

Global Credit Research - 11 Dec 2015

Sao Paulo, Brazil

Ratings

Category	Moody's Rating
Outlook	Rating(s) Under Review
Issuer Rating -Dom Curr	*Baa3
Subordinate -Dom Curr	*Ba1
NSR LT Issuer Rating	*Aa1.br
NSR Subordinate	*Aa2.br
Ult Parent: EDP - Energias de Portugal, S.A.	
Outlook	Stable
Issuer Rating	Baa3
Bkd Sr Unsec MTN -Dom Curr	(P)Baa3
Jr Subordinate -Dom Curr	Ba2
Commercial Paper -Dom Curr	P-3
Parent: EDP - Energias do Brasil S.A.	
Outlook	Negative
Corporate Family Rating -Dom Curr	Ba2
Senior Unsecured -Dom Curr	Ba2
NSR Corporate Family Rating	Aa3.br
NSR Senior Unsecured	Aa3.br

* Placed under review for possible downgrade on December 10, 2015

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Key Indicators

[1]Bandeirante Energia S.A.	9/30/2014(L)	12/31/2013	12/31/2012	12/31/2011	12/31/2010
CFO pre-WC + Interest / Interest	5.2x	7.5x	4.7x	5.8x	7.3x
CFO pre-WC / Debt	48.0%	64.6%	27.9%	55.4%	57.3%
CFO pre-WC - Dividends / Debt	28.9%	59.4%	21.4%	22.2%	32.8%
Debt / Capitalization	46.9%	37.6%	51.6%	50.3%	52.7%

[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

Note: For definitions of Moody's most common ratio terms please see the accompanying [User's Guide](#).

Opinion

Rating Drivers

- Historical solid credit metrics, with periodic support of shareholders
- Weaker liquidity from the acquisition of more expensive thermal energy in 2015
- Resilient access to the local capital and banking markets

Corporate Profile

Bandeirante Energia (Bandeirante), headquartered in São Paulo, Brazil, is an electricity distribution utility fully controlled by EDP Energias do Brasil (EDB), an integrated utility group that is in turn controlled by EDP - Energias de Portugal, S.A. (Baa3 stable). Bandeirante serves around 1.7 million clients in the eastern portion of the industrialized state of São Paulo. In 2014, Bandeirante reported net revenues of BRL 3,060 million (USD 1,301 million), which does not include construction revenues of BRL 138 million (USD 59 million), on sales of 15,452 GWh, constituting around 3.2% of the electricity consumed in Brazil's integrated system.

SUMMARY RATING RATIONALE

The Baa3/Aa1.br issuer ratings reflect the stable and predictable cash flow from Bandeirante's regulated distribution business, strong credit metrics for its rating category and its historically good access to the local banking and capital markets. The ratings are constrained by the company's high dividend pay-out ratio, relatively sizeable capital expenditures and the evolving regulatory environment in Brazil.

The change in outlook to negative from stable in March 2015 reflected the growing uncertainties about the potential impact of any energy rationing on the company's cash flow and liquidity. It also remains unclear how the company will handle the distribution of dividends in light of an expected deterioration in cash flow metrics owing to an increase in debt to finance working capital needs despite the recent mandated increase in tariffs as well as the scheduled fourth tariff review in October 2015.

Recent Events

On December 10, 2015, Moody's placed Bandeirante's ratings under review for downgrade following the placement of Brazil's issuer and bond ratings under review for downgrade on December 09, 2016.

On March 6, 2015, Moody's America Latina Ltda affirmed the Baa3/Aa1.br issuer ratings on Bandeirante. Moody's also affirmed the Ba1/Aa2.br ratings on BRL 390 million in subordinated debentures issued by Bandeirante that are scheduled to mature in July 2016. The outlook for all ratings was changed to negative from stable.

On February 27, 2015, ANEEL (the Regulator) approved an extraordinary tariff adjustment for Bandeirante. The tariff repositioning was set at 32.18%, being 24.89% related to economic part and 7.29% related to financial components. The new tariff was applied on March 02, 2015.

On February 13, 2015, Moody's Investors Service upgraded to Baa3/Prime-3 from Ba1/Not Prime the senior unsecured debt and issuer ratings of EDP - Energias de Portugal, S.A. (EDP, the group), Hidroelectrica del Cantabrico S.A. and the senior unsecured debt ratings of EDP Finance B.V. The outlook on all ratings is stable.

In the course of 2014, Bandeirante received a total of BRL 309.5 million from the Brazilian Electricity clearing House CCEE through ACR Account to compensate for the increased costs incurred acquiring dispatched thermal power energy.

On November 25, 2014, the Regulator, through Decree 5163/2014, announced the new maximum and minimum limits for short-term electricity prices, at BRL388.48/MWh and BRL30.26/MWh, respectively, which will be implemented in 2015.

On October 21, 2014, ANEEL, ("the Regulator") approved the 2014 annual tariff adjustment for EDP Bandeirante, which took place on October 23, 2014. The tariff adjustment was 22.34%.

On July 30, 2014, Moody's affirmed the Ba1, (P) Ba1 and non-prime ratings of EDP - Energias de Portugal S.A. (EDP), EDP Finance B.V. and Hidroelectrica del Cantabrico SA. The outlook was changed to positive from negative.

In April 2014, Bandeirante borrowed BRL 300 million from a local bank Banco Safra with a five-year tenor and a three-year grace period for the payment of principal, which will be paid in five semiannual installments.

In the first four months of 2014, Bandeirante received BRL 204 million from the Brazilian Electricity clearing House CCEE to compensate for the increased costs incurred acquiring dispatched thermal power energy.

In the first quarter of 2014, Bandeirante distributed dividends of BRL 100 million.

In February 2014, Bandeirante borrowed from the federally-owned bank Banco do Brasil BRL 98 million with a bullet payment in July 2015.

In 2013, Bandeirante received BRL 355.6 million from the sector's regulatory charge CDE (Energy Development Account).

On June 5, 2013, Moody's affirmed the ratings of Energias do Brasil S.A. (EDB, Ba1; Aa2.br), Bandeirante Energia S.A. (Bandeirante, Baa3; Aa1.br), Espirito Santo Centrais Eletricas S.A. (Escelsa, Baa3; Aa1.br) and Energest S.A. (Energest, Baa3; Aa1.br). The outlook for all ratings remained stable.

On March 7, 2013, the Federal Government published decree law # 7,945 with the following objectives:

- 1) Use of financial resources from the sector's regulatory charge CDE (Energy Development Account) to fund distribution companies for additional costs incurred with the acquisition of more expensive thermal power due to drought conditions so as to avoid the permanent transfer of these costs to electricity tariffs.
- 2) Changes in the criterion to calculate PLD (spot prices) by including associated costs with the dispatch of energy out of the order of merit.
- 3) Costs associated with promoting energy safety are to be shared among all the electricity industry's players including generators, distributors, traders and free consumers.

DETAILED RATING CONSIDERATIONS

HISTORICALLY STRONG CREDIT METRICS

Bandeirante had historically posted strong profitability and cash flows for five consecutive years up until 2011 driven by the fairly stable nature of its regulated distribution business. In this period, cash drains mainly consisted of capital expenditures and the distribution of dividends, which have been in line with the company's internal cash generation. This is evidenced by the steady financial leverage as measured by the three-year average (2009-2011) of CFO-WC over Debt ratio of 50.8% and retained cash flow (CFO Pre-WC - dividends) over debt ratio of 22.2 %.

Bandeirante recorded a weaker operating performance in 2012 as result of the tariff freeze imposed by the regulator since October 2010 to partly offset the non-application of the third tariff review the company was scheduled to go through in October 2011 until October 2012 due to the delay by the regulator in publishing the methodology and operational procedures of the third tariff review. Consequently, lower operating margins resulted from the combination of the tariff freeze along with increased costs belonging to both categories part A and Part B of the tariff structure. The regulator applied the same tariff freeze procedure to all distribution companies initially scheduled to have their electricity tariffs reviewed in 2011 in accordance with the operational procedures of the third tariff review.

In 2012, Bandeirante posted a weaker operational and financial performance, which was in line with what we had previously anticipated, as evidenced by CFO-WC over Debt ratio of 23.5%. This weaker cash flow ratio was tempered by much lower dividend payment of BRL 54 million in 2012 down from the previous three-year average of BRL 242.7 million, which led to a lower but still strong RCF over debt ratio of 17.0% in 2012.

In 2012, increases in the cost of acquiring thermal energy hurt Bandeirante's cash flow which resulted in BRL134.5 million in net regulatory assets, which were not recovered in the company's tariffs in 2012. The company is entitled to receive higher tariffs to recover any cost not covered by tariffs, which historically has been granted once a year to the distribution companies, which in the case of Bandeirante occurs every October.

Given the magnitude of the higher costs associated with the acquisition of the more expensive thermal energy, the federal government published a provisional measure in March of 2013 to be utilized to alleviate the liquidity pressure of virtually all Brazilian distribution companies due to these unrecovered costs but to also prevent the obvious negative impact these costs could have on inflation.

In 2013, Bandeirante recorded an outstanding financial performance, which exceeded not only ours but also management's expectation. This is evidenced by the significant improvement in the company's credit metrics as measured by the CFO-WC over Debt ratio of 61.6% in 2013 up from the previous three-year average ratio of 43.2% and 23.5% in 2012. Leverage as measured by the debt to capitalization ratio experienced a significant reduction to 37.6% from the previous three-year average ratio of 51.5% and 51.6% in 2012. The RCF to debt ratio dramatically improved to 56.4% in 2013 from the previous three-year average ratio of 20.4% and 17% in 2012.

The improvement in credit metrics in 2013 can be attributed to the combination of higher operating margins, lower payment of dividends and to a lesser extent to the capitalization of BRL 85 million in the first quarter of 2013 by EDB, and a reduction in the accounting amount of unfunded pension liabilities.

Bandeirante's higher operating margins stemmed from the reduction in net regulatory assets to BRL 98.6 million as of December 31, 2013 from BRL 135 million as of December 31, 2012 and negative BRL 6 million as of December 31, 2011. As a result, Bandeirante's EBITDA was overstated by around BRL 36 million in 2013 and understated by BRL 141 million in 2012 in comparison with the company's normalized EBITDA, calculated in accordance with the regulatory accounting procedures, which differ from the IFRS that does not recognize the existence of regulatory assets and liabilities.

The receipt of BRL 355.6 million from CDE in 2013 and the 10.36% tariff adjustment granted by ANEEL in October 2013 were the main factors responsible for the reduction in the company's net regulatory assets. The receipt of resources from CDE not only reduced the amount of regulatory assets the company had been forced to recognize in 2012 but also contributed to a reduction in the pressure on their liquidity.

In light of its tight liquidity position and the uncertainties regarding the receipt of additional resources from the CDE fund, Bandeirante has somewhat reduced the payment of dividends in the past two years. The company paid dividends of BRL 54 million in 2012 and BRL 35 million in 2013, which represented dividend pay-out ratios of 66.6% and 18.3%, respectively.

The non-cash reduction in unfunded pension fund liabilities to just BRL 7.5 million in 2013 from BRL 161.3 million in 2012 also benefitted the company's credit metrics. This reduction derived from the application of a higher internal rate of return on the company's pension fund's assets and liabilities which resulted in a lower present value for the unfunded portion which Moody's considers debt-like.

In 2013, Bandeirante's total volume sales increased by 2.4% to 15,359 GW/h from 15,003 GW/h in 2012, considering all market segments, i.e., regulated, free and spot. The volume of the regulated market remained flat at 9,448 GW/h fueled by the significant growth of the commercial and residential consumer classes, which increased electricity consumption by 3.8% in both consumer classes. This significant sales growth was hurt by the regulated industrial consumers, which reduced their electricity consumption by 7.5%.

The free market segment, which largely consists of large industrial consumers and represents around 38% of the company's total volume sales, increased its electricity consumption by 10.1% which basically reflected the migration of industrial consumers from the regulated to the free market.

In 2014, Bandeirante's total volume sales reached 15,672 GWh, an increase of 2% from 15,359 GWh in 2013 (volumes include short-term energy sales). Consumption volumes in asset classes have been relatively stable, with growth stemming from the commercial and rural classes, with 8.6% and 5.6% growth, respectively.

On the basis of accounting rule OCPC 08, distribution companies must now recognize their balance of regulatory assets and liabilities on their financial statements, a change that was reflected in company's 2014 year-end results. As a consequence, EDP Bandeirante's operating revenue in 2014 was impacted by the booking of sector financial assets in the amount of BRL 351.5 million.

EDP Bandeirante posted net revenues of BRL 3,060.5 million in 2014 (excluding construction revenue), 24.5% above 2013. This increase is largely due to revenue from sectorial financial assets recognized on December 10, 2014 in the amount of BRL 351.5 million. The increase in distributed energy volume and the effects of the annual tariff readjustments also made notable contributions to this value.

On October 21, 2014, the electric power regulator, Aneel approved the annual tariff readjustment of 2014 for the company with a tariff repositioning of 22.34%, 15.05% relative to economic repositioning and the remaining 7.29% with respect to financial components. The average impact on consumer billings will be 21.93%.

CHALLENGING ENVIRONMENT EXPECTED TO CONTINUE OVER THE MEDIUM TERM HORIZON

We expect that the current challenging drought environment EDB has been facing will continue in 2015 and potentially in 2016 as well, which will largely depend on the regularization of the water levels of the Brazilian hydro-power reservoirs especially in the northeastern and southeastern regions of the country. In light of this critical situation the risk of implementing an energy rationing has dramatically increased over the past weeks with some independent consultancy companies forecasting that this risk is running at around 50%.

Bandeirante presented weaker credit metrics in 2014 as we expected. In addition, its net regulatory assets balance expanded as a result of the increase in the acquisition of thermal power. We expect that its net regulatory assets base will continue to increase in 2015, as environmental conditions are not expected to improve in the current year and, as a result, we expect this deficit in acquisition of thermal power will not be fully covered either by CDE or CCEE in 2015. In October 2014, the electric power regulator, ANEEL, approved the annual tariff readjustment of 2014 for the company with a tariff repositioning of 22.34%, 15.05% relative to economic repositioning and the remaining 7.29% with respect to financial components. On February 27, 2015, EDP Bandeirante announced that the Board of ANEEL approved an extraordinary tariff revision of 32.18% for Bandeirante, effective March 2, 2015. However, the challenging environmental conditions and the cost of thermal power energy will continue to pressure Bandeirante's liquidity and credit metrics in 2015. As a result, we estimate that net regulatory assets will increase by BRL 144 million in 2015, reaching an estimated total of BRL 436 million.

We expect that Bandeirante's cash flow improvement will take longer than expected, starting in 2016 boosted either by the receipt of resources from the CDE fund or the pass-through of some portion of the regulatory asset amounts to tariffs, which we project will be reduced by around BRL 200 million per year from 2015 through 2017. A forecasted 3% annual growth in sales volume will also contribute to higher operating margins during this period partly offsetting some forecasted reduction in tariffs in October 2015 as a result of the scheduled fourth tariff review. Starting in 2016, we expect the level of regulatory assets to be extinguished by the end of 2017.

Our projections indicate that CFO before changes in working capital will decrease to BRL 336 million in 2015 (42.6% of debt), further decrease to BRL 192 million in 2016 (18.2% of debt), with an increase in debt levels, mainly due to lower results as a consequence of Bandeirante's fourth tariff review in October 2015. We expect CFO before changes in working capital to improve starting 2017 to an average BRL 269 million (24.9% of debt)

As a result of the forecasted decrease in the company's cash from operations, we expect that Bandeirante will reduce its dividend pay-out ratio, which will increase the RCF to debt ratio to 34.7% in 2015. However, from 2016 to 2018 we expect Bandeirante to resume its historical dividend pay-out ratio levels, with a strong decrease in RCF to debt ratio to an average of 8%.

LOWER TARIFFS FROM THE TARIFF REVIEW IN OCTOBER 2015

According to the Brazilian electricity regulatory model, all Brazilian electricity distribution companies are subject to periodic tariff reviews every four to five years in order to transfer any productivity gains to consumers.

In October 2012, the regulator ANEEL applied the new methodology for its tariff review to Bandeirante. The application incorporated a lower WACC of 7.5% down from the 9.95% utilized in the second tariff review in the face of lower capital costs (equity and borrowings) experienced among the Brazilian electricity distribution companies. The new procedures of the third tariff review have been applied to the Brazilian distribution companies since 2011 and were completed in 2013.

In accordance with ANEEL's technical note #352/2012 on the application of the operational procedures of the third tariff review on Bandeirante' tariffs, the company's part B of the tariff structure was reduced by 22.2%, with an equivalent reduction in tariffs by 6.1%. As a result, the company's regulatory EBITDA was to be around BRL 310 million at the currency value as of October 01, 2012, with effects retroactive to October 2011.

We expect the application of the tariff review in October 2015 will incorporate a WACC of 8.09%, higher from the previous WACC of 7.5% used in the tariff review in October 2012. Although a slight credit positive compared to 2012, we expect a lower regulatory EBITDA for Bandeirante due to the transfer of productivity gains to consumers (Part B of the tariff formula), as determined by ANEEL. The part B of the tariff formula mainly consists of the operating costs (Reference Company), depreciation and the remuneration amount. Bandeirante has consistently

posted higher levels of EBITDA in comparison with that envisaged in the regulator's tariff methodology, which suggests that Bandeirante has adequately managed its operating costs. We foresee that the company's normalized EBITDA will most likely keep exceeding the parameters determined by the regulator and, as a consequence, we expect the tariff review in October 2015 will set the company's regulatory EBITDA to be around BRL 370 million.

LEVEL OF SUPPORT OF EDP PORTUGAL

The ratings assigned for the EDB group also factor in the ownership by its ultimate parent company, EDP Portugal (Baa3; stable outlook). While EDP does not guarantee EDB's debt, the Portuguese parent expects that its subsidiaries will remain financially self-sustainable, as stated in its published policies. We believe that the Brazilian operations of EDP continue to play an important role in the group's growth strategy. We believe that the Brazilian subsidiaries of EDB, mainly the distribution companies, are to a large extent insulated from any potential credit deterioration of their ultimate parent company. These results from regulatory oversight and existing financial covenants embedded in most of the debt contracts which prevent those subsidiaries from increasing their leverage over a certain agreed limit.

Furthermore, we see as a credit positive the fact China Three Gorges Corporation (A1, stable outlook) holds 21.35% of the capital of EDP - Energias de Portugal. In June 2014, EDB received BRL 420 million from the sale of 50% of its participation in two major power projects to CWEI Brazil, the Brazilian subsidiary of the Chinese Three Gorges.

We further believe that EDP Portugal will continue to support the activities of EDB by preserving the current strong capital structure of its Brazilian subsidiary; however, we will continue to monitor the evolution of the creditworthiness of EDP Portugal.

EVOLVING BRAZILIAN REGULATORY ENVIRONMENT

The Brazilian regulatory framework has been a constraining factor in the rating assessment of the Brazilian electric utilities given its history of being unpredictable having undergone substantial changes over the past several years. The electricity regulatory model implemented in 2004 has mitigated many of the uncertainties brought about by constant changes in the Brazilian regulatory framework over the past two decades. This model has provided a relatively more supportive and predictable environment for being, in many aspects, more transparent and technically-driven, thus increasing the predictability of returns on invested capital.

Nonetheless, we believe that the significant improvements that the Brazilian regulatory framework had accomplished since the new model was implemented in 2004 have been offset, to a certain extent, by the manner in which the federal government managed the process of accelerating the renewal of the concessions expiring between 2015 and 2017 last year.

The publication of the federal government's provisional measure #579 in September 2012, which became law #12,783 in January 2013, has caused concern within the electricity industry because the government's proposal to renew the generation and transmission concessions expiring between 2015 and 2017 was materially more costly versus the expectations of most market participants, including concessionaires and investors.

Regardless of the legal aspects involving the implementation of this new legislation which can potentially generate a series of lengthy legal suits and appeals in the Brazilian courts, the manner in which the government managed the whole process since the initial announcement and subsequent discussion and communication ended up creating uncertainties about the quality and the level of supportiveness of the Brazilian electricity regulatory environment. As a result, we foresee a lower assurance of timely recovery of costs and investments in Brazil since the publication of the federal law #12,783.

For Moody's, the regulatory framework (Factor 1) and the ability to recover costs and earn returns (Factor 2) are major drivers in the rating assessment of a given issuer pursuant to our updated methodology "Regulated Electric and Gas Utilities" published in December 2013.

The current low Ba rating assigned to these two factors largely reflects the increased levels of uncertainty relative to the continued development of the Brazilian regulatory framework and the timeliness of recovering costs and earning an adequate return recognizing that there have been inconsistencies in the way the framework has been applied as evidenced by some of the operational procedures contained in the federal law #12,783.

Liquidity

Like most Brazilian companies, Bandeirante does not have any committed banking facility to accommodate any unexpected cash disbursements. The company has been facing a tight liquidity position since the last quarter of 2012 as it has been forced to acquire the more expensive thermal energy at unusual very high prices due to the persistent drought conditions, which we expect will continue in 2015. Typically, Bandeirante, as any other distribution company, is eligible to be reimbursed through the pass-through mechanism to tariffs of any increased cost of part A of the tariff structure, which consists of the so-called non-controllable costs. However, we expect Bandeirante's cash flow be impaired by lower cash flow stemming from lower tariffs from the application of the fourth tariff review in October 2015.

In light of the severe liquidity stress faced by virtually all Brazilian distribution companies during this period and to avoid the permanent transfer of the incurred increased energy costs to tariffs the federal government stepped in by utilizing the transfer of resources from the CDE fund. Total cash injections by CCEE in 2014, via ACR account, for Bandeirante were R\$ 309.5 million.

On December 29, 2014, EDP Bandeirante signed a financing agreement with the Brazilian Development Bank - BNDES in the total amount of BRL 298.8 million. The first drawdown is to take place in the first quarter 2015 with the last to fall due by February 2017. Payment of principal will begin between June 2016 and June 2017, with final maturity falling between May 2022 and December 2024. This financing has a corporate pledge from EDP Energias do Brasil and the fiduciary assignment of revenues.

Moody's understands that Bandeirante has adequately managed its liquidity position considering the rather unfavorable environment the Brazilian distribution companies have been facing since mid 2012. In addition to the receipt of the CDE and CCEE funding, its shareholder EDB capitalized Bandeirante by an additional BRL 85 million in the first quarter of 2013, which we see as evidence of shareholder support. However, liquidity has been reduced in 2014 due to the high dividend pay-out ratio of approximately 93%.

Continued financial support from the federal government as it occurred in the recent past would be the best alternative for strengthening the liquidity position of not only Bandeirante but also for all the Brazilian distribution companies; however, we believe the distribution companies, including Bandeirante, will have to continue offsetting losses via ordinary and extraordinary tariff adjustments granted by ANEEL given the current economic pressures the government is facing.

As per the determination of the Brazilian securities exchange commission (CVM), all distribution utilities will recognize the existence of regulated assets and liabilities in their financial statements starting in December 2014. As a result, all Brazilian distribution utilities will most likely report an extraordinary performance in the fourth quarter of 2014 because most of them reported a sizeable outstanding balance of regulated assets.

Consequently, the existing regulated assets balances were fully recognized in the last quarter boosting the operating profits of EDB's distribution utilities. As a result, cash flow statements changed accordingly - FFO increased while changes in working capital needs increased in tandem with the expected growth in FFO so that cash from operations remained basically unchanged. In the case of Bandeirante, operating revenue was impacted by the booking of sector financial assets (regulatory assets and liabilities) in the amount of BRL 351.5 million the majority of the total of EDB group's BRL 601.5 million.

We deem the change in this accounting procedure as very positive in that it will allow a better and more accurate interpretation of the cash flow performance of a given distribution utility. This new accounting approach is in line with US GAAP's accounting practices which will permit a more reliable comparison between Brazilian and American electric utilities.

We believe that EDB's resilient access to the local banking and capital markets is an important mitigating factor for potential additional pressure on liquidity. Nevertheless, we feel it is very important that EDB and its subsidiaries, including Bandeirante, remain capable of securing adequate long-term funding while at the same time balancing capital expenditures and the distribution of dividends to maintain a capital structure and liquidity position that are commensurate with their current rating category.

We view the current liquidity standing of the holding parent company EDB and some of its subsidiaries as being inadequate when compared with the typical liquidity characteristics of other investment grade issuers in Brazil. EDB's weaker liquidity position has resulted from the delay in the start-up of operations of the PECEM thermal power project followed by repeated technical breakdowns, relatively high payment of dividends at the level of the holding parent company, capital injections in major power projects and the forced purchase of higher priced energy to meet the obligations of its PPAs.

On June 27, 2014, the parent holding company EDB announced it received from CWE Brasil (unrated), controlled by China Three Gorges (A1 stable), BRL 420.6 million related to the sales of its 50% participation in two major power projects as described in our issuer comment published on December 12, 2013.

Corporate Governance

Bandeirante's rating considers that EDB has corporate governance practices that are above the average of Latin American issuers. EDB is a publicly listed company with shares traded on the Novo Mercado of Bovespa. While its shares are only traded on the Sao Paulo stock exchange, the company undertook several steps beyond what is legally required to adapt the US Sarbanes-Oxley Act as part of its commitment of practicing superior standards of corporate governance.

EDB's Board of Directors is made up of eight members, of which three are considered independent. The board relies on four support committees: Audit, Sustainability, Corporate Governance and Related Parties, and Compensation. The Audit, the Sustainability and the Corporate Governance and Related Parties Committees are permanent in nature and are comprised of three members where at least one is independent. There is also a Fiscal Council composed of three members and three alternates elected for a maximum term of one year; however, it is non-permanent and convened only when requested by shareholders.

Rating Outlook

The review for downgrade follows the placement of Brazil's Baa3 issuer and bond ratings under review for downgrade on December 9, 2015. The company's operational and financial performance is subject to the evolution of the macroeconomic and regulatory environment in Brazil as captured by the sovereign rating.

What Could Change the Rating - Up

Given the recent deterioration in EDB's consolidated credit metrics and our expectation that Bandeirante is slated to continue facing pressures on its liquidity standing in 2015 due to challenging electricity sector and environmental conditions, an upgrade rating action is very unlikely over the medium term.

What Could Change the Rating - Down

A downgrade of Brazil's sovereign rating would exert downward pressure on the assigned ratings. Also, a downgrade of Bandeirante could be triggered by a material deterioration of its credit metrics so that RCF over debt ratio were to decline and remain below 10% and interest coverage similarly fell below 3.5x, for any length of time. Alternatively, a downgrade of EDB's ratings could trigger a downgrade of Bandeirante, which could occur if the consolidated RCF over debt ratio is below 10% and interest coverage is below 3.5x on a sustainable basis. Deterioration in the level of supportiveness and involvement of the Brazilian regulatory environment for regulated utilities could also prompt a negative rating action for Bandeirante and EDB.

Rating Factors

Bandeirante Energia S.A.

Regulated Electric and Gas Utilities Industry Grid [1][2]	Current LTM 9/30/2014		[3]Moody's 12-18 Month Forward ViewAs of 3/11/2015	
	Measure	Score	Measure	Score
Factor 1 : Regulatory Framework (25%)				
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	Ba	Ba	Ba	Ba
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)	5.9x	A	4.8x	A
b) CFO pre-WC / Debt (3 Year Avg)	42.7%	Aaa	26.1%	A
c) CFO pre-WC - Dividends / Debt (3 Year Avg)	30.9%	Aa	13.9%	Baa
d) Debt / Capitalization (3 Year Avg)	47.8%	Baa	45.0%	A
Rating:				
Grid-Indicated Rating Before Notching Adjustment		Baa2		Baa3
HoldCo Structural Subordination Notching			0	0
a) Indicated Rating from Grid		Baa3		Baa3
b) Actual Rating Assigned				Baa3

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations. [2] As of 9/30/2014(L); Source: Moody's Financial Metrics [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.

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