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CREDIT OPINION
17 September 2018

Update

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RATINGS

Eletropaulo Met. De Elet. de Sao Paulo

Domicile	Brazil
Long Term Rating	Ba1
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.

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Eletropaulo Met. De Elet. de Sao Paulo

Update following rating upgrade to Ba1

Summary

Eletropaulo Met. De Elet. de Sao Paulo's (Eletropaulo) Ba1/Aaa.br ratings are supported by (1) relatively stable and predictable cash flows derived from a distribution concession through June 2028, (2) the company's historically solid credit metrics, measured by the three-year average (from mid-2015 through June 2018) ratio of cash flow from operations before working capital changes (CFO pre-WC) to debt of 15.5% and interest coverage ratio of 2.6x, and (3) an evolving regulatory environment, with recent evidence of support to the financial risk of electricity distribution companies. Eletropaulo's Ba1/Aaa.br ratings also incorporate a one-notch uplift on the global scale from our assessment of a strong likelihood of timely support from its controlling shareholder, Enel Americas S.A. (Enel Americas, Baa3 negative), given various financial linkages and Eletropaulo´s strategic importance.

Constraining Eletropaulo's ratings are sizable capital investments that we estimate at around BRL1.1 billion primarily for network upgrades and to prevent energy losses before the next review cycle in July 2019. Large pension liabilities of BRL3.7 billion and refinanced contingent obligations with Centrais Eletricas Brasileiras SA-Eletrobras (Eletrobras, Ba3 stable) of BRL1.5 billion constrain what would otherwise be a more rapid improvement in the company's leverage metrics over the next three to four years. Eletropaulo's credit quality is also constrained by Brazil's credit fundamentals because of its regional customer base.

Exhibit 1
Solid credit metrics derived from a distribution concession in an economically robust service area

Source: Moody's Investors Service

Credit strengths

» Support from the controlling shareholder

» Strong fundamentals of the concession area

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

» Generally supportive regulatory environment

Credit challenges

» Exposure to demand risk, with sales volume volatility

» Relatively high leverage compared to peers, with limited room for improvement in the near term

» Expected negative free cash flow, driven by capital investments or dividends

Rating outlook

The stable outlook reflects Moody's expectation of continued improvement in Eletropaulo's operating performance over the next twelve to eighteen months, with the recovery of regulatory assets (BRL626 million as of June, 30 2018), following the 15.84% tariff increase allowed by the regulator ANEEL in July, 04, 2018, which should lead the company's CFO pre WC to Debt and CFO pre WC interest coverage ratios to remain consistently above 15% and approaching 3.0x, respectively. Importantly, the stable outlook assumes that the Enel group will remain highly involved in Eletropaulo's operations and continue to consider the issuer an essential and strategic asset.

Factors that could lead to an upgrade

Given the highly regulated nature of the energy sector and its domestic operating profile, an upgrade of Brazil's sovereign bond rating (Ba2, stable) could trigger upward pressure on Eletropaulo's ratings. In addition, our understanding of stronger support from Enel Americas, as evidenced by a direct or explicit corporate guarantee, could also cause upward pressure on Eletropaulo's credit profile. A rating upgrade would also take into account the company's liquidity position and business profile, and the regulatory environment in which the company operates. Quantitatively, an upgrade would require sustainable improvement in the company's credit metrics, such as:

» a CFO pre-WC to debt ratio consistently above 25%

» a cash interest coverage ratio close to 4.0x

Factors that could lead to a downgrade

The ratings will face downward pressure if the stability and transparency of the regulatory regime for the distribution sector in Brazil is weakened, ultimately resulting in more volatility or decreased visibility into Eletropaulo's cash flow base, causing sustainable declines in the company's credit metrics. A downgrade on Enel Americas or on Brazil's sovereign bond ratings could also exert downward pressure on Eletropaulo's ratings. Moreover, a change in Eletropaulo's ownership structure, particularly if Enel Americas ceases to be a majority shareholder and/or ceases to consider Eletropaulo an significant subsidiary is likely to also trigger a rating downgrade. Quantitatively, a downgrade would be considered if Eletropaulo's credit metrics consistently deteriorate, as indicated by:

» a CFO pre-WC to debt ratio lower than 10%

» a cash interest coverage ratio lower than 2.0x on a sustained basis

Key indicators

Exhibit 2
Eletropaulo Met. De Elet. de Sao Paulo

	6/30/2018(L)	12/31/2017	12/31/2016	12/31/2015	12/31/2014
CFO pre-WC + Interest / Interest	2.6x	3.2x	2.8x	2.2x	1.9x
CFO pre-WC / Debt	11.6%	17.1%	18.9%	16.5%	9.0%
CFO pre-WC – Dividends / Debt	11.4%	16.8%	18.3%	16.5%	7.9%
Debt / Capitalization	80.0%	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 customer units in 2017. The Company has a 30-year concession contract that was granted by ANEEL, the Brazilian electricity sector regulator in 1998. Since June 2018, Eletropaulo is controlled by the Enel Brasil, a subsidiary of Enel Americas.

Headquartered in Santiago, 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.

In the second quarter of 2018, 75% of Eletropaulo's electricity was sold to the regulated market, mainly residential (50%) and commercial (32%) consumers, while the remaining 25% was distributed to the free market. In the 12 months ended June 2018, the company posted net sales (excluding construction revenue) of BRL13 billion and EBITDA of BRL1.65 billion, as per our standard adjustments.

Detailed credit considerations

Strong support from direct and indirect controlling shareholders

Eletropaulo's Ba1/Aaa.br ratings also incorporate a one-notch uplift on the global scale from our assessment of a strong likelihood of timely support from its controlling shareholder, given its strategic importance to and financial links with Enel Americas S.A. (Enel Americas, Baa3 negative). The ratings take into consideration the fact that reputational considerations will incentivize Enel Americas to financially support Eletropaulo, should future free cash flow generation be insufficient for the issuer to fully service its debt obligations.

Last June, Enel Americas acquired around 73.4% of Eletropaulo's total and voting capital in an auction held on the Brazilian Securities Exchange, with the transaction amount totaling around BRL5.6 billion. After the 30-day period of pre-emptive rights exercise by minority shareholders, Enel Americas increased its indirect stake in Eletropaulo to 93.3%. The transaction was successfully approved by the antitrust authority and the Brazilian energy sector regulator. Following the acquisition of Eletropaulo, the Enel Group became the largest electricity distribution company in Brazil, serving about 18 million customers in the country.

On 26 July, Enel Brasil, a subsidiary of Enel Americas, concluded a BRL1.5 billion capital injection into Eletropaulo. The capital increase was carried out through the capitalization of two instruments of advancement for future capital injection (BRL900 million in June and BRL600 million in July).

As of June 2018 Enel Brasil had about BRL9.3 billion in short-term debt backed by Enel Americas that was incurred, among other things, to support the acquisition of Eletropaulo.

More recently, in September, Eletropaulo successfully concluded the issuance of BRL3.0 billion backed senior unsecured amortizing debentures (23rd debentures issuance) with a final maturity date in 2025 under a liability management strategy to refinance around two-thirds of its reported gross debt at lower costs. This transaction is backed by the indirect shareholder Enel Brasil. In turn, the debt raised by Enel Brasil and a sister company to purchase Eletropaulo is backed by a guarantee from Enel Americas.

These transactions are credit positive for Eletropaulo because these will lengthen the company's debt amortization schedule and reduce liquidity risk for the next two years, providing the company more flexibility to focus on investments and operating improvements.

These transactions also reinforce our understanding of strong commitment from the Enel Group to support Eletropaulo's operating and financial profiles.

Moreover, by the end of 2018, Eletropaulo will be considered one of Enel Americas' significant subsidiaries, as per the definitions of Enel Americas' 2026 bonds, which will expose Enel Americas' debt to an event default if Eletropaulo fails to service the debt. These structural incentives further support our perception of the parent's willingness to provide continued support.

Gradual improvement in sales volume growth and continued regulatory support will add stability to credit metrics, despite negative free cash flow

The drought in Brazil affected Eletropaulo's profitability in 2014-15, while the economic recession dragged electricity consumption in 2015-16, when Eletropaulo reported an accumulated sales volume contraction of about 8%. Other side effects of the recessionary scenario in the last few years were the higher delinquency rate and over-contracted energy volumes, which affected the company's operational costs.

In 2017, sales volume growth resumed, with a 0.4% increase through December 2017. In the first half of 2018, compared to the same period of the previous year, revenues increased 0.3%, on the back of a modest economic recovery. Our projections incorporate a continued positive trajectory in economic recovery in Brazil, with 2% annual average growth in electricity consumption through 2020, supporting the company's contracted energy balance within the regulatory ceiling of 105% for adequate cost recovery.

Despite the economic downturn and unfavorable hydrologic conditions in recent years, Eletropaulo's credit metrics remained relatively stable and well positioned for its current rating category. From 2015 through 2017, the CFO pre-WC to debt ratio ranged from 16.5% to 18.9%, while the interest coverage ratio varied from 2.2x to 3.2x (as per our standard adjustments), supported by regulatory allowances for cost recovery.

During the first half of this year, there was some deterioration in the credit metrics. But on July 4, 2018, the regulator ANEEL granted an average 15.84% tariff increase, which will support a recovery of regulatory assets over the next 12 months, amounting to BRL626 million as of June 30, 2018. As a result, we expect the CFO pre-WC to debt ratio to remain in the high teens in percentage terms in our medium-term, forward-looking view, with the interest coverage ratio remaining around 3.0x.

Eletropaulo's next tariff review cycle is scheduled to conclude in July 2019. We consider a relatively higher capital investment plan for the next review cycle through 2023 to support capital investments to upgrade the network and prevent losses. We project an average expenditure of BRL1.0 billion per year in 2018 and 2019, which factors in Enel's guidance of additional investments to improve the company's operations. However, we do not incorporate in our projections significant synergies and margin improvements yet, although we recognize Enel's ability to further improve Eletropaulo's cost structure and EBITDA generation.

Larger investments and potentially higher dividend distributions to the new shareholder will leave limited room for a significant leverage reduction over the next three to four years. Large pension liabilities of BRL3.7 billion and refinanced contingent obligations with Eletrobras of BRL1.5 billion will continue to strain the company's leverage metrics. Unexpected debt increases could come from a time lag between higher energy costs and the required tariff adjustments.

Settlement of the long-standing contingent liability with Eletrobras

In March 2018, Eletropaulo reached a settlement with Eletrobras regarding an overdue payment of a loan provided to the company in 1986. Until this date, the company had no legal provisions related to this contingent liability, since its legal advisers considered this a “process with probability of loss considered possible,” in accordance with Brazilian accounting standards.

As part of that agreement, Eletropaulo agreed to pay BRL1.5 billion over a period of four years as per the following schedule: (1) BRL250 million after the final legal settlement, which is expected in 2018; (2) three annual installments of BRL300 million each, starting 12 months after the payment of the first installment; (3) payment of BRL250 million to be made 48 months after the payment of the first installment; and (4) BRL100 million to be paid in legal fees. All payments will be adjusted by the country's average daily rates of interfinancial deposits (CDI)+1% per year, 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 BRL3.7 billion of underfunded pension liabilities, which we also add to the total debt amount, according to our standard adjustments.

Despite the leverage increase, we consider this resolution a positive outcome as the ratings were also constrained by the uncertainties around the nonfunded contingency liability and its potential effects on the company's liquidity.

Liquidity analysis

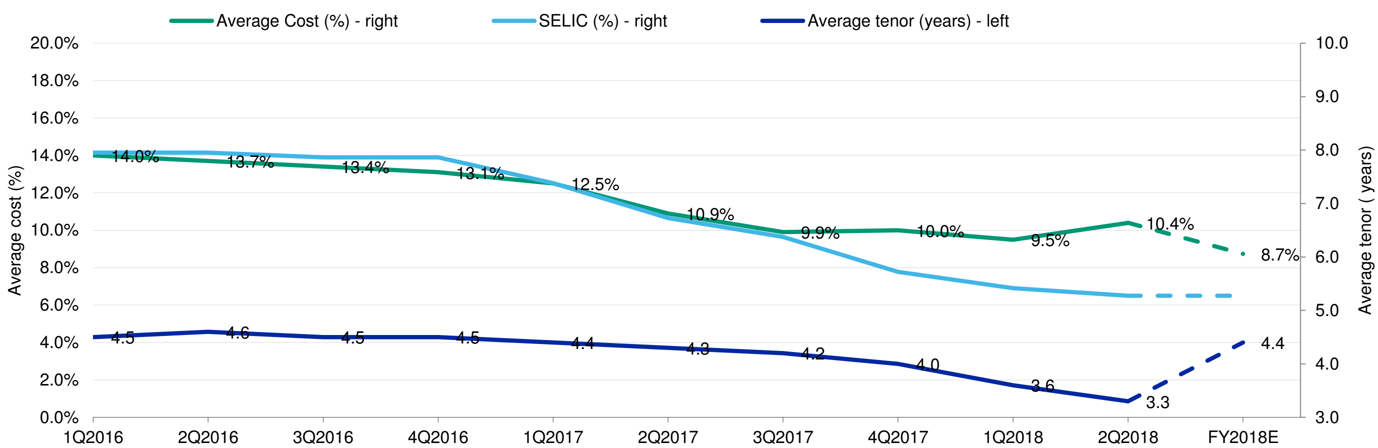
Eletropaulo does not have any committed banking facilities, like most Brazilian corporations. Nevertheless, its liquidity position is currently adequate, as evidenced by a BRL1.5 billion in cash and equivalents balance reported in June 2018, which was further strengthened by BRL600 million in the form of the second installment of the capital injection in July.

Over the last 12 months, Eletropaulo issued primarily short-term debt until the conclusion of the acquisition. As such, the company delayed its plans to refinance long-term debt, and the average cost of borrowing increased significantly.

Now, Eletropaulo plans to pay down two-thirds of its outstanding debt with proceeds from the 23rd debenture issuance, lengthening its maturity profile and returning to average tenor levels of 4.5 years. Our ratings also incorporate Eletropaulo's sound access to the local bank and capital markets, which we deem to continue in the medium-to-long term.

Exhibit 3

Average cost of debt and maturity to return to historical levels



Sources: Company, Moody's Investors Service

There are financial covenants embedded in Eletropaulo's outstanding debenture issuances: adjusted net debt/EBITDA < 3.5x and EBITDA/adjusted interest coverage > 1.75x. As of June 2018, the company reported these ratios at 3.18x and 3.97x, respectively. As the company pays down outstanding debt with proceeds from the 23rd debentures issuance, the only remaining financial covenant will be the one embedded in the new issuance, that is adjusted net debt/EBITDA < 3.5x. Breach of financial covenants for two consecutive quarters could eventually result in debt acceleration, subject to the debenture holders approval, but we expect the company to remain in compliance with those covenants over the next twelve-to-eighteen months

Rating methodology and scorecard factors

Exhibit 4

Rating factors

Eletropaulo Met. De Elet. de Sao Paulo

Regulated Electric and Gas Utilities Industry Grid [1][2]	Current LTM 6/30/2018		Moody's 12-18 Month Forward View [Acquisition] As of 9/11/2018 [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)	2.6x	Ba	3.1x	Baa
B) CFO Pre-WC Debt (3 Year Avg)	15.5%	Baa	17.6%	Baa
C) CFO Pre-WC – Dividends Debt (3 Year Avg)	15.2%	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				Ba1

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations.
[2] As of 6/30/2018(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 5

Category	Moody's Rating
ELETROPAULO MET. DE ELET. DE SAO PAULO	
Outlook	Stable
Corporate Family Rating	Ba1
Senior Unsecured -Dom Curr	Ba1
NSR Corporate Family Rating	Aaa.br
NSR Senior Unsecured	Aaa.br
ULT PARENT: ENEL S.P.A.	
Outlook	Stable
Issuer Rating	Baa2
Senior Unsecured	Baa2
Subordinate	Ba1
PARENT: ENEL AMERICAS S.A.	
Outlook	Negative
Senior Unsecured	Baa3

Source: Moody's Investors Service

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