

ISSUER COMMENT

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Contacts

Yug Santana +55.11.3043.7307
 Associate Analyst
 yug.santana@moody's.com

Aneliza Crnugelj +55.11.3043.6063
 Analyst
 aneliza.crnugelj@moody's.com

CLIENT SERVICES

Americas 1-212-553-1653
 Asia Pacific 852-3551-3077
 Japan 81-3-5408-4100
 EMEA 44-20-7772-5454

Eletropaulo Met. De Elet. de Sao Paulo

Eletropaulo's BRL1.5 billion capital increase is credit positive

On 26 July, Enel Brasil Investimentos Sudeste S.A. concluded a BRL1.5 billion capital increase in [Eletropaulo Met. De Elet. de Sao Paulo](#) (Ba2 stable), following its acquisition of 93% of Eletropaulo's stake in June 2018. The capital increase will support Eletropaulo's investment plan as well as its short-term obligations. We expect a further strengthening of Eletropaulo's debt/capitalization structure to drive lower leverage, which is credit positive. In addition, the transaction reinforces our understanding of Enel's support as the majority shareholder with a strong commitment to improve the company's operations. Enel became the largest energy distribution player in Latin America after the acquisition.

The capital increase was carried out through the capitalization of instruments of advancement for future capital increase executed between Enel and Eletropaulo at BRL45.22 per share, the same price paid by Enel in the auction held in June 2018. The procedures were already cashed in by Eletropaulo as of that date. Minority shareholders can exert preemptive rights up to 30 days after 1 August 2018, when the subscription process will be finalized.

The capital injection, combined with better sales volumes and the recent annual tariff adjustment of 15.8%, will further support the company's credit metrics and liquidity. We project leverage, as measured by debt/capitalization, at around 70% for the next 12-18 months, compared with the 80% average of the past three years.

Until 2019, the higher capital investments will help improve Eletropaulo's service quality by upgrading its network and preventing losses. We project an average BRL1 billion expenditure per year in 2018 and 2019, incorporating Enel's guidance of additional investments to improve Eletropaulo's operations. Our projections do not yet incorporate potential synergies and margin improvements as Eletropaulo becomes part of the Enel group, although Enel expects to improve Eletropaulo's cost structure and EBITDA generation.

Going forward, Eletropaulo will have a smaller free float of shares, which is currently at around 5%, down from 48% before the acquisition. This could exclude the company from the Novo Mercado listing segment in the B3 S.A. - Brasil, Bolsa, Balcao (B3) stock exchange, because B3 requires a minimum 25% free float in this segment. Nonetheless, we expect that Enel will maintain a high-level corporate governance structure in line with its best practices for other subsidiaries and with continued integration and synergies as Eletropaulo is consolidated into the group.

Eletropaulo operates the concession of regulated electricity distribution in 24 municipalities in the Sao Paulo metropolitan area, including the city of Sao Paulo, and in 2017 had around an 11% market share in Brazil serving 7.2 million clients. The company has a 30-year concession contract, which Brazil's electricity sector regulator ANEEL granted in 1998. In

the last 12 months to March 2018, the company had net sales (excluding construction revenue) of BRL12.5 billion and EBITDA of BRL1.7 billion, as per our standard adjustments. Also, interest coverage was 3.3x and the ratio of cash flow from operations pre-working capital to debt was 16% for the same period.

Enel Brasil Investimentos Sudeste S.A. is a Brazilian subsidiary of [Enel Americas S.A.](#) (Baa3 negative), which currently holds 93.32% stake in Eletropaulo. Santiago, Chile-based Enel Americas became the successor to Enersis S.A. after the separation of the group's Chilean and non-Chilean electricity generation, distribution and transmission assets. Enel Americas has stakes in several regulated utilities and power generation companies operating in Colombia, Peru, Brazil and Argentina.

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Credit Opinion

» [Eletropaulo Met. Elet. de Sao Paulo: Update following rating upgrade to Ba2](#), 11 June 2018

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