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Research Update:

Transmissora Alianca de Energia Eletrica 'BBB-' Global Scale And 'brAAA' National Scale Ratings Affirmed; Outlook Stable

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Overview

- We continue to view Brazil-based power transmission company TAESA's financial risk profile as "intermediate," despite more aggressive credit metrics reported in March 2013.
- We are affirming our 'BBB-' global scale and 'brAAA' national scale corporate credit ratings on TAESA.
- The stable outlook reflects our opinion that TAESA will substantially improve its credit metrics in the next two years to levels more aligned with an "intermediate" financial risk profile.

Rating Action

On July 15, 2013, Standard & Poor's Ratings Services affirmed its 'BBB-' global scale and 'brAAA' national scale corporate credit ratings Transmissora Alianca de Energia Eletrica S.A. (TAESA). We are also affirming the 'brAAA' long-term issue rating on the company's debt. The outlook is stable.

Rationale

The ratings on TAESA reflect our view of its "satisfactory" business risk profile, "intermediate" financial risk profile and "adequate" liquidity. We also assess the company's management and governance as "fair."

TAESA's "satisfactory" business risk profile is due to its solid competitive position which is derived from monopoly rights on large electricity transmission assets (about 9,459km) in Brazil, and a proven and favorable regulatory framework--that result in a stable and predictable revenue stream--very low counterparty risk and efficient operations.

We view electricity transmission risk as one of the lowest in the Brazilian electricity sector, based primarily on isolation from competition and demand risk, and very low counterparty risk. Additionally, TAESA benefits from a proven regulatory track record that clearly determines a "permitted revenues model" (Receita Annual Permitida), which depends exclusively on the availability of its assets (therefore insulating TAESA from volume risk) and is annually adjusted by inflation.

Further strengthening the rating is the very low counterparty risk that stems from the contractual foundation of the concession contracts in which the National System Operator (ONS), a government entity, acts as billing agent for the sector and manages credit delinquency in the system, which is diversified between all the users of National Interconnected System (about 280 clients).

TAESA has a strong track record in operating transmission assets in Brazil, reflected in availability rates above 99% and regulatory penalties below 1.5% of total revenues over the past five years. The company's operating efficiency compares favorably with its local and global peers.

TAESA has also benefited from the acquisition of certain transmission assets from Abengoa Concessoes Brasil Holding S.A. (Abengoa) for about R$2 billion in 2012, and part of the assets of Cemig Geracao e Transmissao S.A. (TBE Group) for R$1.7 billion in June 2013, providing higher economies of scale and a more diversified portfolio. These acquisitions added 2,541km and 3,174km of transmission lines to TAESA, making it the largest high voltage (above 230kV) pure play player in the Brazilian market, with a total 9,459km in transmission lines (representing about 10% of the market share).

The stability and predictability of its strong operating cash flows and its smooth debt amortization schedule support its "intermediate" financial risk profile. On the other hand, TAESA's aggressive dividend policy and acquisition-based growth strategy, which deplete its strong operating cash generation, somewhat limit the rating. The company's financial risk profile deteriorated in 2012 and at the beginning of 2013, due to an aggressive increase in leverage to finance acquisitions. Nevertheless, we expect that the aggressive credit metrics reported in last 12 months ended in March 2013--debt to EBITDA of 4.4x and funds from operations (FFO) to debt of 15%--will significantly improve in 2013 and beyond due to sizable cash flows from the newly acquired assets, together with a moderate decrease in debt. Based on pro forma financial results, which consolidate Abengoa and TBE Group assets proportionally, our base-case scenario projects debt to EBITDA improving to less than 4.0x in 2013, and to less than 3.0x in 2014, and FFO to debt increasing to 18%-20% in 2013, and to 20-23% in 2014.

Cemig Geração e Transmissão S.A. (Cemig GT; BB/Stable/--) controls 43.4% of TAESA and investment fund FIP Coliseu (not rated) controls 29.5%. The remaining shares are free floating. We believe TAESA has some independence with regard to decision-making and certain cash segregation from its main shareholders, such that the rating on its major shareholder, Cemig GT, does not limit the rating on TAESA.

Liquidity

We view TAESA's liquidity as "adequate," based on a pro forma cash position of about R$700 million as of June 2013. TAESA reported a cash position of R$2.6 billion as of March 2013, of which R$1.7 billion was used to finance the TBE group acquisition in June 2013. We also base our view on the following assumptions:

- Cash sources will exceed uses by 1.2x-1.3x in the next two years;

- Cash sources will surpass cash uses even if EBITDA declined by 15% in the next two years;
- Dividend policy should remain aggressive, at R$500 million to R$800 million in 2013 and 2014, but flexible;
- Capital expenditures will remain low, at about R$150 million in 2013 and R$50 million in 2014 and beyond; and
- Good financial flexibility, which incorporates good access to capital markets, as reflected by a R$2.1 billion debentures issuance in October 2012, and R$400 million in promissory notes in May 2013. We expect TAESA to refinance about 80%-90% of its debt maturities every year.

Outlook

The stable outlook reflects our opinion that TAESA will substantially improve its credit metrics in the next two years to levels more aligned with an "intermediate" financial risk profile. We expect debt to EBITDA and FFO to debt to reach less than 3.0x and about 25%, respectively, in 2014, compared with 4.4x and 15% in March 2013. We expect this improvement as a result of sizable cash flows from the newly acquired assets, together with a moderate decrease in debt. We do not assume additional mergers and acquisitions or greenfield investments that could potentially weaken its financial metrics in the short-term.

We could raise the ratings if credit metrics improve at a faster rate than expected, leading to a debt to EBITDA consistently less than 3.0x, and FFO to debt consistently above 30%.

We could lower the ratings if operational metrics decline considerably, leading to EBITDA margins of about 80%, or if credit metrics remain at the current aggressive levels, with debt to EBITDA consistently greater than 3.0x and FFO to debt below 20% after 2014. We could also downgrade TAESA if liquidity becomes less than adequate or if financial flexibility deteriorates significantly as a result of additional acquisitions or a very aggressive dividend policy.

Related Criteria And Research

- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Sept. 28, 2011
- Criteria - Corporates - General: 2008 Corporate Criteria: Analytical Methodology, April 15, 2008
- Criteria - Corporates - General: Corporate Criteria--Parent/Subsidiary Links, Oct. 28, 2004

Ratings List

Ratings Affirmed

Transmissora Alianca de Energia Eletrica S.A.	
Corporate Credit Rating	
Global Scale Rating	BBB-/Stable/--
Brazil National Scale	brAAA/Stable/brA-1
Transmissora Alianca de Energia Eletrica S.A.	
Senior Unsecured	
Brazil National Scale	brAAA
Commercial Paper	
Brazil National Scale	brA-1

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