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CREDIT OPINION

20 April 2018

Update

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RATINGS

AES Tiete Energia S.A.

Domicile	Sao Paulo, Sao Paulo, Brazil
Long Term Rating	Ba2
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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AES Tiete S.A.

Update following outlook stabilization and new rating assignment

Summary rating rationale

[AES Tiete Energia S.A.](#)'s (AES Tiete) Ba2/Aa1.br ratings reflect AES Tiete's overall predictable and strong cash generation that leads to adequate credit metrics for the rating category as well as its resilient access to the local banking and capital markets together with management's prudent administration of the generation business. The rating also incorporates AES Tiete's historical high dividend payout and the potential cash outflow of the judicial dispute over the spot market exposure during the hydrological crisis (BRL 711 million, provisioned as of December, 2017).

AES Tiete's ratings are further constrained by its expansion strategy in renewable energy coupled with the capex pressures from the contractual obligation to expand generation capacity by 15% in the [State of Sao Paulo](#) (Ba2 stable). [Brazil's sovereign rating](#) (Ba2 stable) also limits the company's rating given the local revenue dependency and highly regulated business nature as well as the overall more challenging hydrological conditions.

Exhibit 1

Credit metrics to stabilize at a lower level



All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations

Source: Moody's Financial Metrics™, Moody's estimates

Credit strengths

- » Adequate credit metrics for the rating category
- » Overall predictable and strong cash generation
- » Resilient access to local banking and capital markets

Credit challenges

- » Aggressive dividend payout practice
- » Expansion strategy in renewable energy (non-hydro sources)
- » Contractual obligation to expand installed generation capacity
- » Judicial dispute owing to its spot-market exposure during the 2015 hydrological crisis

Rating outlook

The stable outlook largely reflects Brazil's sovereign rating outlook given the company's local-content profile. It also incorporates our view of AES Tiete's relatively stable cash flows in the projected period and our expectation that dividend outflows and any acquisitions or M&A activity will be prudently managed to maintain adequate leverage and credit metrics for the rating category.

Factors that could lead to an upgrade

We could upgrade the ratings if AES Tiete's operational performance surpass our expectations or if liquidity improves. If the credit metrics stay above our projections such that cash interest coverage (CFO Pre WC + Interest/ Interest) stays above 4.5x and the CFO Pre WC/Debt above 35% for a sustainable period, we could also consider an upgrade. Nevertheless, AES Tiete's ratings are constrained by Brazil's sovereign rating given its close linkages to the local economic/regulatory environment and ultimate credit quality.

Factors that could lead to a downgrade

A rapid or significant downturn in AES Tiete's credit metrics such as cash interest coverage (CFO Pre WC + Interest/ Interest) stays below 2.5x and the CFO Pre WC/Debt below 10% on a sustainable basis could prompt a rating downgrade as well as the degradation of the liquidity and overall credit quality. The company's operating margin potentially coming under pressure from a significant mismatch on spot market exposure or on contracted levels could also weigh on the ratings. In addition, Moody's could also review AES Tiete's rating downwards if the company's expansion plan continues to lead to higher leverage thresholds.

Key indicators

Exhibit 2

Key indicators

AES Tiete Energia S.A.

	12/31/2017	12/31/2016	12/31/2015	12/31/2014	12/31/2013
(CFO Pre-W/C + Interest) / Interest	3.3x	3.1x	4.8x	4.3x	10.9x
(CFO Pre-W/C) / Net Debt	23.8%	47.5%	117.6%	15.5%	151.7%
RCF / Net Debt	9.2%	-35.6%	68.6%	-9.8%	14.3%
(CFO Pre-W/C) / Debt	15.8%	28.7%	54.8%	9.5%	89.7%
RCF / Debt	6.1%	-21.5%	32.0%	-6.0%	8.5%

[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™

Corporate profile

AES Tiete is mainly a hydropower generation company with a 30-year concession, granted in December 1999 to operate an installed capacity of 2,658 MW, equivalent to around 2% of Brazil's electricity capacity, and 1,247 MW of assured average energy. The company has 9 hydro-power plants (HPPs) and 3 small hydro-power plants (SHPPs) located in the State of Sao Paulo. As of December 2017, AES Tiete had 79% of its energy contracted for 2018 and did not adhere to the law 13,203 that hedges the hydrological risk for a premium as negotiated with the regulator, Aneel, although we expect the company to maintain an uncontract cushion of up to 20% through its portfolio.

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 for the most updated credit rating action information and rating history.

In 2017 the company started investing in non-hydro renewable sources generation with four new projects until date: (i) Alto Sertão II wind power plant with 386.1 MW of installed capacity located in the State of Bahia, (ii) Boa Hora and Guaimbê solar complexes with 91 MWp and 180 MWp of installed capacity respectively and (iii) the AGV solar project acquired in Aneel's auction held in December 2017 with 94 MWp installed capacity and total investments of BRL 280 million. These renewable contracts are supported by long-term PPA agreements maturing around 2033-40 with fixed prices yearly adjusted by inflation. AES Tiete's expansion strategy is to continue investing in wind/power projects that should represent 50% of EBITDA in the medium-term, partially mitigating the company's exposure to local hydrological conditions.

According to Moody's standard adjustments, AES Tiete reported net operating revenues of BRL 1.7 billion and EBITDA of BRL 920 million in the FY ended December 2017 while total debt amounted BRL 3.6 billion in the period.

AES Tiete Energia is directly controlled by AES Holdings Brasil Ltda. (24%) and [BNDES Participacoes S.A.](#) (BNDESPAR; Ba2 stable) (28%), as well as indirectly controlled by [The AES Corporation](#) (Ba2 positive).

Detailed rating considerations

Strong credit metrics for the rating category to stay at lower thresholds but still adequate

AES Tiete has historically posted strong credit metrics, characterized by CFO pre-WC/debt of 27.2% in the last three years and interest coverage of 3.7x in the 12 months ended December 2017. Nevertheless, these levels are well below the historical averages (2011-13) of 93% and 10.1x, respectively, driven by the negative effects of the hydrological crisis that increased costs, combined with the termination of the supply contract with [Eletropaulo Met. Elet. de Sao Paulo](#) (Ba3 stable) which was set above market prices.

We recognize lower ratios in our projections owing to the acquisitions performed in 2017 and the additional debt and investment needs related to those, which drive these metrics to around 3.0x and 14%, respectively.

In addition, the more challenging overall hydrological conditions in Brazil could further strain the company's cash generation because water reservoir levels are still below the historical levels.

AES Tiete increased its uncontracted position to 21% in December 2017 from 12% as of the beginning of the year to reduce its exposure to the spot market, which presented increasing prices and a lower generation scaling factor throughout the year. The company is expected to maintain a buffer of up to 20% for hedging purposes and manage its portfolio to continue to mitigate its exposure to the spot market. The company did not adhere to the Law 13,203, which hedges the hydrological risk as per the negotiation with Aneel.

Contractual obligation to expand capacity and new investments could strain leverage

Pursuant to the privatization carried out by the State of Sao Paulo, AES Tiete has an outstanding contractual obligation to increase its generation capacity in the state by 15% (around 400 MW). The company has had difficulty in meeting this commitment because there are few sites available for new hydroelectric facilities or adequate for wind power projects in the state. Nonetheless, in 2017, the company acquired three new solar projects (Boa Hora, Guaimbê and AGV), which together address around 96% of that requirement (considering MWp), significantly meeting the demand from the state under the contractual obligation.

AES Tiete also acquired a new wind power project, Alto Sertão II, in August 2017, the first in its portfolio. The company bought the 386 MW complex from Renova for BRL 600 million, plus an additional BRL 100 million earn-out depending on the project's performance over the next five years.

The company's strategy is to increase the contribution of its wind/solar portfolio up to 50% of its EBITDA by 2020. Such an increase will (1) contribute to a more stable cash flow because these projects have power purchase agreements with terms of 20 years, versus the company's average of three to five years; (2) diversify the power-generation mix away from its concentration in hydropower, and (3) reduce the company's exposure to hydro deficits after it decided not to take advantage of a recently passed law that allows the hedging of hydrological risk by paying a premium negotiated with Aneel.

We expect AES Tiete's leverage to increase because the company is likely to raise additional debt to finance its recent acquisitions and their respective investment needs, as well as incorporate Alto Sertão II's total debt of BRL 1.15 billion. The company's leverage, as measured by net debt/EBITDA, should increase to around 3.8x in our projections from 2.6x as of December 2017, approaching the

3.85x leverage financial covenant ceiling embedded in some of its financing agreements (this ceiling can change to 3.85x from 3.5x for three years as the company performs acquisitions).

Additional M&A activity that would further strain the company's leverage and EBITDA margin levels beyond our projections could lead us to revise the ratings downward, although we understand the expansion will be prudently managed to maintain adequate leverage and credit metrics for the rating category. In addition, the company's management should also balance its dividend distribution policy and retain more cash within AES Tiete if needed. AES Tiete has an aggressive profile of historical dividend payout that could serve as an additional source to support its liquidity.

Judicial dispute outcome still uncertain

AES Tiete has a legal injunction preventing the payment of costs associated with its exposure to the spot market since May 2015. The merit of the suit filed by APINE (Brazilian Association of Independent Producers of Electric Energy), which represents the company as well as other generators, has not been decided yet.

The company recognized a BRL 711 million provision related to this matter as of December 2017, but could still face cash outflow in case of an unfavorable court ruling, which we incorporate in our projections for 2018. The company had a strong cash position of BRL 1.1 billion as of December 2017, which we understand would be adequate to meet this obligation, in case of need.

Liquidity analysis

Similar to other Brazilian companies, AES Tiete does not have committed banking facilities to face unexpected cash requirements but the company proved that it has strong access to the capital markets, which we deem will continue in the coming years, because the company will tap these markets to complement its funding needs.

AES Tiete has an adequate liquidity profile, given its BRL 1.1 billion cash position as of December 2017 and a similar amount of short-term debt that was mostly refinanced with the recent debenture issuance. We anticipate that the company will continue to leverage, mainly to pay dividends and meet its capital spending needs, while management prudently manages its dividend distributions, financial leverage and liquidity, so that its credit metrics remain in line with its rating category.

The fully-amortizing BRL 200 million proposed debentures will have a 12-year maturity with customized bi-annual amortization schedule. The debentures have a 6-month DSRA with standard project finance security package including: (i) pledge of the Boa Hora project's shares; (ii) pledge of its receivables (iii) pledge of reserve accounts; (iv) the three SPV's also guarantee the issuance. The interest payment is accrued until November 2018 and has biannual interest payments starting in May 2019, with variable interest rate that will be defined in book building.

The proposed debentures have a financial covenant of a minimum DSCR of 1.20x annually tested according to the indenture's calculation formula. AES Tiete may cover any amount necessary to meet this threshold by capitalizing the project's complementation account ("Conta de Complementação do ICSD") in addition to the project's cash waterfall structure. Among other acceleration clauses and subject to creditor's waiver, a covenant breach could trigger cross-default with other group's debt.

Proceeds of the issuance will be used to fund Boa Hora solar power project investment needs. The project is comprised of three SPVs, still under construction, authorized by Aneel/Ministry of Energy and Mining to operate the solar farm with total installed capacity of 91 megawatt peak (MWp) located in the State of Sao Paulo with official commercial operations date for 100% of the project expected in November 2018. Its revenue profile is composed of a long-term 20-year power purchase agreement (PPA) from the 2015 Reserve Energy Auction, which allows eventual surplus and/or deficits in generation within the year to be compensated in monthly installments during the following year. The project's offtaker, is the CCEE (Brazilian Electricity Clearing House), associated to the federal energy regulator with strong linkages to the Brazilian sovereign.

Rating methodology and scorecard factors

Exhibit 3

Rating factors

AES Tiete Energia S.A.

Unregulated Utilities and Unregulated Power Companies Industry Grid [1][2]			Current FY 12/31/2017		Moody's 12-18 Month Forward View As of 4/17/2018 [3]	
Factor 1 : Scale (10%)	Measure	Score	Measure	Score		
a) Scale (USD Billion)	B	B	B	B		
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		
e) Business Mix Impact on Cash Flow Predictability		NA				
Factor 3 : Financial Policy (10%)						
a) Financial Policy	Ba	Ba	Ba	Ba		
Factor 4 : Leverage and Coverage (40%)						
a) (CFO Pre-W/C + Interest) / Interest (3 Year Avg)	3.7x	Ba	2.7x	B		
b) (CFO Pre-W/C) / Debt (3 Year Avg)	27.2%	Baa	13.6%	Ba		
c) RCF / Debt (3 Year Avg)	5.5%	B	6.8%	B		
Rating:						
a) Indicated Rating from Grid		Ba2		Ba2		
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 12/31/2017.

[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
AES TIETE ENERGIA S.A.	
Outlook	Stable
Corporate Family Rating	Ba2
NSR Corporate Family Rating	Aa1.br
Senior Unsecured -Dom Curr	Ba2
NSR Senior Unsecured	Aa1.br
ULT PARENT: AES CORPORATION, (THE)	
Outlook	Positive
Corporate Family Rating	Ba2
Sr Sec Bank Credit Facility	Ba1
Senior Unsecured	Ba2

Source: Moody's Investors Service

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