FitchRatings

FITCH: BRAZIL CONCESSION RENEWAL OFFER NEGATIVE FOR ELETROBRAS, MARGINAL FOR OTHERS

Fitch Ratings-Rio de Janeiro-07 November 2012: The Brazilian Government's offer through its Ministry of Mines and Energy (MME) for an early renewal of some expiring electricity concessions will have various impacts for different companies, according to Fitch Ratings. Fitch considers the offer negative for Centrais Eletricas Brasileiras S.A. (Eletrobras, IDR 'BBB') and neutral to negative for other affected companies.

The Brazilian government is offering monetary compensation to companies with concessions expiring between 2015 and 2017 to renew these concessions early in 2013 at tariffs that will generate breakeven EBITDA. The upfront payment might not be enough for Eletrobras to adjust its capital structure to a level that will still be in line with the company's credit quality. Other companies could use the government payment to repay debt and continue to have balanced capital structures, depending on what they do with cash inflow.

The government's proposal for generation and transmission revenues would significantly reduce Eletrobras' and Companhia de Transmissao de Energia Eletrica Paulista S.A.'s (CTEEP; IDR 'AA+(bra)') cash flow generation. Companhia Paranaense de Energia (COPEL; IDR 'AA+(bra)') could see its EBITDA decline by 10% to 15% beginning in January 2013, if they accept the government's offer given these expiring concessions represent only a small proportion of their total cash generating assets. Companhia Energetica de Minas Gerais (CEMIG; IDR 'AA(bra)') will also have a EBITDA reduction of 10% to 15% beginning in January 2013 if they accept the government's offer. This will increase to around 30% after 2015, as Cemig has three important hydroelectric plants with concessions expiring during this period and will not be renewed early under the government's scheme. In general, the government's proposals will limit available funds to reinvest internal cash flow generation back into the electricity sector and reduce their ability to access debt capital markets and bank financing.

Eletrobras Most Exposed

The MME offer for renewing Eletrobras' electric concessions that expire between 2015 and 2017 holds the potential to negatively impact the company's credit quality. The MME offered approximately BRL14 billion to Eletrobras to renew its concessions for a period of 30 years beginning in January 2013. The new concessions would be at significantly lower revenues, which will result in zero to negative EBITDA for Eletrobras. The BRL14 billion renewal compensation compares unfavorably with the company's net adjusted debt of approximately BRL32.1 billion, particularly considering the ensuing EBITDA would be close to zero or potentially negative should the company accept the offer.

Although the company is not expected to face immediate liquidity constrains should it decide to accept the government's offer, its leverage level, as measured by total debt to EBITDA will significantly increase. The company would be able to service its debt over the next five years, given its favorable debt maturity schedule. Nevertheless, Eletrobras' liquidity could be pressured as the company is significantly involved in the development of the country's electricity infrastructure expansion efforts. Significant direct government support in the form of capital contribution and access to financing from the different government development agencies would play an important role in mitigating the aforementioned risk and for the company to maintain its current ratings.

Eletrobras' consolidated EBITDA, as measured by operating income plus depreciation, for the last 12 months (LTM) ended June 30, 2012 was BRL6.4 billion and would likely decline to a range of zero to negative. The company would require significant financial support from the Federal Government to meet its ambitious investment plans and be able to service its debt obligations. The company's reported and estimated capex for 2011 and 2012 are BRL10 billion and BRL13 billion, respectively. Fitch expects Eletrobras to accept the government's proposal given the government's ownership interest, which will pressure Eletrobras' credit quality given its weak credit metrics for the assigned rating category on a standalone basis. Under this scenario, the absence of direct financial support from the Federal Government could result in a negative rating action.

CTEEP and ISA Capital: Likely Neutral to Credit Quality

MME's offer for renewing electric concessions is neutral to negative for CTEEP's credit quality, depending on how the company uses the renewal proceeds. The MME offered CTEEP approximately BRL2.9 billion to renew in 2013 its concession expiring in 2015 and reduce tariffs to a breakeven level for the next 30 years. The MME's upfront payment is greater than the company's stand-alone debt of approximately BRL2.1 billion, which should be enough for CTEEP to repay all its outstanding debt, excluding project finance debt. The company could also upstream enough dividends to its controlling shareholder, ISA Capital do Brasil S.A. (ISA Capital), for this entity to repay its financial debt outstanding, excluding preferred equity, of approximately BRL64 million. Should the company decide to accept the government's offer and use the proceeds to invest in projects and not repay debt, its credit quality would deteriorate significantly.

Fitch believes it is unlikely that CTEEP will accept the government's proposal. Under the government's proposal, CTEEP's pro-forma EBITDA for the LTM ended June 30, 2012 would be negative and the company will depend on its current ongoing investments to generate positive cash flow in the future. MME's proposal will lower the company's revenues by approximately BRL1.6 billion to approximately BRL1.3 billion from BRL2.9 billion, which would wipe out the company's EBTIDA of BRL1.5 billion as of the LTM ended June 30, 2012. This offer would also significantly hindered CTEEP's investment ability going forward as it would limit the company's ability to raise debt at the holding company level and it would affect its cash flow generation to support investments.

If CTEEP declines the government's offer and waits until 2015 when its main concession expires, the company will benefit from the permitted annual revenue (PAR) generated by this concession between 2013 and 2015. The company will also likely receive compensation for the remaining value of this asset, net of depreciation, when the concession expires in 2015, which will likely be disputed. Under this scenario, the company would also have the possibility of participating on a bidding process to retain the asset or returning this asset to the government if it deems its ensuing PAR is unattractive. Of CTEEP's BRL2.9 billion of consolidated revenues reported for the LTM ended June 30, 2012, BRL2.0 billion came from its concession expiring in 2015. The government offered CTEEP BRL2.9 billion of an upfront payment to lower this revenue to approximately BRL500 million.

The current government's proposal could also have other negatives implications for CTEEP as significant capital investment requirements as well as asset impairments that could hurt net income and the company's ability to distribute dividends. If the government payment for CTEEP's concession expiring 2015 is lower than the book value of this asset, it will immediately result in an impairment of the asset that will lower net income and impact the company's ability to pay dividends to its shareholders. Also, the current government proposal for extending the concession has some mandatory capital investments that will be difficult for CTEEP to accomplish given its resulting limitation to its capital structure and cash flow generation ability.

Copel: Impact Marginal

The concession renew process is not expected to materially pressure Copel's credit profile. Under the government's offer for Copel, the company would receive approximately BRL894 million to renew its concessions expiring between 2015 and 2017 and accept the lower generation and transmission revenues. As a result, EBITDA would decline by approximately 10% to 15%. As of the LTM ended June 30, 2012, Copel reported an EBITDA of approximately BRL1.8 billion. Fitch expects Copel's credit metrics to continue to be in line with its assigned ratings even if it accepts the government offer. As of June 2012, the company's consolidated net leverage of approximately 0.8 times was considered strong for the rating category. The company can use this proceeds to pay a portion of its BRL2.7 billion of debt outstanding, pay dividends or reinvest in new projects without significantly impacting its ratings.

Cemig: Negative Impact Partially Offset by New Investment

A majority of Cemig's concessions expire between 2013 and 2017. Cemig has informed the government it was not interested in an offer to renew three of its largest concessions early at significantly lower tariffs for an upfront government payment. The company was interested in receiving an offer for other certain concessions.

The government offered BRL285 million and lower revenues to the company to renew the other eligible concessions, which compares unfavorable with the company's total net debt of approximately BRL15.2 billion. If Cemig accepts MME's proposal, the company's cash flow generation and credit quality would be marginally affected as its EBITDA could decline by approximately 10% to 15% beginning in 2013.

After 2015, Cemig is exposed to losing another 15% of its EBITDA due to the expiration of three concessions. The company has already indicated to the government that it would not participate in any early renewal offer of approximately 2,542 MW of installed capacity coming from three hydroelectric plants. Cemig will let these concessions expire and is likely going to litigate the renewal of these concessions at similar terms with the government in court.

Cemig's credit quality will be subject to the company's ability to quickly increase revenues and EBITDA from new projects and maintain adequate liquidity from the potential sale of assets. The company is currently in the processes of selling some assets to Transmissora Alianca de Energia Eletrica S.A. (Taesa) for approximately BRL1.8 billion and the company could receive approximately BRL2.0 billion from the Minas Gerais Government in relation to CRC debt.

Fitch rates the various companies as follows:

Eletrobras
--Foreign Currency IDR 'BBB';
--Local Currency IDR 'BBB';
--National Scale rating 'AAA(bra)';
--USD1 billion senior unsecured notes due 2019 'BBB';
--USD1.75 billion senior unsecured notes due 2021 'BBB'.

Furnas Centrais Eletricas S.A.
--Foreign Currency IDR 'BBB';
--Local Currency IDR 'BBB';
--National Scale rating 'AAA(bra)'.

Cemig
--National Scale rating 'AA(bra)'.

Cemig Distribuicao S.A.
--National Scale rating 'AA(bra)';
--BRL250.5 million 1st debenture issuance due 2014 'AA(bra)';
--BRL400 million 2nd debenture issuance due 2017 'AA(bra)'.

Cemig Geracao e Transmissao S.A.
--National Scale rating 'AA(bra)';
--BRL1.35 billion 3rd debenture issuance due 2022 'AA(bra)'.

Copel
--National Scale rating 'AA+(bra)'.

CTEEP
--National Scale rating 'AA+(bra)' ;
--BRL548 million 1st debenture issuance due 2017 'AA+(bra)'.

ISA Capital
--Foreign Currency IDR 'BB+';
--Local Currency IDR 'BB+';

--National Scale rating 'AA-(bra)';
--USD31.6 million outstanding senior secured notes due 2017 'BBB-'.

Contact:

Lucas Aristizabal
Director
+1-312-368-3260
Fitch, Inc.
70 West Madison St.
Chicago, IL 60602

Mauro Storino
Senior Director
+55-21-4503-2625

Renata Pinho
Director
+55-11-4504-2207

Ricardo Carvalho
Senior Director
+55-21-4503-2627

Media Relations: Elizabeth Fogerty, New York, Tel: +1 (212) 908 0526, Email: elizabeth.fogerty@fitchratings.com.

Additional information is available at 'www.fitchratings.com'.