

Credit Opinion: Transmissora Aliança de Energia Eletrica S.A

Global Credit Research - 17 Sep 2014

Brazil

Ratings

Category	Moody's Rating
Outlook	Stable
Issuer Rating -Dom Curr	Baa3
Senior Unsecured -Dom Curr	Baa3
Subordinate -Dom Curr	Ba1
NSR Senior Unsecured -Dom Curr	Aa1.br
NSR LT Issuer Rating -Dom Curr	Aa1.br
NSR Subordinate -Dom Curr	Aa2.br
Ult Parent: Companhia Energetica de Minas Gerais - CEMIG	
Outlook	Stable
Issuer Rating -Dom Curr	Ba1
NSR LT Issuer Rating -Dom Curr	Aa2.br
Parent: Cemig Geracao e Transmissao S.A.	
Outlook	Stable
Issuer Rating -Dom Curr	Baa3
Bkd Senior Unsecured -Dom Curr	Baa3
NSR LT Issuer Rating -Dom Curr	Aa1.br
NSR BACKED Senior Unsecured -Dom Curr	Aa1.br

Contacts

Analyst	Phone
Alexandre De Almeida Leite/Sao Paulo	55.11.3043.7300
Jose Soares/Sao Paulo	
William L. Hess/New York City	1.212.553.1653

Key Indicators

[1]Transmissora Aliança de Energia Eletrica S.A

ACTUALS	LTM 2Q2014	2013	2012	2011	2010
FFO + Interest / Interest	6.2x	5.5x	3.3x	3.7x	3.8x
Net Debt / RAV	84.4%	82.1%	81.2%	65.9%	40.7%
FFO / Net Debt	37.5%	33.8%	19.5%	19.8%	37.7%
RCF / Capex	7.6x	5.7x	8.7x	-18.3x	20.3x

[1] All ratios calculated in accordance with the Regulated Electric and Gas Networks Rating Methodology using Moody's standard adjustments.

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

Opinion

Rating Drivers

- Strong, stable and predictable operating cash flows supported by long-term concession contracts based on fixed capacity and inflation-adjusted tariffs
- Good access to bank and capital market financing
- Financial debt concentrated in the long-term
- Relatively strained liquidity
- High dividend pay-out ratio

Corporate Profile

Transmissora Alianca de Energia Eletrica S.A. ("TAESA" or the "Company") operates and maintains 9,844 km of high voltage (138 to 525kV) transmission lines through 28 (twenty eight) 30-year concessions. The Company currently controls directly 10 concessions.

TAESA is controlled by CEMIG GT (Baa3; stable) and the FIP Coliseu equity fund, which own 43% and 30% of TAESA's total capital, respectively. The remaining 27% shares are free float, traded on the local stock market (BM&FBOVESPA).

According to Moody's standard adjustments, in the last twelve months ended on June 30, 2014 (LTM ended on 06/30/2014), TAESA had consolidated net operating revenues of BRL1,358 million and EBITDA of BRL1,458 million, an increase of 1.65%, and 2.1%, respectively, as compared to the LTM ended on 12/31/2013. Since 2012, EBITDA has been higher than net operating revenues due to the equity income originated from the Company's acquisitions, which are not operating revenues. Also, according to our standard adjustments, interest income is included in our EBITDA calculation.

Recent Developments

On July 14, 2014 announced the payment of interests and amortization of the Company's 1st Issuance of Debentures.

On April 17, 2014 TAESA redeemed the entire 6th Issuance of Promissory Notes.

On December 13, 2013 TAESA won the auction 013/2013 organized by ANEEL for a 30-year concession to develop a 85km, 500 kV transmission line in the State of Minas Gerais (Baa3 stable).

On October 17, 2013 TAESA, through its affiliate EATE, concluded the acquisition of the totality of the shares held by Orteng Equipamentos e Sistemas S.A. in the transmission companies (i) Companhia Transleste de Transmissao (ii) Companhia Transirape de Transmissao and (iii) Companhia Transudeste de Transmissao. As a result, EATE holds 10% of the voting capital of each of the above companies. The total amount paid was about BRL33.5 million.

On June 28, 2013, TAESA announced that its shareholders approved the merger with its subsidiary ATE II. The transaction was approved by the regulator - ANEEL.

On May 31, 2013, it was announced that the transfer to TAESA of its direct interests in the following electricity transmission concessionaires was completed: Empresa Catarinense de Transmissao de Energia S.A. (ECTE), Empresa Regional de Transmissao de Energia S.A. (ERTE), Empresa Norte de Transmissao de Energia S.A. (ENTE), Empresa Paranaense de Transmissao de Energia S.A. (ETEP), Empresa Amazonense de Transmissao de Energia S.A. (EATE), and Empresa Brasileira de Transmissao de Energia S.A.(EBTE). At the same time, TAESA announced the incorporation of its indirect interests in the following electricity transmission concessionaires: Sistema de Transmissao Catarinense S.A.(STC), Lumintrans - Companhia Transmissora de Energia, Empresa Santos Dumont de Energia S.A. (ESDE), and Empresa de Transmissao Serrana (ETSE), all of which were previously held by Companhia Energetica de Minas Gerais (CEMIG) and CEMIG-GT.

On May 15, 2013, TAESA's subsidiary ATE II paid off the loans from the Inter-American Development Bank (IDB)

as well as from the BNDES through the issuance of BRL400 million promissory notes. By pre-paying these loans TAESA managed to significantly reduce both its cost of debt and foreign currency exposure.

On April 9, 2013, the regulator ANEEL approved the transfer to TAESA of the Company's direct interests in the electricity transmission concessionaires ECTE, ERTE, ENTE, ETEP, EATE, EBTE as well as its indirect interests in STC, Lumitrans, ESDE, and ETSE which were previously held by CEMIG and CEMIG-GT. TAESA disbursed BRL1,691 million (adjusted by the CDI index as of December 31, 2011, less dividends and/or interest on equity declared, whether paid or not). With this transaction, TAESA added 3,188 km to its asset base (an increase of approximately 50%).

On March 15, 2013, TAESA prepaid the loans from the BNDES to NTE, STE, ATE as well as the financing from a bank syndicate formed by Santander, Citibank and BNP Paribas. The total amount involved was BRL278.1 million.

On January 31, 2013, TAESA announced the full incorporation of its subsidiaries NTE, STE, ATE and UNISA. There was no increase in the Company's share capital, given that these entities were wholly-owned subsidiaries.

Following a new instruction from the Brazilian securities and exchange commission (CVM) issued in December 2012 which determined the adoption of IFRS11, as of January 1, 2013 TAESA started to treat ETAU, Brasnorte and TBE as joint-ventures, thus reporting their financial results according to the equity method, as opposed to using the partial consolidation method.

Rating Rationale

We rate TAESA in accordance with the Regulated Electric and Gas Networks rating methodology published in August 2009. As the grid below shows, the Company's implied rating under this methodology is Baa2 based on three year-average historical credit metrics, and Baa3 on our 12 to 18-month projections.

The Baa3 issuer rating reflects TAESA's strong consolidated credit metrics for the rating category, which are supported by the stable and predictable cash flows as a result of its many long-term electricity transmission concession contracts. The rating also takes into account the evolving regulatory framework for transmission companies in Brazil, which we consider relatively new and not fully tested. The Company's expansion strategy through recent acquisitions and associated capital expansion programs, which affects leverage and liquidity in a significant way, constrain the rating.

DETAILED RATING CONSIDERATIONS:

THE IMPACT OF IFRS ON THE REPORTING OF TAESA's FINANCIAL RESULTS

The International Financial Reporting Standards (IFRS) introduced significant changes in the way that transmission companies report their financial results, the most relevant being related to the recognition of revenues and the accounting treatment of concession assets. The recognition of revenues in a given year will no longer reflect the operating revenues (RAP), which transmission companies are entitled to receive as envisaged in the concession contract; rather, revenues will consist of three components: (i) construction revenues; (ii) operating and maintenance revenues; and (iii) the remuneration on financial assets.

Pursuant to IFRS transmission infrastructure under the concession is no longer recognized as a fixed asset, rather as a financial asset since the utility is not the owner of the transmission infrastructure but has the right to operate? the infrastructure asset, which entitles the transmission company to be remunerated as specified in the concession contract. Notwithstanding the impact from IFRS, we expect that TAESA's internal cash generation will remain relatively unchanged as the Company continues to collect billed receivables regardless of the accounting method.

REGULATORY ENVIRONMENT AND ASSET OWNERSHIP MODEL

Since TAESA is a regulated company, the quality of the Brazilian regulatory and political framework is a key factor in our assessment of TAESA's credit quality. We consider the regulatory framework for transmission companies in Brazil well developed, but with a limited track record and relatively untested with regard to certain procedures such as the indemnification of non-depreciated assets upon the non-renewal or termination of an existing concession. The stable and predictable nature of the transmission sector results from the Permitted Annual Revenues (RAP), which are fixed capacity payments (i.e. based on availability of the transmission lines, and not on volume transmitted) throughout the concession period that have provisions for automatic annual adjustments for inflation.

On September 11, 2012, the Brazilian Federal Government issued the Provisional Measure 579 (MP579), later

converted into Law 12,783 / 2013, which established the terms and conditions according to which generation, transmission and distribution companies could renew their concessions awarded prior to Law 8,987/1995 and scheduled to expire between 2015 and 2017, by accelerating their renewal to January 1, 2013. The broader objective of the Government was to reduce tariffs by 20%, on average, to final consumers. However, MP579 established very harsh conditions for generation and transmission companies by drastically reducing their revenue and cash flow generation capacity in exchange for the renewal of their concessions for an additional 30 years (starting on January 1, 2013). Given that TAESA's concessions as well as those of its subsidiaries were awarded after the enactment of Law 8,987, Law 12,783 does not apply to said concessions.

With the exception of Brasnorte, Sao Gotardo, EBTE, ESDE, ETSE and Mariana concessions (which were awarded after 2006), all other 22 concessions operated by TAESA were awarded between 1999 and 2006. According to the current legal framework, these 22 concessions are entitled to annual inflation adjustments, and will not be subjected to periodic tariff reviews defined by the regulator - ANEEL. However, at their 16th year of operation, these concessions will have their RAPs halved, i.e. reduced by 50%. ETEO will suffer this decrease in RAP in October, 2016, ECTE will have its RAP decrease in March, 2017 and ETEP, in August 2017. In the case of Brasnorte, Sao Gotardo, EBTE, ESDE, ETSE and Mariana concessions these undergo periodic tariff reviews every 5 years. ESDE will undergo its first periodic tariff review in 2014 and both ETSE and São Gotardo will undergo their first periodic tariff reviews in 2017.

Pursuant to the new accounting rules that were introduced in January 2013, Brasnorte, ETAU and TBE's results are now reported according to the equity method instead of being fully consolidated given TAESA's non-controlling ownership stake.

OPERATING EFFICIENCY

TAESA has had a good track record of operating performance with an average availability of 99.98% in 2013 and 99.97% in the first semester of 2014. In the event of non-programmed interruptions and unavailability of the transmission grid, the Company is subject to penalties in the form of variable discounts of up to 12.5% of the scheduled RAP; the Company's historical average of variable discount is 1%. The potential risk of RAP discounts is mitigated by the increasing geographical diversification of TAESA's portfolio of concessions, and the fact that its transmission assets are relatively new with an average age of ten years. Given its relatively new asset base, maintenance CAPEX represents less than 5% of the regulated asset base which translates into a high rating for this factor in our methodology. Additionally, commercial losses are mitigated by a contractual guarantee mechanism managed by the National System Operator (ONS), which provides protection against potential payment defaults.

BUSINESS MODEL BASED ON THE ACQUISITION OF TRANSMISSION ASSETS

TAESA is exclusively dedicated to the operation of a portfolio of electricity transmission concessions. However, the mapping within this rating factor is constrained by high leverage and significant capital expenditures as a result of new concessions and acquisitions of other transmission companies. We expect TAESA's expansion strategy to continue, albeit at a slower pace, driven primarily by CEMIG, one of the key shareholders of the Company. We have incorporated into our long-term rating assessment the impact on leverage as we expect that TAESA will continue to be the vehicle for CEMIG and for FIP Coliseu to further expand their transmission business.

KEY CREDIT METRICS AND IMPACT OF ACQUISITIONS

Due to the sizeable acquisitions consummated in 2012 and 2013 combined with generous dividend distributions, TAESA's credit metrics have deteriorated as a result of the increased level of debt raised to finance these transactions. Nevertheless, as of June 30, 2014, TAESA complied with the financial covenants of all of its financial obligations.

From 2013 to the LTM ended on 06/30/2014, leverage, as measured by the Net Debt-to-Regulatory Asset Value (RAV) ratio, increased slightly to 84.4% from 82.1%; the interest coverage ratio ((Funds From Operations + Interest)/Interest) improved slightly to 6.2x from 5.5x; and Funds From Operations (FFO) to Net Debt improved marginally to 37.5% from 33.8%. Notwithstanding the large number of recent acquisitions, the entities that have been incorporated to TAESA's group are "going concerns" with healthy, stable and predictable, contractually-guaranteed operating cash flows which is demonstrated by the Company's strong regulatory (i.e. non-IFRS) EBITDA. According to Moody's standard adjustments, in the LTM ended on 06/30/2014, EBITDA reached BRL1,458 million, slightly higher than BRL1,428 million registered in 2013. Therefore, provided the Company prudently manages dividend payments, we expect that TAESA's credit metrics will steadily improve as new operational cash flows from acquired entities are added to the Company's existing ones. However, further

acquisitions accompanied with a material increase in leverage will likely push the current Baa3 rating into the Ba1 category.

Liquidity Profile

Like most Brazilian companies, TAESA does not have committed banking facilities to help fund any unexpected cash disbursements, if needed. Notwithstanding, TAESA has been able to access the local capital markets via debenture issuances as well as financing from local private and public banks, such as the BNDES and CEF.

According to Moody's standard adjustments, as of June 30, 2014, TAESA had a consolidated cash & equivalents position of BRL75.3 million against total short-term financial debt of BRL692 million due in the following 12 months, and gross financial debt of BRL4,258 million. Given that the majority of TAESA's financial debt is due in the longer term, and that the Company has a proven track record in successfully accessing both the capital markets and bank financing, we expect that TAESA will continue to exhibit a somewhat strained but satisfactory liquidity position in the next 12-18 months.

Since BNDES' loans contain restrictions regarding changes of control, TAESA's new acquisitions could result in a contractual breach triggering the acceleration of BNDES' outstanding debt. Nevertheless, TAESA has prepaid most of the loans from BNDES, therefore the potential impact is relatively small.

FORWARD LOOKING PERSPECTIVE

We have made the following assumptions for our 3-year forward looking projections, as per our rating methodology:

- For the calculation of the financial asset and the RAP, we considered the annual inflation adjustments by the IPCA or IGPM official indexes, depending on the concession, and took into consideration the 50% reduction of the RAP value for ETEO (October/2016), ECTE (March/2017) and ETEP (August/2017).
- The dividend pay-out ratio considered is the maximum permitted by law (95%), aligned with the Company's assumptions as well as with what the company has paid out historically.
- The 3-year average CAPEX amount considered in our projections is BRL 35 million, based on the Company's assumption with a cost overrun of 5%. We did not consider any new acquisitions in our projections, based on the Company's information.

We expect a reduction of the Cash Interest Coverage (i.e. FFO + Interest / Interest) from the 4.85x current historical 3-year average to a 2.67x forecasted 3-year average. The financial leverage as measured by FFO / Net Debt is also expected to deteriorate from the current 3-year average of 29.2% to a forecasted 3-year average of 19.2%. Nevertheless, these metrics still map to a Baa3 on a forward-looking basis.

Rating Outlook

TAESA's stable rating outlook reflects the systematic execution of the Company's business plan. We also expect that, despite the recent significant acquisitions, TAESA will prudently manage its capital structure, CAPEX and dividend payments so that its credit metrics continue to be compatible with the Baa3 rating category. We also expect that TAESA will continue to maintain an adequate debt maturity profile and liquidity position.

What Could Change the Rating - Up

The ratings could be upgraded upon the satisfactory management of the increase in debt used to finance the recent acquisitions combined with the prudent management of future CAPEX and dividend payments, leading to an FFO-to-Net Debt above 20%, and Funds from Operations (FFO) Interest Coverage above 3.5x on a sustainable basis.

What Could Change the Rating - Down

The ratings or outlook could be downgraded if there is a material increase in leverage and/or a deterioration in the Company's liquidity position as a result, for example, of an unexpected sizeable investment / acquisition, as has been the case in the past, and/or large dividend distributions. Quantitatively, the ratings or outlook will come under downward pressure if the credit metrics deteriorate so that FFO-to-Net Debt falls below 8%, and the FFO Interest Coverage falls below 2.5x for an extended period of time. A perceived deterioration in the quality of the sector regulatory framework in Brazil could also cause downward pressure in the ratings or outlook.

Rating Factors

Transmissora Aliança de Energia Eletrica S.A

Regulated Electric and Gas Networks	[1]Current 30-Jun-2014		[2]Moody's 12-24 month	
	Measure	Score	Measure	Score
Factor 1: Regulatory Environment and Asset Ownership Model (40%)				
a) Stability and Predictability of Regulatory Regime (15%)		Ba		Ba
b) Asset Ownership Model (10%)		Baa		Baa
c) Cost and Investment Recovery (10%)		A		A
d) Revenue Risk (5%)		Aa		Aa
Factor 2: Efficiency and Execution Risk (10%)				
a) Cost Efficiency (6%)		Baa		Baa
b) Scale and Complexity of Capital Programme (4%)		Aa		Aa
Factor 3: Stability of Business Model & Financial Structure (10%)				
a) Ability & Willingness to Pursue Opportunistic Corp. Activity (3.33%)		Ba		Ba
b) Ability & Willingness to Increase Leverage (3.33%)		Baa		Baa
c) Targeted Proportion of Op. Profit outside Core Reg. Activities (3.33%)		Aa		Aa
Factor 4: Key Credit Metrics (40%) [2]				
a) (FFO + Interest) / Interest (15%)	4.99	A	2.9x - 2.9x	Baa
b) Net Debt / RAV (15%)	82.56%	Ba	78.2% - 88.9%	Ba
c) FFO / Net Debt (5%)	30.27%	Aaa	22.0% - 24.4%	Aa
d) RCF / Capex (5%)	7.32	Aaa	-1.2x - -1.1x	B
Rating:				
a) Methodology Implied Senior Unsecured Rating		Baa2		Baa3
b) Actual Senior Unsecured Rating				Baa3

[1] 3-year historical average [2] 12 - 24 month Moody's forecast

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