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

Global Credit Research - 06 Jun 2013

Sao Paulo, Brazil

Ratings

Category	Moody's Rating
Outlook	Stable
Issuer Rating -Dom Curr	Ba1
Senior Unsecured -Dom Curr	Ba1
NSR Senior Unsecured -Dom Curr	Aa2.br
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

Contacts

Analyst	Phone
Jose Soares/Sao Paulo	55.11.3043.7300
Alexandre De Almeida Leite/Sao Paulo	
William L. Hess/New York City	1.212.553.1653

Key Indicators

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

ACTUALS	**LTM 03M 2013**	**2012**	**2011**	**2010**	**2009**	**2008**
(CFO Pre-W/C + Interest) / Interest Expense	**3.4x**	**3.4x**	**4.3x**	**5.6x**	**5.1x**	**3.9x**
(CFO Pre-W/C) / Debt	**20.2%**	**17.3%**	**28.7%**	**32.6%**	**32.3%**	**36.2%**
(CFO Pre-W/C - Dividends) / Debt	**8.6%**	**7.2%**	**17.4%**	**23.7%**	**24.7%**	**29.3%**
Debt / Book Capitalization	**39.9%**	**43.9%**	**38.3%**	**37.5%**	**37.3%**	**38.4%**

[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

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

-Weaker liquidity at the level of the holding and distribution subsidiaries

- Sizeable capital expenditure program

- Resilient access to the local capital and banking markets

-Completion of the PECEM thermal project

-Growing contribution of the generation business

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 2012, EDB`s power distribution business represented 41.4% of the consolidated EBITDA, the power generation business represented 54.7% and the commercialization of energy represented the remaining 3.9%. The two distribution subsidiaries, Bandeirante and Escelsa, distributed in aggregate 24,923 GWh in 2012 (approximately 5.7% of the electricity consumed in the Brazilian electricity integrated system). The generation business totaled 2,012MW of installed capacity at year-end 2012 which accounted for approximately 1.6% of the country's electricity installed capacity. EDB reported consolidated net revenues of BRL6.3 billion (USD3.2 billion) and net profit of BRL342 million (USD175 million) in 2012.

Recent Developments

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 remains stable.

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.

In December 2012, PECEM's first turbine project started operating. EDB has a 50% participation in the PECEM project, which is a 720 MW coal fired power plant consisting of two turbines of 360 MW.

On May 10, 2013, the second turbine started operating. The PECEM project was originally planned to start operating in January 2012 and 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 recently when the

second turbine commenced operations.

On December 14, 2012, the regulator ANEEL granted EDB a 30-year concession to construct and operate the hydro power plant "Usina Hidreletrica Cachoeira Caldeirão" in the state of Amapá in the north of the country. This project will have an installed capacity of 219 MW and assured energy of 129 MW to be sold in the regulated market starting in January 2017.

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 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.

SUMMARY RATING RATIONALE

EDB's ratings reflect the group's adequate credit metrics for the rating category, despite some recent deterioration, 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 recent deterioration in liquidity, 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 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

ADEQUATE CREDIT METRICS

EDB posted healthy profitability and stable cash generation on a consolidated basis from 2008 through 2011.This is evidenced by the CFO Pre WC (CFO) over debt ratio which steadily remained above the 30% level during this period. Likewise, interest coverage was also at very healthy levels for the company' rating category at around 5.4x in the same period.

In 2012, the company's consolidated cash flow considerably deteriorated from the historical performance as measured by CFO of BRL 918 million or 17.3% over adjusted debt down from the previous BRL1,270 million three-year average or 31.2% over debt. Likewise, interest coverage was much weaker at 3.4x in 2012 down from the previous 5.4x three-year average.

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 209 million. The company's cash flow was also very weak as measured by negative funds from operations (FFO) of BRL 305 million. Increased working capital needs of BRL 331 million plus capital expenditures of BRL 406 million to complete the project further hurt results.

Energia Pecem again posted a very poor performance in the first quarter of 2013, with a negative EBITDA of BRL 143.4 million and a net loss of BRL 124 million. As a result, the company's shareholders had to step in once again to support the project by injecting an additional BRL 110 million capital in the first quarter of 2013.

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 last October 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 142 million as of December 31, 2012, these additional costs were accounted for as regulatory assets to be included in the company's next tariff adjustment in October 2013. Consequently, Bandeirante posted CFO Pre working Capital (CFO) of BRL 217 million (26.1% of total debt), down from the previous three-year average of BRL 429.6 million or 50.8% of total debt.

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 August 2013, the regulator ANEEL will apply the new procedures of the third tariff review on the company's tariffs, which will be reduced accordingly. The reductions, however, will be partly tempered by the recognition of the previous operating costs not included in the company's tariffs in the previous period.

In 2012, Escelsa posted CFO of BRL 295 million (27% over debt) slightly up from the previous three-year average of BRL 265.6 million (29.7% over debt); however, the deterioration in this ratio largely stems from Escelsa's recognition of an additional BRL 171 million in unfunded pension liabilities which Moody's treats as debt.

FINANCIAL LEVERAGE TO REMAIN RELATIVELY HIGH FOR THE RATING CATEGORY

We expect the next two years will be challenging for EDB in light of its sizeable capital expenditures program which should average over BRL 1 billion per year. While we don't expect EDB's credit metrics to materially change over the next couple of years, they will improve thereafter when two other major hydro-power projects commence operations. In the interim, we project that EDB's consolidated credit metrics will remain commensurate with the Baa3 rating but now more at the lower end of the rating category.

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.

COMPLETION RISK OF PECEM PROJECT HAS BEEN 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) has been 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 3.5 billion.

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 couple of strikes from the employees working in the construction site along with a particularly wet season in the region which caused some interruption in 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 to meet the extended deadline date agreed with the regulator. The first turbine only came on stream in December 2012; the second one started operating on May 10, 2013. As a result of the delay in the start-up, the company was forced to acquire energy in the spot market at unusually high prices to honor the Purchase Power Agreements (PPA) during the second half of 2012 and first quarter of 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.

Despite the startup of the first turbine in December, which reduced the amount of energy Energia Pecem needed to acquire from the spot market to honor the PPAs, Energia Pecem again posted a very poor performance in the first quarter of 2013, with a negative EBITDA of BRL 143.4 million and a net loss of BRL 124 million. As a result, the company's shareholders had to step in once again to support the company by injecting an additional BRL 110 million capital in the first quarter of 2013.

We expect Energia Pecem to generate positive cash flow in the second half of the year when the two turbines should be operating at full capacity; however, we do not rule out the potential need of additional capitalization from the shareholders over the next couple of months to help the company meet its main cash needs, which mostly

consists of meeting its debt service requirements, which are currently estimated at BRL 40 million per quarter; however, the actual amount of additional capital needed should be much lower.

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

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 have been 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.

The publication of the federal government's provisional measure #579 last year has caused uneasiness 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 both concessionaries and investors.

Regardless of the legal aspects involving the implementation of this provisional measure which could potentially generate lengthy series of judgments and appeals in the Brazilian courts, the manner in which the government handled the whole process since the initial disclosure and subsequent discussion and communication was very poorly handled in our opinion since it has created uncertainties about the quality and the level of supportiveness of the Brazilian electricity regulatory environment.

For Moody's, the stability and the predictability of the regulatory framework (Factor 1) and the ability to recover costs on a timely manner (Factor 2) are major drivers in the rating assessment of a given issuer pursuant to our methodology "Regulated Electric and Gas Utilities". We believe that the significant improvements that the Brazilian regulatory framework had accomplished since the new model was implemented in 2004, have been tempered to a certain extent by the manner in which the federal government addressed the renewal of concessions expiring between 2015 and 2017.

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 government's provisional measure #579.

LEVEL OF SUPPORT OF EDP PORTUGAL

The ratings assigned for the EDB group also factor in the ownership by 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. We believe that the Brazilian operations of EDP play an important role in the group's growth strategy. The 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 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 and 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. 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.

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.

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 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 and the forced purchase of higher priced energy to meet the obligations of its PPAs and the unexpected poor financial performance of its distribution subsidiaries Bandeirante and Escelsa.

In order to support the weaker cash generation of its subsidiaries and added capital injections in PECEM, EDB has tapped the local market over the past ten months by raising BRL 950 million during this period. Going forward, EDB will need to be more effective in handling its overall liquidity position given the scheduled maturity of BRL 450 million in February 2014, the maintenance of historically dividend pay-out ratio along with sizeable capital expenditures over the next couple of years.

Management has indicated it could execute capital splits at some of its generation subsidiaries and increase the receipt of dividends from other subsidiaries to meet its cash needs in 2013, which we deem feasible but challenging given the sizeable amount of financial resources of around BRL 2 billion needed in 2013-2014 to complete its hydro-electric projects.

Most of the long-term debt will be raised by different EDB's operating subsidiaries and in many cases has already been negotiated with local financial institutions either in the capital or banking markets. EDB group's resilient access to the local capital and banking market tempers the relatively high amount of financial resources to be raised over the next four quarters.

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 recent deterioration in credit metrics 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 its sizeable capital expenditure program. Quantitatively, 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.

Rating Factors

EDP - Energias do Brasil S.A.

Regulated Electric and Gas Utilities	Current 12/31/2012			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%)		Ba			Ba
b) CFO pre-WC + Interest / Interest (7.5%) (3yr Avg)	4.3x	Baa		3.5x - 4.5x	Baa
c) CFO pre-WC / Debt (7.5%) (3yr Avg)	25.5%	A		20.0% - 22.2%	Baa
d) CFO pre-WC - Dividends / Debt (7.5%) (3yr Avg)	15.3%	Baa		10.6% - 11.6%	Baa
e) Debt / Capitalization or Debt / RAV (7.5%) (3yr Avg)	40.0%	A		43.0% - 44.6%	A
Rating:					
a) Methodology Implied Issuer Rating		Baa3			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

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