CREDIT OPINION
10 April 2019

Update

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RATINGS

Energest S.A.

Domicile	Brazil
Long Term Rating	Ba2
Type	LT Issuer Rating - Dom Curr
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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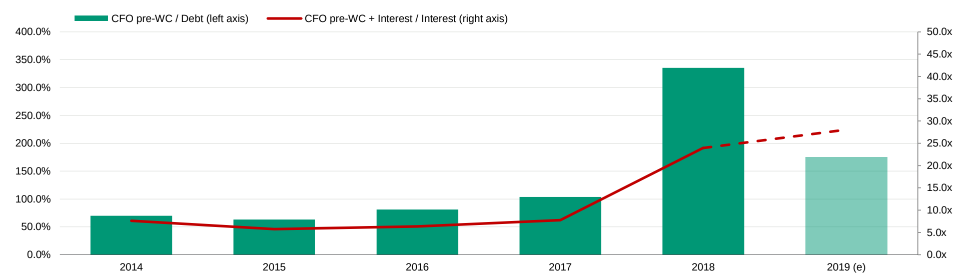
Energest S.A.

Update to credit analysis

Summary

The credit profile of Energest S.A.'s (Energest, Ba2/Aa2.br stable) reflects its long track record and mature operating profile with robust operating margins and a low leveraged capital structure. The ratings also take into consideration the intrinsic benefits from being part of the EDP Energias do Brasil S.A. (EDB; Ba2 stable) group, given its expertise in operating hydro plants in Brazil and resilient access to the debt and banking markets. The ratings also take into consideration (1) Energest's relatively small scale, (2) the high sales concentration to a single client, EDP Comercialização e Serviços de Energia Ltda. (EDP Comercializadora), which represents around 51% of the company's energy supply contracts; (3) a track record of high dividend payout to the parent. The ratings are constrained by the Government of Brazil's rating (Ba2 stable), given the intrinsic links between the company and the credit quality of the sovereign because of its regional customer base.

Exhibit 1
Credit metrics to remain robust after a significant decrease in leverage in 2018



Source: Moody's Investors Service

Credit strengths

- » Stable and predictable cash flows, supported by medium-term supply contracts
- » Strong credit metrics for the rating category
- » Long operating track record

Credit challenges

- » Small scale and limited asset and revenues diversification
- » Exposure to hydrological risks
- » Track record of high dividend distribution

Rating outlook

The stable outlook on Energest's ratings reflects our expectation that the company's credit metrics will remain well positioned for the rating category, despite volatile hydrologic conditions. The stable outlook is also in line with that on EDB's and Brazil's ratings.

Factors that could lead to an upgrade

A rating upgrade would be considered if the sovereign rating or EDB's rating, or both, are upgraded. A ratings' upgrade would also take into account the company's liquidity and business profile, along with the regulatory environment in which the company operates.

Factors that could lead to a downgrade

Sales volume below our expectations or a significant mismatch on spot market exposure could prompt a downgrade, as well as a rapid or significant deterioration in leverage and liquidity. A downgrade of EDB's rating or Brazil's sovereign rating could strain Energest's ratings. Quantitatively, the ratings could be downgraded if:

» cash flow from operations (CFO) pre-working capital (WC)/debt falls below 50%, or

» interest coverage remains below 5.0x for a prolonged period

Key indicators

Exhibit 2

Energest S.A.

	12/31/2014	12/31/2015	12/31/2016	12/31/2017	12/31/2018
(CFO Pre-W/C + Interest) / Interest	7.6x	5.7x	6.3x	7.8x	23.9x
(CFO Pre-W/C) / Debt	69.9%	63.1%	81.1%	103.5%	335.2%
RCF / Debt	28.5%	-5.7%	6.1%	62.1%	137.2%

[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™

Profile

Energest, a wholly owned subsidiary of EDB, is a hydro generation company with an installed capacity of 198 megawatts (MW; 134.8 MW of assured energy) consisting of a single hydropower plant, UHE Mascarenhas, located between the states of Espírito Santo and Minas Gerais (B2 stable). The concession was granted in July 1995 for 30 years and will expire in July 2025, subject to a 20-year renewal depending on regulatory approvals. In 2018, Energest posted consolidated net sales of BRL283 million and a net income of BRL127 million.

Detailed credit considerations

Medium-term supply contracts support cash flow, but are concentrated in a single off-taker

Energest relies primarily on medium-term energy supply contracts to the unregulated market that provide predictable and stable cash flows over the next 12 to 18 months. As its former long-term energy supply contracts with distribution companies expired in recent years, the company has gradually shift focus to supply contracts with free consumers. As of March 2019, the company had 19.9% of its contracted energy in the regulated market and 80.1% of PPAs in the free market, with an average tenor of 7.2 years, up from 3.7 years in 2017. We estimate the weighted average price of those PPAs was at BRL204/MWh in January 2019, adjusted for inflation from the energy auction date.

Exhibit 3

80% contracted position in the free market and 51% intragroup

Contract type	Volume (MWh)	Updated price (BRL/MWh) [1]	Auction price (BRL/MWh)	Inflation index	Start Date	End Date
Regulated	201,480	234.07	115.98	IPCA	Jan-08	Dec-37
Unregulated	473,040	194.96	112.00	IGP-M	Jan-13	Dec-22
Unregulated	78,840	293.67	233.00	IPCA	Jan-15	Dec-19
Unregulated	35,916	135.38	95.31	IPCA	Jan-17	Dec-44
Unregulated	5,589	116.47	82.00	IPCA	Jan-17	Dec-46
Unregulated	70,080	188.24	175.00	IGP-M	Jan-19	Dec-19
Unregulated	148,920	172.10	160.00	IGP-M	Jan-20	Dec-20

[1] Updated prices from auction date to January 1, 2019.
Sources: Energest, Moody's Investors Service

On the other hand, most of Energest's sales volume is concentrated intragroup. EDP Comercializadora, a wholly owned subsidiary of EDB, is a pure electricity trading company that plays a strategic role within the EDB group. Most of the large industrial consumers that migrated from the regulated markets served by affiliates EDP Sao Paulo Distribuicao de Energia S.A. (Ba2/Aa1.br stable) and EDP Espirito Santo Distribuicao de Energia SA (Ba2/Aa1.br stable) to the free market over the past several years have signed bilateral supply contracts with EDP Comercializadora, which now represents about 51% of Energest's energy PPAs for 2019.

Hydrological risk issue mitigated

Brazilian hydro generation companies have been experiencing a challenging operating environment over the past few years as a combined result of prolonged drought seasons and ineffective government policies toward operation and expansion of the energy matrix. In this scenario, hydropower generators experienced a significant increase in energy costs related to purchases on the spot market to make up for generation shortfalls. In 2018, the Generation Scaling Factor (GSF), which indicates the level of stored energy of hydropower reservoirs in Brazil, fell to an average of 84% from 85% in the previous three years. Meanwhile, the average spot prices reached BRL294/MWh in 2018 from an average of BRL250 in the previous three years. We currently expect a GSF of 86% in 2019 and 91% in 2020, up from 84% in 2018. The improvement is a combination of more favorable rainy season, additional installed power capacity coming on stream and a gradual recovery in electricity consumption.

As of March 2019, the company's contracted position represented 85% of its physical guarantee. Since the expiration of certain supply contracts in early 2016, Energest strategically decided to maintain a portion of its energy output uncontracted which works as a buffer to reduce its exposure to mandatory purchases in the spot market in a scenario in which the total generation of hydropower is considerably lower than the allocated physical energy. As a result, the company is relatively well insulated in scenarios where the generating scaling factor (GSF) is at or above 85%.

To mitigate the exposure to hydrological risks for the regulated contracts, Energest has also adhered to the law #13,203/2015, which has established the terms on the renegotiation of the hydrological risks in 2015 and allows for the transfer of part of the hydrological risks from 2016 through 2024 to final consumers n exchange for a premium payment that varies according to the level of protection chosen. Among the different levels of protection available on the regulated market, Energest has opted for the SP94 product, which limits its exposure up to 6% of its assured energy sold in the regulated market (equivalent to 23 MW average annual production), effectively protecting its hydrological risk in the future in cases where the system GSF falls below 94%.

Strong credit metrics, despite large dividend distributions

Energest has historically posted strong credit metrics, characterized by low leverage and high interest coverage ratios. In the last three years ended in December 2018, the company's average consolidated CFO pre-WC/debt reached 123%, while the retained cash flow/ debt was at 42% and interest coverage of 9.1x. In the same period, the company's EBITDA margin, as per our standard adjustments, has been in the 59% to 74% range. Those metrics compare favorably with those of other Ba-rated unregulated power companies. Such strong performance reflects Energest's medium- and long-term power purchase agreements (PPAs), annually adjusted by inflation, and its low cost structure and leverage.

In 2016, a corporate restructuring of the EDB group resulted in a capital split of Energest and the transfer of its small hydropower concessions to the parent company (that is, PCH Viçosa, PCH Sao Joao, PCH Alegre, PCH Fruteiras and PCH Jucu e Rio Bonito) and one large hydropower plant (UHE Suiça), with a total installed capacity of 102 MW. Those units represented one-third of Energest's installed capacity and about 15% of its consolidated gross revenue. Despite this reduction, Energest's cash flow generation continued strong, supporting a material leverage reduction in 2018.

Low carbon transition risk

Energest has low carbon transition risk within the utility sector because it is an electricity generation company with 100% of its installed capacity concentrated in one hydropower plant.

Brazil's energy generation matrix mostly comprises hydropower plants. The government expects the proportion of hydropower in the national energy supply to decline from 64% to 52% by 2027, due to the expansion of alternative renewables, such as wind and solar power plants. As such, renewable sources, will remain predominant in Brazil's energy matrix, at well above 85% of the energy installed capacity. As a result, we expect risks to the sector from environmental issues or those related to the transition to a low-carbon electric grid to remain low for Brazil, a country that has pledged to maintain carbon emissions below the targets set out as part of the Paris climate accord.

Liquidity analysis

Energest's liquidity is adequate, despite a cash position of BRL19 million as of December 31, 2018, vis-à-vis BRL22 million of debt maturities through December 31, 2019. The low cash balance is compensated by the company's resilient cash flow generation. We expect operational cash flow generation after capital spending in the range of BRL130 million-BRL140 million over the next 12-18 months.

Like other Brazilian companies, Energest does not have committed banking facilities to face any unexpected cash disbursements; however, we deem the company's liquidity as manageable, given its track record of resilient access to capital markets and intrinsic benefits derived from being part of the EDB group.

Energest has a track record of high dividend payout, which is supported by its resilient cash flow generation, low capital spending requirements and robust operating margin. We expect Energest to continue to distribute significant dividends, while its cash flow generation remains sustainable or reduce it during critical periods, if needed.

Energest's second debenture issuance has a financial covenant of 2.5x net debt to EBITDA embedded in its indenture, which was 0.1x on December 31, 2018. We expect the company to maintain its conservative financial policy with a lowly leveraged capital structure within the covenant limit.

Rating methodology and scorecard factors

The grid outcome from our 12-18-month forward view based on our Unregulated Utilities and Unregulated Power Companies Industry methodology is Baa1, which is four notches above Energest's current rating.

Exhibit 4
Rating factors
Energest S.A.

Unregulated Utilities and Unregulated Power Companies Industry Grid [1][2]	Current FY 12/31/2018		Moody's 12-18 Month Forward View As of 4/4/2019 [3]	
Factor 1 : Scale (10%)	**Measure**	**Score**	**Measure**	**Score**
a) Scale (USD Billion)	Caa	Caa	Caa	Caa
Factor 2 : Business Profile (40%)				
a) Market Diversification	Ba	Ba	Ba	Ba
b) Hedging and Integration Impact on Cash Flow Predictability	Baa	Baa	Baa	Baa
c) Market Framework & Positioning	Ba	Ba	Ba	Ba
d) Capital Requirements and Operational Performance	Baa	Baa	Baa	Baa
Factor 3 : Financial Policy (10%)				
a) Financial Policy	Baa	Baa	Baa	Baa
Factor 4 : Leverage and Coverage (40%)				
a) (CFO Pre-W/C + Interest) / Interest (3 Year Avg)	9.1x	A	15x - 30x	Aaa
b) (CFO Pre-W/C) / Debt (3 Year Avg)	122.9%	Aaa	105% - 175%	Aaa
c) RCF / Debt (3 Year Avg)	41.9%	A	13% - 20%	Baa
Rating:				
a) Indicated Outcome from Grid		Baa1		Baa1
b) Actual Rating Assigned				Ba2

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations.
[2] As of 12/31/2018.
[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 Investors Service

Ratings

Exhibit 5

Category	Moody's Rating
ENERGEST S.A.	
Outlook	Stable
Issuer Rating -Dom Curr	Ba2
Senior Unsecured -Dom Curr	Ba2
NSR Senior Unsecured	Aa2.br
NSR LT Issuer Rating	Aa2.br
ULT PARENT: EDP - ENERGIAS DE PORTUGAL, S.A.	
Outlook	Stable
Issuer Rating	Baa3
Bkd Sr Unsec MTN -Dom Curr	(P)Baa3
Jr Subordinate -Dom Curr	Ba2
Commercial Paper -Dom Curr	P-3
PARENT: EDP - ENERGIAS DO BRASIL S.A.	
Outlook	Stable
Corporate Family Rating -Dom Curr	Ba2
Senior Unsecured -Dom Curr	Ba3
NSR Corporate Family Rating	Aa2.br
NSR Senior Unsecured	A1.br

Source: Moody's Investors Service

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