FITCH UPGRADES ENERGISA HOLDING'S LOCAL CURRENCY IDR TO 'BB+', SUBSIDIARIES' IDRS AFFIRMED

Fitch Ratings-Sao Paulo-03 April 2018: Fitch Ratings has upgraded to 'BB+' from 'BB' Energisa S.A.'s (Energisa) Local Currency Issuer Default Ratings (IDR) and to 'AA+(bra)' from 'AA(bra)' its Long-term National Scale Rating. At the same time, Fitch has affirmed Energisa's Foreign Currency IDR at 'BB'. Fitch has also affirmed Energisa's subsidiaries Local and Foreign Currency IDRs at 'BB+' and their Long-term National Scale Ratings at 'AA+(bra)'. The Rating Outlook is Stable. A full list of rating actions follows at the end of this press release.

The upgrade of Energisa's Local Currency IDR and Long-term National Scale Rating reflect Fitch's expectation that its leverage on a standalone basis will improve due to a more robust flow of dividends coming from its operating subsidiaries. In addition, Fitch considers that the guarantees provided by the holding company to part of its subsidiaries' debt and the cross-default clauses equalize the ratings.

Energisa group's IDRs reflect a low to moderate business risk for the Brazilian power distribution segment, which is partially mitigated by the group's diversification through nine different concessions in the country. The analysis also considers that the group will consistently improve its operating cash generation and bring its net leverage to the 2.0x-3.0x range, consistent with its ratings, despite of a negative FCF forecasted for the next three years. Fitch considers that Energisa is succeeding in improving the below-average operational performance of the subsidiaries acquired in 2014. Positively, Energisa group should remain with a robust liquidity profile based on high cash balances and lengthened debt maturity profile. The analysis incorporates a moderate regulatory for the Brazilian power sector and a hydrological risk currently above average. The Foreign Currency IDRs are capped by Brazil's country ceiling at 'BB'.

KEY RATING DRIVERS

Improving Leverage: Fitch forecasts that Energisa's consolidated net leverage will remain in the range of 2.0x-3.0x in the coming years. Increasing cash flow generation due to efficiency gains and the fourth tariff review cycle of important distribution subsidiaries will positively impact the credit metrics. In 2017, total debt/EBITDA and net debt/EBITDA were 4.7x and 3.5x, respectively.

FCF Under Pressure: Energisa's consolidated FCF should remain negative in the next three years as a result of high capex and dividend distribution. The group expects to improve the operations of its distribution companies and is building two transmission lines, which require significant amount of investments. The agency expects average annual capex needs of BRL1.5 billion until 2020. In 2017, cash flow from operations (CFFO) amounted BRL642 million, not sufficient to cover investments of BRL1.3 billion and BRL203 million in dividend payment, resulting in a negative FCF of BRL865 million.

EBITDA Above Regulatory Targets: On a consolidated basis, Energisa has been efficient in achieving an EBITDA higher than the sum of all of the individual regulatory EBITDAs defined for each one of its nine power distribution companies during the last tariff review. In 2017, Energisa's distribution companies EBITDA was BRL1.8 billion versus a regulatory EBITDA of BRL1.4 billion. Fitch expects the energy consumption in its main concession areas to benefit from an economic growth above the national average, mainly supported by the positive impact of the agribusiness. In addition, the forecasted investments may improve operational efficiencies and benefit some distribution companies' performance in terms of energy losses and delinquency ratios.

Manageable Debt at the Holding Level: Fitch considers that the guarantees provided by the holding company to a great portion of its subsidiaries' loans and debentures, as well the existing cross-default clauses, equalize the ratings of all companies. In addition, the holding company's standalone credit profile benefits from a strong liquidity position and manageable amortization schedule. The dividend upstream from subsidiaries is also expected to increase due to its higher participation in Energisa Mato Grosso - Distribuidora de Energisa S.A. (EMT) (from 57% to 98%) and improvements in the subsidiaries cash flow generation. The capital needs in the two new transmission projects do not involve significant amounts of equity from the holding and the agency believes the group has financial flexibility to obtain funding structures adequate to project finance at the projects level. The ratio net debt/dividends received should gradually reduce to less than 3.0x in the next three years from the 10x presented at the end of 2017.

Strategic Sector: Fitch incorporates in the analysis that the credit profile of the Brazilian power companies benefits from the strategic importance of the sector to support the potential economic growth. The Government has been historically acting to solve any systemic problem that can impact the operational cash flow of the companies and open discussions to regulatory framework improvement in order to mitigate the sectors risks. Nevertheless, the agency considers that the distribution segment presents a higher risk when compared with the transmission and generation segments.

DERIVATION SUMMARY

Energisa and its subsidiaries' Foreign Currency IDRs at 'BB' are capped by the country ceiling. The Local Currency IDRs at 'BB+' are based on the group's low to moderate business risk and the expectation that liquidity will remain robust and the net leverage will migrate to the range of 2.0x-3.0x. Energisa financial profile is more aggressive when comparing to Enel Americas S.A. (Enel Americas, BBB+/Stable) and, despite the fact that other peers in Latin America, such as Empresas Publicas de Medellin S.A E.S:P. (EPM, BBB+/Stable) and Grupo Energia Bogota S.A. E.S.P. (GEB, BBB/Stable), present similar financial profiles of Energisa, a historical high level of local interest rates justifies the different IDRs. In terms of business profile, all of them operate as a regulated company.

KEY ASSUMPTIONS

Fitch's key assumptions within our rating case for the issuer include:

--Increase in energy consumption in line with the Brazilian GDP growth;
--Annual average capex of BRL1.5 billion until 2021;
--Dividends pay-out of 50% of net profit;
--No new debt financed acquisition.

RATING SENSITIVITIES

Future Developments That May, Individually or Collectively, Lead to Positive Rating Action
--Consolidated net leverage below 2.0x in a sustained basis;
--Cash and marketable securities/short term debt above 1.5x.

Future Developments That May, Individually or Collectively, Lead to Negative Rating Action

--New projects or acquisitions involving significant amounts financed by debt;
--Consolidated net leverage above 3x consistently;
--Cash and marketable securities/short-term debt below 1.0x;
--At the holding level: dividends received + cash and marketable securities/short-term debt service below 1.0x.

LIQUIDITY

Strong Liquidity Profile: Energisa group presents strong liquidity and high financial flexibility to finance its investment plans and refinance outstanding short term debt, if needed. At the end of 2017, the total adjusted cash and marketable securities of BRL2.5 billion represented 1.2x its short-term debt of BRL2.0 billion - the total debt was BRL9.5 billion. At the holding company level, the liquidity was also strong, with BRL525 million adjusted cash position compared to short-term debt of BRL325 million, representing a short-term debt coverage of 1.6x. Despite the BRL533 million disbursed to acquire the shares of EMT at the beginning of 2018, increasing the participation of Energisa in that subsidiary, the conclusion of the 9th debentures issue in the amount of BRL800 million improved the liquidity.

FULL LIST OF RATING ACTIONS

Fitch has taken the following rating actions:

Energisa S.A.
--Foreign Currency IDR at affirmed at 'BB';
--Local Currency IDR upgraded to 'BB+' from 'BB';
--National Scale Rating upgraded to 'AA+(bra)' from 'AA(bra)';
--8th Debenture Issue affirmed at 'AA+(bra)';
--9th Debenture Issue affirmed at 'AA+(bra)'.

Energisa Paraiba - Distribuidora de Energia S.A.
--Foreign Currency IDR affirmed at 'BB';
--Local Currency IDR affirmed at 'BB+';
--National Scale Rating affirmed at 'AA+(bra)';
--4th Debenture Issue affirmed at 'AA+(bra)'.

Energisa Sergipe - Distribuidora de Energia S.A.
--Foreign Currency IDR affirmed at 'BB';
--Local Currency IDR affirmed at 'BB+;'
--National Scale Rating affirmed at 'AA+(bra)'.

Energisa Minas Gerais - Distribuidora de Energia S.A.
--Foreign Currency IDR affirmed at 'BB';
--Local Currency IDR affirmed at 'BB+';
--National Scale Rating affirmed at 'AA+(bra)'.

Energisa Mato Grosso - Distribuidora de Energia S.A.
--National Scale Rating affirmed at 'AA+(bra)';
--8th Debenture Issue affirmed at 'AA+(bra)'.

Energisa Mato Grosso do Sul - Distribuidora de Energia S.A.
--National Scale Rating affirmed at 'AA+(bra)';
--8th Debenture Issue affirmed at 'AA+(bra)';
--10th Debenture Issue affirmed at 'AA+(bra)'.

The Rating Outlook is Stable for all corporate ratings.

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Summary of Financial Statement Adjustments -

The construction revenues and construction costs were excluded from total revenues and operational costs from the financial statements from 2013 to 2017. On Dec. 31, 2017, the amount was BRL1,392,054. The derivatives charges of BRL594,167 in December 2017 were added to the total amount of debt.

Marketable securities were adjusted to exclude the R$229.708 in 2017 (R$298.142 in 2016), related to debentures issued by a group company Energisa Mato Grosso.

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Additional information is available on www.fitchratings.com. For regulatory purposes in various jurisdictions, the supervisory analyst named above is deemed to be the primary analyst for this issuer; the principal analyst is deemed to be the secondary.

Applicable Criteria
Corporate Rating Criteria (pub. 23 Mar 2018)
https://www.fitchratings.com/site/re/10023785
National Scale Ratings Criteria (pub. 07 Mar 2017)
https://www.fitchratings.com/site/re/895106
Sector Navigators (pub. 23 Mar 2018)
https://www.fitchratings.com/site/re/10023790