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CREDIT OPINION
11 June 2018

Update

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RATINGS

Eletropaulo Met. Elet. de Sao Paulo

Domicile	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.

Contacts

Aneliza Crnugelj *Analyst* aneliza.crnugelj@moodys.com	+55.11.3043.6063
Alejandro Olivo *Associate Managing Director* alejandro.olivo@moodys.com	+1.212.553.3837
Yug Santana *Associate Analyst* yug.santana@moodys.com	+55.11.3043.7307

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Eletropaulo Met. Elet. de Sao Paulo

Update following rating upgrade to Ba2

Summary Rating Rationale

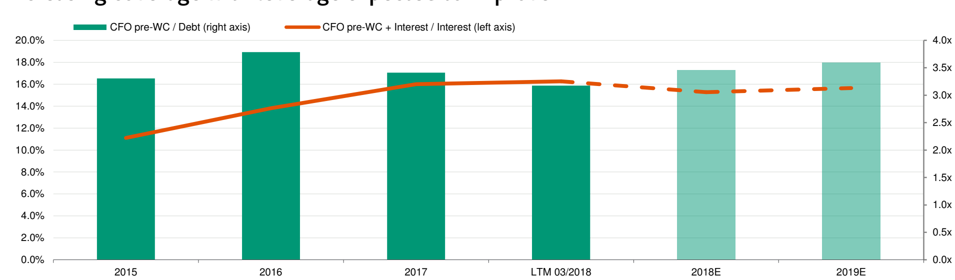
The Ba2/Aa3.br ratings are supported by Eletropaulo´s relatively stable cash flows from the long-term electricity distribution concession in Brazil's wealthiest metropolitan area which drives the strong credit metrics for the rating category. Eletropaulo´s sound access to the local banking and capital markets will continue in the projected period combined with generally supportive regulatory environment further supporting the ratings.

The upgrade reflects primarily our expectation of improved performance that will further support the company´s already adequate credit metrics in terms of liquidity and leverage. This rating action also considers the March settlement that the company reached with Centrais Eletricas Brasileiras SA -- Eletrobras (Ba3 stable) on their long-standing judicial dispute. As part of that agreement, the company will pay Eletrobras BRL 1.5 billion over a period of about four years. Finally, the rating action notes the control acquisition of Eletropaulo by Enel Americas S.A. (Enel Americas, Baa3 negative) through the purchase of a 73.38% stake in the company that will bring a capital injection from Enel Americas of BRL 1.5 billion further strengthening the capital structure of the company.

On the other hand, the ratings still consider that Eletropaulo is a purely domestic operation that has clear linkages with Brazil´s credit fundamentals as captured in the credit quality of the sovereign due to its regional customer and financing base. The relative high capital investment plan to support capital investments to upgrade the network and prevent losses before the next tariff review cycle in 2019 also constrain the ratings as well as the potential higher dividend payout practice going forward.

Exhibit 1

Increasing coverage with leverage expected to improve



Source: Moody's Investors Service

Credit Strengths

» Strong fundamentals of the concession area

» Overall stable cash flows and relatively strong credit metrics for the rating category

» Enel acquisition and commitment to capital injection

» Sound access to the local capital and banking markets

» Generally supportive regulatory environment

Credit Challenges

» Exposure to demand risk with sales volume volatility

» Relative high capital investment plan

» Potential higher dividend payout practice going forward

» Constrained by the sovereign rating

Rating Outlook

The stable outlook reflects our expectation that Eletropaulo will have relatively stable cash flows in the projected period and maintain adequate liquidity and credit metrics for the rating category. In addition, the overall supportive regulatory framework and the stable outlook for Brazil are also incorporated in the company´s outlook given the domestic nature of its operations and, consequently, its links to the local economic/regulatory environment, and ultimate credit quality.

Factors that Could Lead to an Upgrade

Given the stable outlook, an upgrade is unlikely in the short term. An upgrade of Brazil's sovereign bond rating could trigger upward pressure on the company´s ratings given the intrinsic linkages of Eletropaulo and the Brazilian sovereign. In addition, our understanding of a timely and adequate support from Enel Americas as the controlling shareholder could cause upward pressure on Eletropaulo´s standalone credit profile, which is currently constrained by the sovereign credit quality.

Factors that Could Lead to a Downgrade

On the other hand, deterioration in the sovereign's credit quality could exert downward pressure on Eletropaulo ratings. The ratings could also be downgraded if there is a significant and sustained deterioration in the company´s credit metrics and liquidity. Quantitatively, the ratings or outlook would come under downward pressure if the interest coverage remains below 1.8x, and the CFO pre-WC-to-Debt falls below 5% for an extended period. Our perception of deteriorated stability and transparency of the regulatory regime would also add pressure to the ratings as well if volumes stay consistently below Moody's forecast.

Key Indicators

Exhibit 2

Key Indicators

Eletropaulo Met. Elet. de São Paulo

	3/31/2018(L)	12/31/2017	12/31/2016	12/31/2015	12/31/2014
CFO pre-WC + Interest / Interest	3.3x	3.2x	2.8x	2.2x	1.9x
CFO pre-WC / Debt	15.9%	17.1%	18.9%	16.5%	9.0%
CFO pre-WC – Dividends / Debt	15.6%	16.8%	18.3%	16.5%	7.9%
Debt / Capitalization	84.5%	83.2%	72.7%	68.9%	70.8%

[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™

Profile

Eletropaulo operates the concession of the regulated electricity distribution in 24 municipalities in the Sao Paulo metropolitan area, including the city of Sao Paulo, with an estimated 11% market share in Brazil serving 7.2 million clients in 2017. The Company has a 30-year concession contract that was granted by Aneel, the Brazilian electricity sector regulator ("Regulator") in 1998.

As of March 30, 2018, 74% of Eletropaulo's electricity was sold to the regulated market, mainly residential (50%) and commercial (33%) consumers, while the remaining 26% was distributed to the freemarket. In the LTM 032018 ended in March 2018, the company posted net sales (excluding construction revenues) of BRL 12.5 billion and EBITDA of BRL 1.7 billion, as per Moody´s standard adjustments. Also, interest coverage was 3.3x, and the CFO pre-WC-to-Debt 16% in the period.

Detailed Rating Considerations

Improved results driven by continued sales volume growth

Brazil´s drought affected Eletropaulo´s profitability in 2014-15 while the economic recession dragged electricity consumption in 2015-16, when the company reported accumulated sales volume contraction of about 8%. Also, other side effects of the recessionary scenario in the last years were the higher delinquency rate and overcontraction issue that significantly affected its operational costs.

Going forward, we consider the company´s overcontraction exposure will stay below the 105% regulatory ceiling up to which all costs are passed through tariffs. Eletropaulo claims its overcontraction exposure was involuntary and should be compensated by Aneel, but we do not consider any reimbursements in our projections.

Also, since 2017 sales volume resumed growth with a 0.4% increase in the FY2017 on the back of the economic recovery, which should continue to drive operational performance in the short- and medium-term. Moody´s projections incorporate the positive trend to be maintained in the next 12-18 months with an average 2% electricity consumption growth per year in the period.

Better cash flow generation and overall stronger credit metrics but higher Capex plan

During the hydrology and economic crisis, the company accumulated significant 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. Nonetheless, since 2017 we see a positive improvement in its credit metrics which we forecast will continue overall stable in the projected period.

Eletropaulo´s interest coverage ratio reached 3.3x in the LTM ended March 2018, gradually improving since the bottom of 1.9x recorded in 2014, as per Moody´s standard adjustments. We expect this ratio to remain overall stable in the next 12-18 months period. We also forecast the CFO Pre-WC over debt ratio to stay at around 17%-18% in our forward looking view.

The company´s next tariff review cycle is expected in 2019 and therefore we consider the relative higher capital investment plan will continue until then in order to support the capital investments to upgrade the network and prevent losses. We project an average BRL 1 billion expenditure per year in 2018-19, already incorporating Enel´s guidance of additional investments to improve the company´s operations. We do not yet incorporate in our projections potential synergies and margin improvements from the acquisition, as the company becomes part of the Enel´s group, although Enel expects to improve Eletropaulo´s cost structure and EBITDA generation.

We expect Eletropaulo will continue to gradually reduce its leverage returning to the pre-crisis threshold of Debt/Cap around 65%-70% in the medium term. Unexpected debt increases could come from a time lag between higher energy costs and the required tariff adjustments or also from higher dividend distributions. We forecast the company should continue to issue debt (releverage), primarily to support its investment needs and pay dividends, but under prudent administration to maintain its credit metrics in line with its rating category.

Settlement of the long-standing contingent liability with Eletrobras

Eletropaulo had a BRL 1.5 billion (as of December 2017) contingent liability from a judicial dispute with Eletrobras (Ba3 stable) regarding the payment of a loan provided to Eletropaulo in 1986, which was undergoing the legal process for almost 29 years.

The company did 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. Nevertheless, in March 2018 the company reached a settlement with Eletrobras in which as part of that agreement Eletropaulo will pay BRL 1.5 billion over a period of about four years as per the following: (i) BRL 250 million after final legal settlement expected to happen in 2018; (ii) 3 annual installments of R$ 300 million, the first 12 months after payment of the first installment; (iii) Payment of R$ 250 million to be made 48 months after payment of the first installment; (iv) BRL 100 million to be paid in legal fees. All payments will be adjusted by CDI+1%, on the effective date of payment of each installment.

We add this amount to the company´s total debt and upcoming amortization schedule. Moreover, Eletropaulo has BRL 3.7 billion of underfunded pension liabilities, which Moody´s also sums to the total debt amount, according to our standard adjustments.

We consider this resolution a positive outcome as the ratings were constrained by the uncertainties around the non-funded contingency liability and its potential effects on the company´s liquidity.

Ownership change after the control acquisition by Enel Americas

On June 4th, 2018, in an auction held on the Brazilian Securities Exchange, with bids from Enel Americas and Neoenergia S.A., Enel acquired at the price of BRL 45.22 per share approximately 73.4% of the Company's total and voting capital, with the transaction totaling around BRL 5.5 billion. The offer will be open for another 30 days until July 4th in case existing shareholders decide to sell their shares in the meantime.

The Brazilian antitrust authority (the Administrative Council for Economic Defense or “CADE”) already approved the transaction, whilst the Brazilian energy regulator (Agência Nacional de Energia Elétrica or “ANEEL”) is expected to approve it in the coming days.

Eletropaulo scheduled meetings for June 21st, 2018 with its debenture holders to obtain the final waivers for the change in control, as this could be an event of acceleration according to the company´s indentures. Since May 2018, Eletropaulo has been negotiating a pre-approval from these creditors in the form of a pre-waiver for the transaction, therefore we do not expect the company will face difficulties in concluding the sale without triggering a debt acceleration.

Following the acquisition, the Enel Group will become the largest electricity distribution company in Brazil, serving 17.1 million customers. Headquartered in Santiago, Enel Americas became the successor company of Enersis S.A. after the separation of the group's Chilean and non-Chilean electricity generation, distribution and transmission assets. Enel Americas holds interest stakes in several regulated utilities and power generation companies operating in Colombia, Peru, Brazil and Argentina. ENEL S.p.A (Baa2 stable) holds a 51.8% interest stake in Enel Americas.

Enel has the commitment to perform a subsequent capital increase in Eletropaulo of at least BRL 1.5 billion in the short-term, which we expect will further strengthen the capital structure of the company. Enel said it already secured the financing to pay for the acquisition and this capitalization.

Liquidity Analysis

Eletropaulo´s liquidity has improved in the last couple years. The company posted BRL 0.8 billion cash position in the LTM ended March 2018, which should be further strengthened by Enel´s capital injection, compared to its short-term maturities of BRL 1.4 billion in the period, which were already partially refinanced.

We notice Eletropaulo´s latest debt activity was more of short-term debt issuances, which we consider is due to the tender offer process from the last months, as the company delayed its plans to refinance the long-term debt and ended up issuing short-term debt. Nonetheless, we consider this was a temporary strategy and that Eletropaulo will maintain its long-term debt profile mainly through local debentures issuances, returning its average maturity to the historical levels around 5 years compared to the 3.5 reported in the 1Q2018.

Our ratings incorporate Eletropaulo´s sound access to the local bank and capital markets which we deem to continue in the projected period. The company does not have any committed banking facilities, like most Brazilian corporations.

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 March 2018, the company reported these ratios at 3.13x and 3.58x, respectively. Breach of financial covenants could result in debt acceleration if reported in two consecutive quarters depending on the debenture holders waiver with a quorum of 75-90% to accelerate the debt in a General Assembly.

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 3/31/2018		Moody's 2019-21 Forward View As of 6/6/2018 [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
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)	2.8x	Ba	3.1x	Baa
b) CFO pre-WC / Debt (3 Year Avg)	17.2%	Baa	17.6%	Baa
c) CFO pre-WC – Dividends / Debt (3 Year Avg)	16.9%	Baa	15.2%	Baa
d) Debt / Capitalization (3 Year Avg)	76.2%	Caa	69.1%	B
Rating:				
Grid-Indicated Rating Before Notching Adjustment		Ba1		Ba1
HoldCo Structural Subordination Notching				
a) Indicated Rating from Grid		Ba1		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 3/31/2018(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	Ba2
NSR Corporate Family Rating	Aa3.br
Senior Unsecured -Dom Curr	Ba2
NSR Senior Unsecured	Aa3.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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