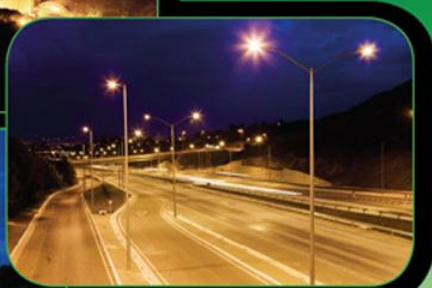


XVI Encontro Anual CEMIG-APIMEC



3rd Tariff Review Cycle for Distributors

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Proposed Methodology

Operational costs
NT 101/2011*

Timetable of AP040

WACC
NT 095/2011

Remuneration base
NT 91/2011

Other revenues
NT 092/2011

Non-technical losses
NT 031/2011

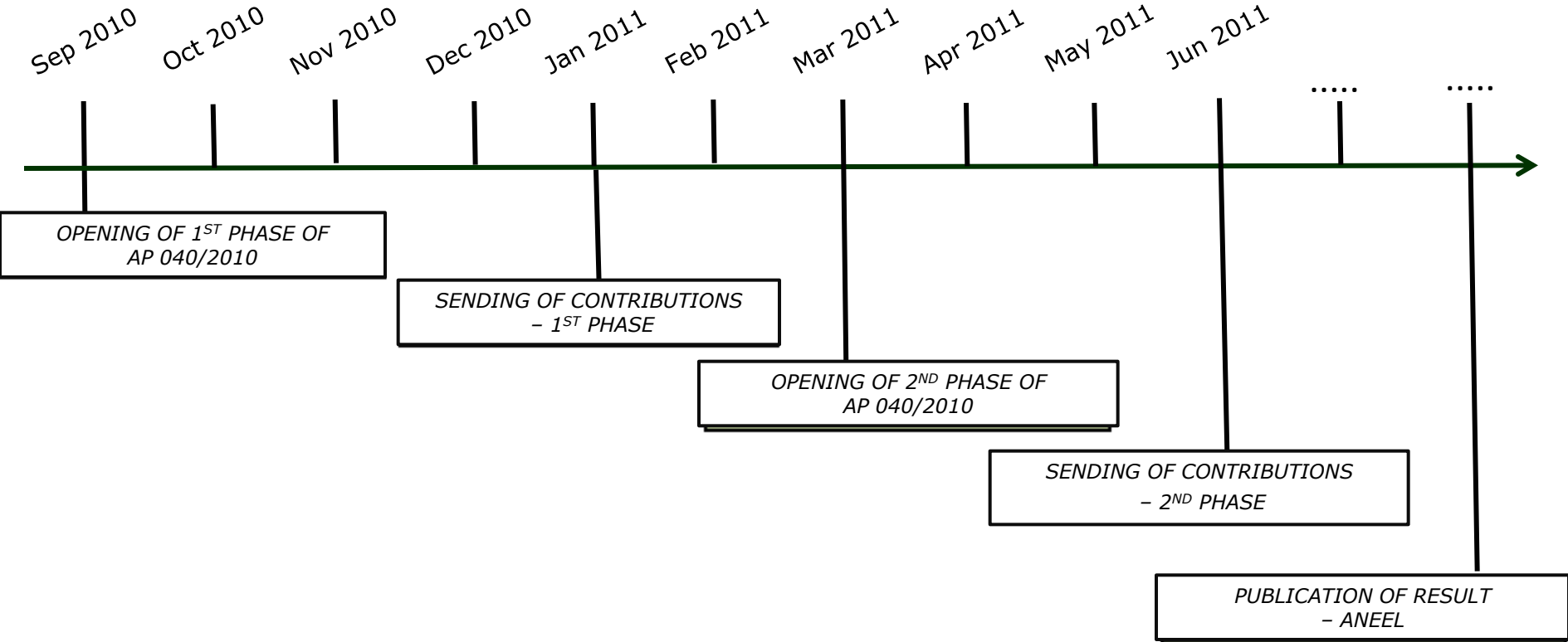
X Factor
NT 093/2011

General procedures
– test year
NT 094/2011

* NT = Aneel Technical Note

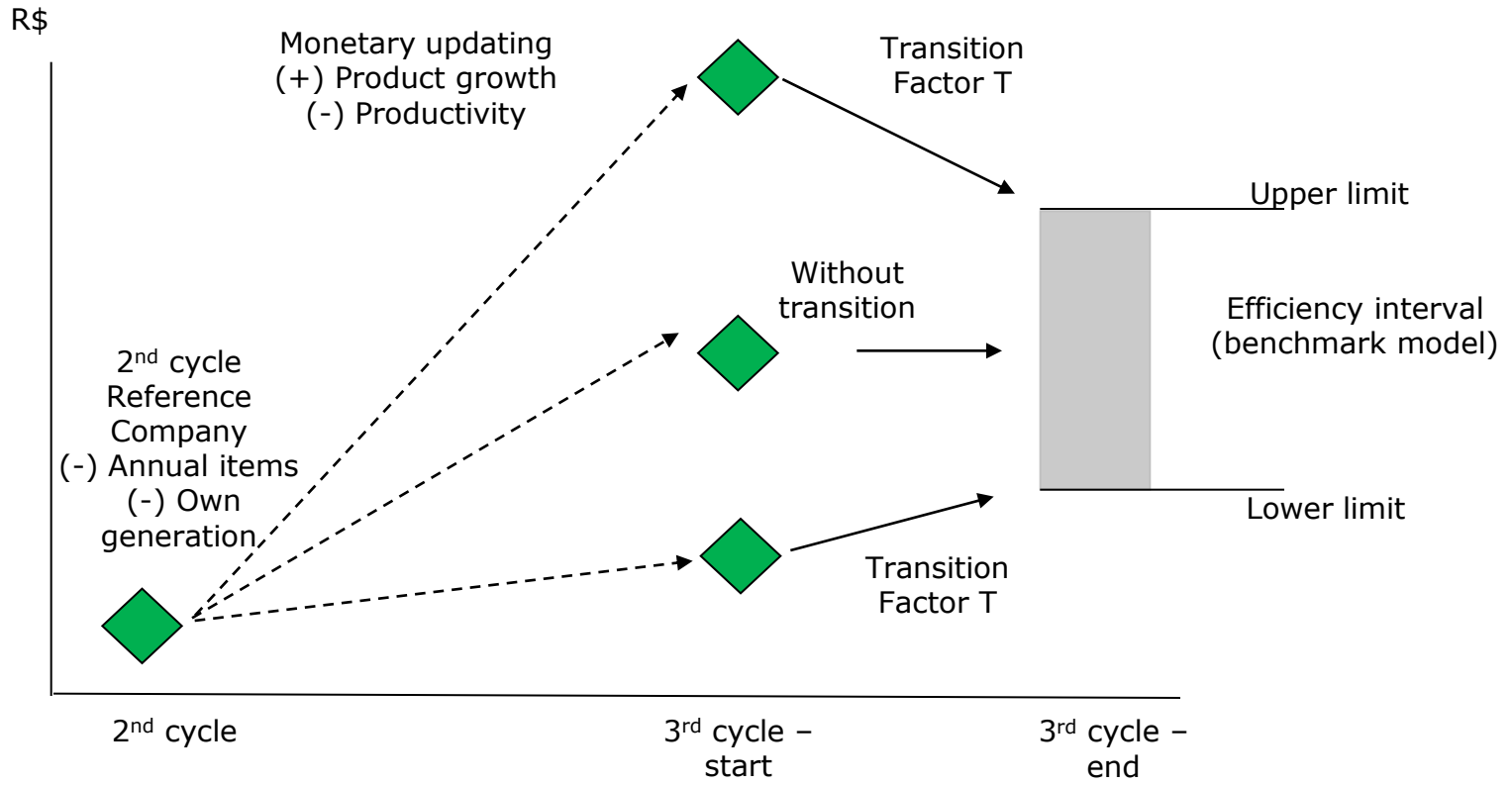


Timetable





Operational Costs



 Phase 1 Update Reference Company characteristics

 Phase 2 Comparative analysis





Operational Costs

Cemig's contribution

- Update some concepts and parameters of "Reference Company":
 - Adjust the weightings to calculate average product of each company
 - Allow flexibility to calculate productivity: apply Aneel's parametric formula to companies with lower than average productivity growth
- Benchmark model:
 - Replace the specification of non-diminishing returns (NDRS) in the DEA model by variable returns (VRS)
 - Replace the Cobb Douglas COLS model with the Translog COLS model



WACC

| Component | 2nd Cycle | Aneel Proposal | |
|---|--------------|----------------|--------------|
| | | 1st Phase | 2nd Phase |
| Capital structure | | | |
| Own capital | 42.84% | 40% | 50% |
| Third party capital | 57.16% | 60% | 50% |
| Cost of own capital | | | |
| Risk free rate | 5.32% | 4.96% | 4.87% |
| Market risk premium | 6.09% | 5.78% | 5.82% |
| Unlevered beta, average | 0.296 | 0.33 | 0.399 |
| Levered beta, average | 0.554 | 0.65 | 0.663 |
| Business and financial risk premium | 4.70% | 3.76% | 3.86% |
| Brazil risk premium | 6.69% | 4.42% | 4.25% |
| Nominal cost of own capital | 16.71% | 13.14% | 12.98% |
| Real cost of own capital | 13.75% | 10.40% | 10.28% |
| Cost of third party capital | | | |
| Credit risk premium | 2.96% | 2.12% | 2.14% |
| Nominal cost of debt | 14.97% | 11.50% | 11.26% |
| Real cost of debt | 12.06% | 8.80% | 8.60% |
| Weighted average cost (with 34% tax) | | | |
| Nominal WACC after taxes | 12.81% | 9.81% | 10.21% |
| Real WACC after taxes | 9.95% | 7.15% | 7.57% |



Cemig's contribution

- Include FX risk
- Include regulatory risk
- Change credit risk, Baa3 efficiency frontier
- Risk free rate – use longer historic series compatible with the concession period
- Country risk – calculate from average and not from median



Other Revenue

- The number of items to be taken into account for “moderation of tariffs” has been increased:

| Nature | Classification | Description | % of revenue reverted |
|--|--|-----------------------------|-----------------------|
| Revenues inherent to the distribution service (Clause 7 of the Concession Contracts) | | Demand excess | 70% - 100% |
| | | Power excess | 70% - 100% |
| | | Capacity reserve | 100% |
| | | Chargeable services | 100% |
| | | Connection charges | 100% |
| Complementary activities (Clause 1) | Captures the expense and 50% of profit | Sharing of infrastructure | 90% |
| | | Communication systems (PLC) | 60% |
| Other corporate activities (Clause 1) | Captures 50% of profit | Consultancy services | 30% |
| | | O&M services | 10% |
| | | Communication services | 40% |
| | | Engineering services | 10% |
| | | Advertising | 40% |
| | | Working Agreements | 40% |
| | | Other | 50% |

Taking into
2º Cycle
Review into
account
(Use of
posts)

Cemig's contribution

- Demand excess and power excess: legal and contractual provisions
- Revenues inherent to the distribution service: expenses for the provision of these services are not included in their totality in the revenue from regulated service
- Generates a distorted economic signal to agents



The X Factor

- Calculation of productivity based on historic figures
- Use of Tornqvist and Malmquist indices to calculate productivity
- Elimination of Malmquist index breakdown
- Removal of productivity component from transmission
- Variation of productivity in accordance with market variation (ex-ante)
- Adjustment of X in accordance with variations in service quality





The X Factor

Cemig's contribution

- Correction of the Database that overestimates productivity
- Proposed adjustment variable for individual investment needs
- Regulation of quality in only one sphere; Call for a Public Hearing to discuss specific subjects



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