MOODY'S INVESTORS SERVICE

CREDIT OPINION

27 March 2017

Update

Rate this Research

Eletropaulo Met. Elet. de Sao Paulo

Update Following Outlook Stabilization

RATINGS

Eletropaulo Met. Elet. de Sao Paulo

Domicile	Brazil
Long Term Rating	Ba3
Type	LT Corporate Family Ratings
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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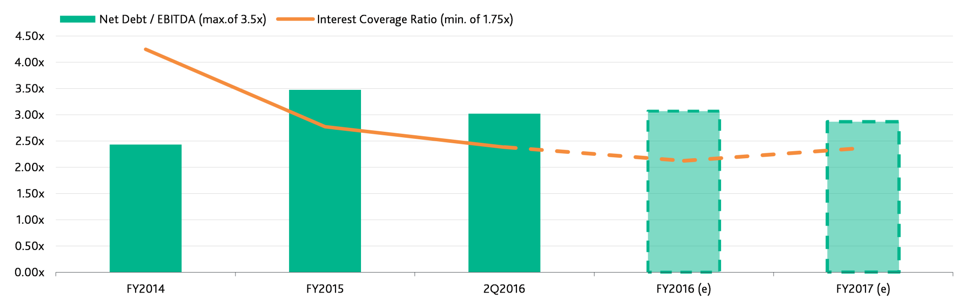
Summary Rating Rationale

The Ba3/A3.br ratings are supported by the relatively stable cash flow of the long-term electricity distribution concession in Brazil's wealthiest metropolitan area which drives the strong credit metrics for the rating category. Eletropaulo´s sound access to bank and capital markets which we expect will continue in the projected period combined with generally supportive regulatory environment further support the ratings.

Eletropaulo´s ratings are constrained by the lower sales volumes as well as the significant non-funded contingency related to a judicial dispute with Eletrobras, which could significantly affect liquidity.

Exhibit 1

Improving Leverage But Still High Compared to Historical Levels



Source: Moody's Investors Service and Company's Financial

Credit Strengths

» Cash flow to benefit from the reduction of regulatory assets from 2016

» Good access to the local capital and banking markets

» Relatively strong credit metrics for the rating category

Credit Challenges

» Still relatively high leverage

» Lower sales volume and risk of over-contracting exposure

» High level of contingent liabilities that could affect liquidity

Rating Outlook

The stabilization of Eletropaulo's outlook follows the stabilization of Brazil's outlook, given the company´s high exposure and close linkages to the local economic/regulatory environment and ultimate credit quality. The stable outlook also reflects our view that Eletropaulo will have relatively stable cash flows in the projected period and maintain adequate liquidity and credit metrics for the rating category.

Factors that Could Lead to an Upgrade

We could see upward pressure on the ratings if Eletropaulo´s cash interest coverage ratio remains above 2.4x and the CFO pre WC/ Debt above 15% on a sustainable basis as well as with more clarity on the contingent liabilities outcome.

Factors that Could Lead to a Downgrade

A rating downgrade could be triggered by a deterioration in the company´s leverage or liquidity position as well as if there is any change in the perceived level of support from the electricity regulatory framework. Quantitatively, the ratings could be downgraded if the interest coverage remains below 1.8x, and the CFO pre-WC-to-Debt falls below 5%, on a sustainable basis. Further deterioration in the respective sovereign's credit quality could also exert downward pressure on the ratings.

Key Indicators

Exhibit 2

Key Indicators

Eletropaulo Met. Elet. de São Paulo

	6/30/2016(L)	12/31/2015	12/31/2014	12/31/2013	12/31/2012
CFO pre-WC + Interest / Interest	2.4x	2.2x	1.7x	2.8x	3.1x
CFO pre-WC / Debt	17.7%	16.8%	7.4%	18.5%	13.7%
CFO pre-WC – Dividends / Debt	17.7%	16.8%	6.3%	17.6%	5.1%
Debt / Capitalization	75.7%	69.0%	70.9%	65.7%	80.6%

[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

Better Cash Flow Generation But Still Relatively High Leverage

The company accumulated a significant BRL 1.3 billion net position of regulatory assets in 2015, which resulted in higher working capital needs and indebtedness, one of the main drivers for the financial covenant tightness in the period together with lower sales volumes and higher delinquency rates. Eletropaulo reported an adjusted net debt/Ebitda of 3.47x in the FY2015, compared to the maximum 3.5x embedded in the debentures and above the 2.43x recorded in the FY2014.

In spite of the challenging macroeconomic environment that will continue to weigh on the company´s operational performance, we forecast a better cash flow generation in the next 12-18 months due to a net position of regulatory assets below BRL 50 million in 2016. Therefore, company reported an adjusted net debt/Ebitda of 3.22x in FY2016 and our projections indicate it will stay below 3.0x in 2017.

Eletropaulo´s CFO Pre-WC over debt ratio increased to 18% in the LTM 062016 from 16.8% in the FY2015 while interest coverage grew to 2.5x up from 2.2x. Our forward looking basis for the next 12-18 months considers average ratios of 18% and 2.2x, respectively.

Unexpected debt increases could come from a time lag between higher energy costs and the required tariff adjustments or also if the company returns its dividend distribution to historical levels of 100%, which are not considered in our projections.

Results Remain Pressured by Lower Sales Volume and Over-Contraction

Brazil´s drought affected Eletropaulo´s profitability in 2014-15 while the economic recession has dragged electricity consumption since 2015, when company reported a sales volume contraction of 4.7% compared to 3.1% in the 1H2106. Moody´s projections incorporate an average volume contraction of 0.7% per year in the next 12-18 months with some recovery afterwards to an average growth of 1.3% per year from 2018-2020.

Another side effect of the recessionary scenario is the high delinquency rate that affects costs at BRL 250-300 million per year. Eletropaulo also had a 111% average electricity level contraction in 2016, which translated into additional costs of around BRL 92 million. In the following years, we consider its exposure will stay below the current 105% regulatory ceiling up to which all costs are passed through tariffs. The company claims its over-contraction exposure is involuntary and should be compensated by Aneel, but we do not consider any reimbursements in our projections.

Sizeable Amount of Contingent Liabilities

Eletropaulo has a BRL 1.9 billion (at prices of June 30, 2016) contingent liability from a judicial dispute with Eletrobras (Ba3 stable) regarding the payment of a loan provided to Eletropaulo in 1986, which is undergoing the legal process for almost 28 years.

The company does not have any legal provisions related to this dispute since its legal advisors consider this “process with probability of loss considered possible”, in accordance with Brazilian accounting standards. Eletropaulo is just required to make provisions if their legal advisor understands the company will lose the dispute in the second level court. Nevertheless, in September, 2015, a consultant appointed by the court concluded in a preliminary appraisal report that Eletropaulo is responsible for the full payment of the outstanding debt, which was questioned by the company and remains under analysis by the expert and the judge in the first level court.

We do not incorporate any payment or deposit in our projections, as we consider the process will remain under judicial discussion in the five-year projected period. However, there is a likelihood the company is required to hire a guarantee insurance that would cost around 3% of the total amount or BRL 50-70 million per year, as per Moody´s estimates.

Moreover, the company has BRL 3.6 billion of underfunded pension liabilities, which Moody´s adds to the total debt amount according to our standard adjustments.

Liquidity Analysis

Eletropaulo´s liquidity has improved in 2016 with the company reporting an adequate position considering its BRL 1.3 billion cash versus the short-term maturities of BRL 879 million as of 2Q2016. We expect that the company will maintain a minimum dividend pay-out of 25% in the next 12-18 months as well as limit its Capex to the maintenance of adequate quality services, using a portion of its cash to repay debt. We estimate a BRL 500-600 million decrease in Eletropaulo´s financial debt in the period.

Our ratings incorporate Eletropaulo´s good access to the capital markets which we deem to continue in the projected period. The company does not have any committed banking facilities, like most Brazilian corporations. Also, we do not incorporate any payments related to the ongoing judicial dispute of BRL 1.9 billion with Eletrobras, that could significantly affect the company´s leverage and liquidity.

We consider Eletropaulo will remain in compliance with the financial covenants embedded in the debenture issuances: (i) adjusted net debt/Ebitda < 3.5x and adjusted interest coverage > 1.75x. As of June 30, 2016, the company reported these ratios at 3.02x and 2.38x, respectively. Breach of financial covenants could result in debt acceleration if reported in two consecutive quarters. Debenture holders need a quorum of 75-90% to accelerate the debt in a General Assembly.

Profile

Eletropaulo Metropolitana de Eletricidade de Sao Paulo S.A. ("Eletropaulo" or the “Company") is a regulated electricity distribution utility, listed on the BM&FBOVESPA stock exchange. Eletropaulo is controlled by the AES Corporation (50,52% of the voting capital) and BNDES (22,56% of the voting capital).

Eletropaulo distributes electricity to 24 municipalities in the Sao Paulo metropolitan area, including the city of Sao Paulo, with an estimated 11% market share in Brazil. The Company has a 30-year concession contract that was granted by Aneel, the Brazilian electricity sector regulator (“Regulator”) in 1998.

As of June 30, 2016 82% of Eletropaulo's electricity was sold to the regulated market, mainly residential (44%) and commercial (35%) consumers while the remaining 18% was distributed to the freemarket. In the LTM 062016 ended in June 30, 2016, the company posted net sales (excluding construction revenues) of BRL 12 billion and EBITDA of BRL 1.5 billion, as per Moody´s standard adjustments.

Rating Methodology and Scorecard Factors

Exhibit 3

Rating Factors

Eletropaulo Met. Elet. de São Paulo

Regulated Electric and Gas Utilities Industry Grid [1][2]	Current LTM 6/30/2016		Moody's 12-18 Month Forward View As of 8/19/2016 [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	Baa	Baa	Baa	Baa
Factor 4 : Financial Strength (40%)				
a) CFO pre-WC + Interest / Interest (3 Year Avg)	2.1x	Ba	2.2x	Ba
b) CFO pre-WC / Debt (3 Year Avg)	13.2%	Baa	17.6%	Baa
c) CFO pre-WC – Dividends / Debt (3 Year Avg)	12.6%	Baa	16.9%	Baa
d) Debt / Capitalization (3 Year Avg)	72.1%	B	66.7%	B
Rating:				
Grid-Indicated Rating Before Notching Adjustment		Ba2		Ba1
HoldCo Structural Subordination Notching				
a) Indicated Rating from Grid		Ba2		Ba1
b) Actual Rating Assigned				Ba3

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations.
[2] As of 6/30/2016(L)
[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
ELETROPAULO MET. ELET. DE SAO PAULO	
Outlook	Stable
Corporate Family Rating	Ba3
Senior Unsecured -Dom Curr	Ba3
NSR Corporate Family Rating	A3.br
NSR Senior Unsecured	A3.br
ULT PARENT: AES CORPORATION, (THE)	
Outlook	Positive
Corporate Family Rating	Ba3
Senior Unsecured	Ba3/LGD4
Speculative Grade Liquidity	SGL-2

Source: Moody's Investors Service

Recent Developments

On March 17, 2017 Moody's changed Eletropaulo´s outlook to stable from negative and affirmed its senior unsecured ratings. At the same time, Moody's assigned Ba3/A3.br corporate family ratings (CFRs) to Eletropaulo and withdrew its Ba3/A3.br issuer ratings.

In December 2016, company concluded its corporate reorganization resulting in BNDES and AES Holdings Brasil Ltda will directly control Eletropaulo with the same proportion Brasiliana Participações used to have. The new structure is effective from December, 30, 2016.

On June 28 2016, Aneel granted to Eletropaulo a negative annual tariff adjustment of 1.29% composed of an economic readjustment of -3.48% and financial component of +2.19%, which will be applied as of July 4, 2016.

On May 09 2016, Moody's repositioned the national scale ratings (NSRs) of certain Brazilian infrastructure issuers, including Eletropaulo, as a result of the recalibration of the Brazilian national rating scale. This resulted in a repositioning of Eletropaulo' NSRs as follows: Issuerand Senior Unsecured ratings to A3.br from A2.br.

On February 25, 2016, Moody's downgraded Eletropaulo's issuer ratings to Ba3/A2.br from Ba2/Aa3.br on the global scale and on the National scale rating, respectively. Outlook remained negative. At the same time, the ratings on the BRL 750 million senior unsecured debentures were downgraded to Ba3/A2.br from Ba2/Aa3.br on the global scale and on the National scale rating, respectively. Outlook remained negative.

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

On January 06, 2016, company concluded its corporate reorganization resulting in the split of Companhia Brasiliana de Energia assets (former controlling company) to Brasiliana Participações S.A. the new controlling shareholder of Eletropaulo. The indirect control of AES and BNDES in Eletropaulo will keep the same given their participation in Brasiliana Participações. The new structure is effective from December, 31, 2015.

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