

## CREDIT OPINION

17 June 2016

Update

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### RATINGS

#### Bandeirante Energia S.A.

Domicile	Sao Paulo, Brazil
Long Term Rating	Ba2
Type	LT Issuer Rating - Dom Curr
Outlook	Negative

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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# Bandeirante Energia S.A.

## Annual Update

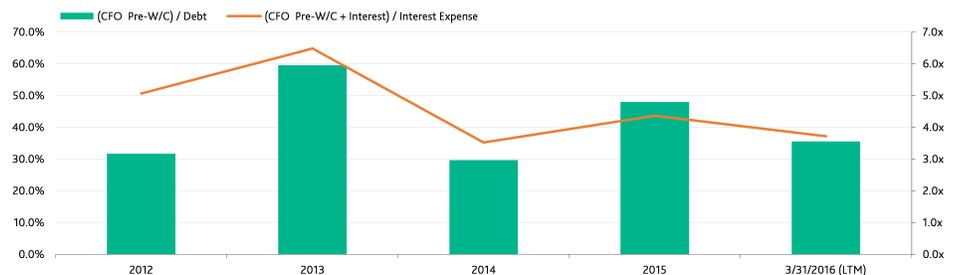
### Summary Rating Rationale

The Ba2/Aa2.br issuer ratings reflect the stable and predictable cash flow from Bandeirante's regulated distribution business, current strong credit metrics for its rating category and its historically good access to the local banking and capital markets. The ratings are constrained by the company's high dividend payout ratio and relatively sizeable capital expenditures.

The negative outlook reflects the current negative outlook of Brazil's sovereign rating, as we understand that the company's rating is constrained by Brazil's Ba2 Bond rating. It also reflects the expectation of weaker credit metrics in 2016 from lower operating margins because of lower tariffs and volume sales and costs associated with the company's energy over-contracting. We expect that the reduction of regulatory assets will partly offset the company's lower operating margins in 2016.

Exhibit 1

### Resilient credit metrics to continue



Source: Moody's Financial Metrics

### Credit Strengths

- » Strong credit metrics
- » Cash flow to benefit from the reduction of regulatory assets in 2016
- » Relatively stable cash flow supported by long-term concession
- » Lower pressure from the holding company EDB to upstream dividends

### Credit Challenges

- » Relatively lower tariffs from the fourth tariff review in October 2015

- » Decreasing operating margins from lower volume sales and over-contracting

## Rating Outlook

The company's operational and financial performance is subject to the evolution of the macroeconomic and regulatory environment in Brazil as captured by the sovereign rating.

## Factors that Could Lead to an Upgrade

In light of the recent rating action and the negative outlook, an upgrade of the ratings is unlikely in the near term.

## Factors that Could Lead to a Downgrade

A downgrade of Brazil's Ba2 sovereign rating will likely prompt a downgrade action for Bandeirante. We would consider a downgrade action if we perceive a pronounced deterioration in the company's liquidity. Quantitatively, we could consider a downgrade rating action if Bandeirante posts weaker credit metric so that CFO Pre-WC over debt becomes lower than 15% and interest coverage falls below 3.0x on a prolonged basis.

## Key Indicators

Exhibit 2

### [1] Bandeirante Energia S.A.

	3/31/2016(L)	12/31/2015	12/31/2014	12/31/2013	12/31/2012
CFO pre-WC + Interest / Interest	3.7x	4.4x	3.5x	6.5x	5.1x
CFO pre-WC / Debt	35.5%	48.0%	29.6%	59.5%	31.7%
CFO pre-WC – Dividends / Debt	25.0%	31.7%	5.3%	54.5%	25.5%
Debt / Capitalization	48.8%	47.9%	46.1%	38.7%	52.9%

[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

## Detailed Rating Considerations

### STRONG CREDIT METRICS TO DETERIORATE FROM LOWER SALES AND OVER-CONTRACTING

Bandeirante had historically posted strong profitability and cash flows as evidenced by the three-year average CFO Pre- WC over debt ratio of 39.2% and interest coverage of 4.1x as measured as of March 31, 2016. In 2015, these ratios were 48% and 4.4x, respectively.

Notwithstanding, we forecast a pronounced deterioration in the company's cash flow metrics in 2016 as measured by CFO Pre-WC over debt ratio because of the combination of lower electricity consumption and the company's over-contracting position. We estimate that this ratio will not exceed 20% in 2016 but improve thereafter to beginning thirties based on our assumption of higher annual volume sales of 3% in 2017 and 2018 coupled with the elimination of the company's current over-contracting position in the same period.

We estimate that Bandeirante's volume sales will decrease by 4% in 2016 because of the economic recession, which mainly affects the industrial consumers. The company's performance in the first quarter of 2016 corroborates this estimate; Bandeirante's volume sales decreased by 4.7% in comparison with the same period of 2015, which does not include short-term market sales.

According to management, Bandeirante's over-contracting position was 8.4% in the first quarter of 2016. As a result, the company sold the exceeding energy acquisition in the spot market at much lower prices estimated at around BRL30 per megawatt hour during the first quarter. Considering the company's average energy cost of around BRL 180 per megawatt hour, Bandeirante incurred additional costs of BRL 150 per megawatt hour in the first quarter of 2016. According to management, the costs associated with over contracting were BRL 15.5 million in the first quarter, which annualized will reach BRL 60 million or around 16% of the company regulatory EBITDA.

According to the current regulation, distribution utilities receive tariff increases to reimburse acquisition costs derived from over-contracting up to 5% once a year at the time of their tariff anniversary, which in the case of Bandeirante is every October. In the interim, the company recognizes these costs as regulatory assets. The costs related to the amount that exceeds 5% is absorbed by the distribution utility.

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 [www.moody's.com](http://www.moody's.com) for the most updated credit rating action information and rating history.

We conservatively estimate that Bandeirante's leverage as measure by the Debt to EBITDA ratio will increase to 3.3x in 2016 considerably higher than the 2.1x recorded in 2015. We project that starting in 2017 this ratio will converge to around 2.0x.

#### **RELATIVELY LOWER TARIFFS FROM THE FOURTH TARIFF REVIEW IN OCTOBER 2015**

According to the Brazilian electricity regulatory model, all electricity distribution companies are subject to periodic tariff reviews every four to five years in order to transfer any productivity gains to consumers.

In October 2015, the regulator applied the fourth tariff review to Bandeirante, which resulted in a reduction of Part B of the company's tariff formula by 2.9%, equivalent to 0.6% of the company's prevailing tariff as of October 2015. The part B of the tariff formula mainly consists of the operating costs (Reference Company), depreciation and the remuneration amount. As a result, the company's regulatory EBITDA decreased from BRL 411 million in the previous tariff cycle to BRL 385 million, a decrease of BRL 26 million or 6.3%.

We deem this tariff review as relatively positive for Bandeirante given that the reduction in the company's tariffs were not material. The rationale for such a small tariff decrease as reflected in the Part of B of the company's tariff formula, stems from the combination of a higher WACC of 12.25% (before income tax) up from the previous 11.36%, a relatively sizeable regulatory asset base and the maintenance of the operational cost structure virtually unchanged from the previous cycle.

Bandeirante has consistently posted higher levels of EBITDA in comparison with that envisaged in the regulator's tariff methodology, which suggests that Bandeirante has adequately managed its operating costs. We foresee that the company's normalized EBITDA will most likely keep exceeding the parameters determined by the regulator as soon as the electricity consumption resumes and that the company's somehow eliminates its over- contracting position.

#### **CASH FLOW TO BENEFIT FROM THE REDUCTION OF REGULATORY ASSETS IN 2016**

Bandeirante, in line with most of the distribution utilities that operate in the southern and south-eastern regions of the country, will benefit from an expected material reduction in their regulatory assets position.

The reduction of regulatory assets stems from the fact that the company's Part A of its tariff formula contemplates since October 2015 the expectation of higher costs from the acquisition of the energy from Itaipu and the collection of a higher amount of the regulatory charge CDE.

Starting in January 1, 2016, the cost of energy from Itaipu decreased by 31% in dollar terms while the CDE amount the company is obligated to transfer to ELETROBRAS, which manages this regulatory fund, decreased by another 30%.

The company's tariffs are expected to be overstated until October 2016 when the regulator will remove the exceeding tariff represented by the so-called financial components. The company will recognize this exceeding tariff as a regulatory liability during this period, which will dramatically reduce its net regulatory assets and liabilities.

In the first quarter of 2016, Bandeirante's net regulatory asset and liability position reduced by BRL 296 million more than offsetting lower operating margins in the period. If this trend remains, Bandeirante's net regulatory assets of BRL 499 million as of December 31, 2015 will become a regulatory liability of BRL 482 million.

#### **LOWER PRESSURE FROM THE HOLDING COMPANY EDB TO UPSTREAM DIVIDENDS**

In light of our expectation that Bandeirante's cash flow will be boosted by the receipt of sizeable regulatory assets in 2016, we forecast that the company will be able to comfortably distribute dividends of BRL 249 million as it has recently announced.

Notwithstanding, we understand that its Holding company EDB will reduce the pressure to upstream more sizeable dividends from Bandeirante because of EDB's recent capitalization of BRL 1.5 billion executed by EDP Portugal at the end of May.

#### **Liquidity Analysis**

Like most Brazilian companies, Bandeirante does not have any committed banking facility to accommodate any unexpected cash disbursements. Notwithstanding, we deem the company's liquidity as adequate given its strong cash position of BRL 429.6 million, which comfortably covers short-term debt of BRL 148.3 million.

Despite an expected much lower FFO in 2016 from lower volume sales associated with additional costs from the company's over contracting position, Bandeirante is expected to receive sizeable amount of regulatory assets, which will offset lower operating margins during the year.

Bandeirante has adequately managed its liquidity position considering the rather unfavourable environment the Brazilian distribution companies have been facing since mid-2012.

We believe that EDB's resilient access to the local banking and capital markets is an important mitigating factor for potential additional pressure on liquidity. Nevertheless, we feel it is very important that EDB and its subsidiaries, including Bandeirante, remain capable of securing adequate long-term funding while at the same time balancing capital expenditures and the distribution of dividends to maintain a capital structure and liquidity position that are commensurate with their current rating category.

## Profile

Bandeirante Energia (Bandeirante), headquartered in São Paulo, Brazil, is an electricity distribution utility fully controlled by EDP Energias do Brasil (EDB; Ba3/A1.br negative), an integrated utility group that is in turn controlled by EDP - Energias de Portugal, S.A. (Baa3 stable). Bandeirante serves around 1.8 million clients in the eastern portion of the industrialized state of São Paulo. In the last twelve months ended March 31, 2016, Bandeirante reported net revenues of BRL 3.532 million (USD 992 million), which does not include construction revenues of BRL 171 million (USD 48 million), on sales of 15.669 GWh, constituting around 3% of the electricity consumed in Brazil's integrated system.

## Rating Methodology and Scorecard Factors

Exhibit 3

### Bandeirante Energia S.A.

Regulated Electric and Gas Utilities Industry Grid [1][2]	Current		Moody's 12-18 Month Forward	
	LTM 3/31/2016		View As of 6/15/2016 [3]	
Factor 1 : Regulatory Framework (25%)	Measure	Score	Measure	Score
a) Legislative and Judicial Underpinnings of the Regulatory Framework	Ba	Ba	Ba	Ba
b) Consistency and Predictability of Regulation	Ba	Ba	Ba	Ba
Factor 2 : Ability to Recover Costs and Earn Returns (25%)				
a) Timeliness of Recovery of Operating and Capital Costs	Ba	Ba	Ba	Ba
b) Sufficiency of Rates and Returns	Ba	Ba	Ba	Ba
Factor 3 : Diversification (10%)				
a) Market Position	Ba	Ba	Ba	Ba
b) Generation and Fuel Diversity	N/A	N/A	N/A	N/A
Factor 4 : Financial Strength (40%)				
a) CFO pre-WC + Interest / Interest (3 Year Avg)	4.1x	Baa	3.1x	Baa
b) CFO pre-WC / Debt (3 Year Avg)	39.2%	Aa	29%	A
c) CFO pre-WC – Dividends / Debt (3 Year Avg)	23.8%	A	11.9%	Baa
d) Debt / Capitalization (3 Year Avg)	45.9%	Baa	51.1%	Baa
Rating:				
Grid-Indicated Rating Before Notching Adjustment		Baa3		Ba1
HoldCo Structural Subordination Notching				
a) Indicated Rating from Grid		Baa3		Ba1
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 9/30/2014(L); Source: Moody's Financial Metrics [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
<b>BANDEIRANTE ENERGIA S.A.</b>	
Outlook	Negative
Issuer Rating -Dom Curr	Ba2
Subordinate -Dom Curr	Ba3
NSR LT Issuer Rating	Aa2.br
NSR Subordinate	A2.br
<b>ULT PARENT: EDP - ENERGIAS DE PORTUGAL, S.A.</b>	
Outlook	Stable
Issuer Rating	Baa3
Bkd Sr Unsec MTN -Dom Curr	(P)Baa3
Jr Subordinate -Dom Curr	Ba2
Commercial Paper -Dom Curr	P-3
<b>PARENT: EDP - ENERGIAS DO BRASIL S.A.</b>	
Outlook	Negative
Corporate Family Rating -Dom Curr	Ba3
Senior Unsecured -Dom Curr	Ba3
NSR Corporate Family Rating	A1.br
NSR Senior Unsecured	A1.br

Source: Moody's Investors Service

## Recent Developments

On April 13, 2016, shareholders approved the distribution of BRL63.3 million and BRL185.6 million of interest on own capital and dividends, respectively.

On February 25, 2016, Moody's downgraded Bandeirante Energia's issuer ratings to Ba2/Aa2.br from Baa3/Aa1.br, under review for downgrade on the Global Scale and on the National Scale, respectively. At the same time, Moody's downgraded the BRL 390 million subordinated debentures to Ba3/A2.br from Ba1/Aa2.br, under review for downgrade on the global scale and on the National scale rating, respectively. All the ratings outlook changed to negative.

On February 24, 2016, Moody's downgraded Brazil's issuer and bond ratings to Ba2 from Baa3, with a negative outlook.

On December 10, 2015, Moody's placed Bandeirante's ratings under review for downgrade following the placement of Brazil's issuer and bond ratings under review for downgrade on December 09, 2016.

On October 20, 2015, the regulator ANEEL approved the fourth tariff review for Bandeirante, which resulted in an averaged 11.65% tariff increase to consumers. The impact of the part B of the tariff structure, which encompasses the operating and capital costs (remuneration and depreciation) decreased by 2.9% or 0.60% of the company's prevailing tariff.

On March 6, 2015, Moody's America Latina Ltda affirmed the Baa3/Aa1.br issuer ratings on Bandeirante. Moody's also affirmed the Ba1/Aa2.br ratings on BRL 390 million in subordinated debentures issued by Bandeirante that are scheduled to mature in July 2016. The outlook for all ratings was changed to negative from stable.

On February 27, 2015, ANEEL (the Regulator) approved an extraordinary tariff adjustment for Bandeirante. The tariff repositioning was set at 32.18%, being 24.89% related to economic part and 7.29% related to financial components. The new tariff was applied on March 02, 2015.

On February 13, 2015, Moody's Investors Service upgraded to Baa3/Prime-3 from Ba1/Not Prime the senior unsecured debt and issuer ratings of EDP - Energias de Portugal, S.A. (EDP, the group), Hidroelectrica del Cantabrico S.A. and the senior unsecured debt ratings of EDP Finance B.V. The outlook on all ratings is stable.

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