase.

CHALLENGING ENVIRONMENT TO CONTINUE IN THE MEDIUM HORIZON

We expect that the current challenging drought environment EDB has been facing will continue over the remaining part of 2014 and potentially in 2015, which will largely depend on the regularization of the water levels of the Brazilian hydro-power reservoirs especially in the northeastern and southeastern regions of the country.

Higher levels of water at hydro-power reservoirs would likely reduce the liquidity and cash flow pressure on hydro generation and distribution companies as the resumption of a regular rainy season starting at the end of November would help to reduce the dispatch of the more expensive thermal power and consequently reduce the generation companies' exposure to the spot market while also lowering the distribution companies' energy costs and significantly reducing electricity spot prices.

We project that EDB will post lower consolidated cash generation as measured by CFO Pre - WC in 2014 estimated at BRL1,089 million (29.6% over debt) down from BRL1,308 million (31.8% over debt) in 2013 in light of the weaker performance of its distribution companies and the expectation of weaker cash flow stemming from losses to be posted by EDB's generation subsidiaries associated with their exposure to the spot market.

In 2014, EDB's consolidated cash flow will be boosted by unusual revenues of BRL 420.6 million related to EDB's sale of its 50% share in two major power projects as previously described, which will temper the expected weaker performance of both the distribution and generation businesses.

The poor performance of EDB's distribution subsidiaries will come from our projection that their net regulatory assets will increase by BRL 180 million in 2014, which will not be reimbursed either from the CDE fund or CCEE or fully recognized in their tariffs. The increase in net regulatory assets will come from the higher thermal power costs for Bandeirante and Escelsa and costs associated with Escelsa's involuntary exposure to the spot market.

Notwithstanding, we project that the distribution companies' cash flows will improve starting in 2015 mainly from the combination of tariff increases to be granted in the second half of 2014 and the receipt of funding from the CDE fund or CCEE to recover the net regulatory assets incurred in 2014. We estimate that their annual net regulatory assets position will decline by BRL 150 million from 2015 through 2017.

EDB `s generation companies are bound to post a lower cash flow in 2014 in comparison with 2013 given their exposure to the spot market. In the face of the current severe drought season, the National System Operator-ONS has been dispatching the more expensive thermal power since the beginning of the year to preserve water at the Brazilian hydro power reservoirs.

As a result, the hydro power plants have been generating less energy than their physical energy since the beginning of the year reflected by the Generation Scaling Factor published by the Brazilian Electricity Clearing House CCEE every month. The GSF was 94.6% and 93.8% in the first and second quarters of 2014, respectively.

Typically, hydro generation companies need to make up for the difference by acquiring energy in the spot market to honor their supply contracts at very high prices. The spot price (PLD) averaged BRL 682 per megawatt hour in the second quarter of 2014 and are slated to remain high in the second half of the year. EDB has indicated that the generation business earnings were reduced by BRL 120 million in the first half of the 2014 from its exposure to the spot market.

As GSF is expected to remain at low levels for the remainder of the year just above 90% EDB's generation subsidiaries are expected to post lower earnings in the second half of the year, which we estimate could range between BRL 120 million and BRL 150 million during this period.

Our base case scenario assumes that the risks that the Brazilian generation and distribution companies have been facing since the end of 2012 will be considerably lower in 2015 in light of our expectation that a normal rainy season starting this November will allow some recovery of the hydro-power water reservoirs so that the dispatch of thermal power is significantly reduced in comparison with 2014, which will bring average spot prices to much lower levels.

The recovery of the Brazilian water reservoirs should also be followed by the expansion of the overall energy supply as planned by the federal government. and our expectation that Brazil adequately uses the acquired experience during the current crisis to efficiently manage the potential risks arising from an unusual drought season to avoid an energy rationing and reduce the potential impact that the lower generation of hydro power would cause to the Brazilian electricity sector.

If the base scenario outlined above does not unfold as expected, we will review our position accordingly and evaluate the impact that a potential energy rationing or the occurrence of a similar scenario in 2015 would have on EDB's cash flow and liquidity.

We will keep monitoring EDB'S financial and operating performance over the medium-term horizon to evaluate its cash flow generation and liquidity position, as well as its ability to turnaround and stabilize the Pecem project while successfully completing its other major power projects as scheduled.

Management's ability to secure long-term debt in a timely and adequate manner to fund its major capital expenditures and to lengthen its debt profile will be an important key rating driver going forward. Also important will be the group's ability to balance capital expenditures and the distribution of dividends with any materially lower-than-expected level of cash generation.

TURNAROUND OF PECEM PROJECT HAS BEEN A MAJOR CHALLENGE

EDB holds a 50% participation in Energia Pecem, which comprises two 360 MW turbines. The thermoelectric power plant, which was scheduled to come on stream in January 2012, had been delayed because of a series of unexpected events which caused the interruption of the construction works.

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. However, further technical events prevented the company from meeting the extended deadline agreed with the regulator. The first turbine only came on stream in December 2012; the second one started operating on May 10, 2013.

The Pecem I thermoelectric power plant has been a major challenge to EDB because of the technical risks associated with the completion of this sizeable project and achieving the improvement of operations by increasing the level of availability of the two turbines.

As a result of the delay in the start-up and the occurrence of some technical shutdowns since it started operating, the company has not achieved the 90% minimum availability index as envisaged in its concession contract. As a result, the company was forced to acquire energy in the spot market at unusually high prices to honor its Purchase Power Agreements (PPA) during the second half of 2012 and first half of 2013.

Pecem has been improving its operational performance as evidenced by the availability index of 82% registered in the first half of 2014 up from the 62% availability index recorded in 2013 as per management information. As a result of this operational improvement the amount of energy the company needed to acquire in the spot market to honor its PPAs has decreased to a more manageable level, which has allowed the company to post positive EBITDA for the last four consecutive quarters.

In the first half of 2014, Pecem recorded EBITDA of BRL 81.3 million up from the negative EBITDA of BRL 207.3 million registered in the same period of 2013. Consequently, Energia Pecem posted a very poor performance in 2013 with a negative EBITDA of BRL 106 million and a net loss of BRL 282.3 million. In order to fund its negative cash generation and fund capital expenditures, the company's shareholders had to step in to support the project by injecting BRL 197 million in equity capital and extending inter-company loans of BRL 269 million in 2013.

In 2012, both shareholders capitalized Energia Pecem by BRL 703 million and extended inter-company loans of BRL 267 million in proportion to their participation in Pecem Energia's capital, i.e. 50% in EDB's case, to cover the shortfalls in cash flow.

EDB' s management is confident that Energia Pecem will improve its operational performance and achieve the 90% availability index of its two turbines over the short-to-medium horizon but has not committed to any specific target date. The achievement of the 90% availability index is paramount for the company's financial turnaround as it would dramatically increase its cash flow and profitability and allow the shareholders to avoid providing additional financial support as they have done the past two years. EDB's management does not currently forecast any capital injection or extension of inter-company loans to Pecem in the short-term.

The major downside risk for this expectation is that some unforeseen technical problem arises in the operation of the power plant that would prevent the company from generating the level of energy as required by the National Operating system (ONS).

EVOLVING BRAZILIAN REGULATORY ENVIRONMENT

The Brazilian regulatory framework has been a constraining factor in the rating assessment of the Brazilian electric utilities given its history of being unpredictable having undergone substantial changes over the past several years. The electricity regulatory model implemented in 2004 has mitigated many of the uncertainties brought about by constant changes in the Brazilian regulatory framework over the past two decades. This model has provided a relatively more supportive and predictable environment for being, in many aspects, more transparent and technically-driven, thus increasing the predictability of returns on invested capital.

Nonetheless, we believe that the significant improvements that the Brazilian regulatory framework had accomplished since the new model was implemented in 2004 have been offset, to a certain extent, by the manner in which the federal government managed the process of accelerating the renewal of the concessions expiring between 2015 and 2017 last year.

The publication of the federal government's provisional measure #579 in September 2012, which became law #12,783 in January 2013, has caused concern within the electricity industry because the government's proposal to renew the generation and transmission concessions expiring between 2015 and 2017 was materially more costly versus the expectations of most market participants, including concessionaries and investors.

Regardless of the legal aspects involving the implementation of this new legislation which has generated a series of lengthy legal suits and potential appeals in the Brazilian courts, the manner in which the government managed the whole process since the initial announcement and subsequent discussion and communication ended up creating uncertainties about the quality and the level of supportiveness of the Brazilian electricity regulatory environment. As a result, we foresee a lower assurance of timely recovery of costs and investments in Brazil since the publication of the federal law #12,783.

For Moody's, the regulatory framework (Factor 1) and the ability to recover costs and earn returns (Factor 2) are major drivers in the rating assessment of a given issuer pursuant to our updated methodology "Regulated Electric and Gas Utilities published in December 2013.

The current low Ba rating assigned to these two factors largely reflects the increased levels of uncertainty relative to the continued development of the Brazilian regulatory framework and the timeliness of recovering costs and earning an adequate return recognizing that there have been inconsistencies in the way the framework has been applied as evidenced by some of the operational procedures contained in the federal law #12,783.

LEVEL OF SUPPORT OF EDP PORTUGAL

The ratings assigned for the EDB group also factor in the ownership by its ultimate parent company, EDP Portugal (Ba1; positive 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. We believe that the Brazilian operations of EDP continue to play an important role in the group's growth strategy. The previous rating downgrades 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 adequate credit metrics for the rating category, and the relatively stable cash flows emanating from the regulated distribution utilities and the long-term supply contracts underpinning the generation business along with continued conservative financial management.

In addition, we 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. These 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.

We further believe that EDP Portugal will continue to support the activities of EDB by preserving the current strong capital structure of its Brazilian subsidiary; however, we 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.

In light of the recent change of EDP Portugal's rating outlook to positive from negative indicates that Moody's views a more benign scenario for the company's performance in the short-to-medium horizon.

## Structural Considerations

EDB's issuer rating is one notch lower than the operating subsidiaries' issuer ratings to reflect the structural subordination of 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 view the current liquidity standing of the holding parent company EDB and some of its subsidiaries as being inadequate when compared with the liquidity characteristics of other investment grade issuers in Brazil. EDB's weaker liquidity position has resulted from the delay in the start-up of operations of the PECEM project along with the occurrence of some technical shutdowns since it started operating in December 2012, which forced EDB to inject additional capital and extend inter-company loans to this 50% owned subsidiary over the past two years.

EDB's high level of dividend distributions along with its relatively ambitious capital expenditure program forced the company to tap the local banking market in 2013; EDB borrowed a three-year amortizing BRL 500 million with one-year grace period from local banks which increased the company's total debt to BRL1 billion while maintaining a cash position of BRL 244 million as of December 31, 2013. In February, 2014, EDB raised an additional BRL 300 million loan to mature in August 2015 to pay off part of an existing debenture of BRL 450 million and roll over the remaining portion to August 2015.

EDB's receipt of BRL 420.7 million on June 27, 2014 from the sale of its participation in two major power projects has somewhat improved its liquidity position as evidenced by a significant reduction in its net debt position of BRL 372 million as of June 30, 2014, consisting of BRL 822 million of debt and cash position of BRL 450 million.

EDB's distribution subsidiaries Bandeirante and Escelsa also face challenging liquidity positions in light of the exacerbated increase in their working capital needs because of the acquisition of more expensive thermal power and some exposure to the spot market.

Going forward, we expect that EDB will be more effective in handling its overall liquidity position given the maintenance of its historically high dividend pay-out ratio along with the sizeable capital expenditures over the next couple of years.

### 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 prudently manage its 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

Given the expected deterioration in credit metrics in 2014 an upgrade action is very unlikely in the short to medium term.

### What Could Change the Rating - Down

There would be growing pressure for a downgrade action if EDB and its subsidiaries do not improve their liquidity by lengthening their debt profile and securing more timely and adequate long-term funding to meet the sizeable capital expenditure program. Quantitatively, a downgrade could be triggered by a fall in the RCF over debt ratio below 10% and interest coverage declining below 3.5x for a prolonged period.

## Rating Factors

**EDP - Energias do Brasil S.A.**

| **Regulated Electric and Gas Utilities** | [1]**Current31-Dec-2013** | | | **Moody's 12 - 24 Month Forward View** | |
|---|---|---|---|---|---|
| **Factor 1: Regulatory Framework (25%)** | **Measure** | **Score** | | **Measure** | **Score** |
| a) Judicial & Legislative Underpinnings (12.5%) | | Ba | | | Ba |
| b) Consistency & Predictability of Regulation (12.5%) | | Ba | | | Ba |
| **Factor 2: Ability to Recover Costs and Earn Returns (25%)** | | | | | |
| a) Timeliness of Recovery of Costs (12.5%) | | Ba | | | Ba |
| b) Reasonableness of Allowed Rates & | | Ba | | | Ba |

| | | | | |
|---|---|---|---|---|
| Returns (12.5%) | | | | |
| **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%)** | | | | |
| a) CFO pre-WC + Interest / Interest (7.5%) (3yr Avg) | 4.5x | A | 3.8x - 4.1x | Baa |
| b) CFO pre-WC / Debt (15%) (3yr Avg) | 29.2% | Aa | 29.6% -31.7% | Aa |
| c) CFO pre-WC - Dividends / Debt (10%) (3yr Avg) | 16.7% | A | 12.8% - 17.7% | Baa |
| d) Debt / Book Capitalization (7.5%) (3yr Avg) | 38.4% | Aa | 36.3% - 36.7% | A |
| **Rating:** | | | | |
| a) Methodology Implied Rating | | | | Baa3 |
| b) Actual Issuer Rating [2] | | Ba1 | | Ba1 |

[1] 3-year historical average [2] Reflects the structural subordination of the holding company

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 http://www.moodys.com for the most updated credit rating action information and rating history.