STANDARD & POOR'S RATINGS SERVICES

RatingsDirect®

Research Update:

Companhia Energetica de Minas Gerais Upgraded To 'BB+' From 'BB' On Stronger Business Risk Profile, Outlook Stable

Primary Credit Analyst:
Alejandro Gomez Abente, Sao Paulo (55) 11-3039-9741; alejandro.gomez.abente@standardandpoors.com

Secondary Contact:
Julyana Yokota, Sao Paulo (55) 11-3039-9731; julyana.yokota@standardandpoors.com

Table Of Contents

Research Update:

Companhia Energetica de Minas Gerais Upgraded To 'BB+' From 'BB' On Stronger Business Risk Profile, Outlook Stable

Overview

- We are revising our business risk profile assessment on Brazil-based electric utility, Cemig, to "satisfactory" from "fair" in light of clearer and more transparent rules in the regulatory framework.
- We are raising our ratings to 'BB+' from 'BB' on global scale and to 'brAA+' from 'brAA-' on Brazilian national scale on the company.
- The stable outlook reflects our expectation that Cemig's financial risk profile will remain "significant" and its liquidity "adequate" despite the outcome of the legal disputes with the regulator related to the extension of certain concession agreements.

Rating Action

On Nov. 14, 2013, Standard & Poor's Ratings Services raised its corporate credit ratings on Companhia Energetica de Minas Gerais S.A. (Cemig) and its operating subsidiaries, Cemig Distribuicao S.A. (Cemig D) and Cemig Geracao e Transmissao S.A. (Cemig GT), to 'BB+' from 'BB' on global scale. We also raised our ratings on these companies to 'brAA+' on national scale. The outlook is stable. The stand-alone credit profile (SACP) of these companies is 'bb+'.

Rationale

The upgrade reflects the group's improving business risk profile, which we revised to "satisfactory" from "fair," in light of clearer and more transparent rules in the regulatory framework that reduced the uncertainties of the group's business and financial performance. Although Cemig is continuing its legal disputes over its rights to renew the concessions for its hydropower plants with an installed capacity of about 2,500 megawatts (MW), we believe that the outcome won't jeopardize its competitive position. Cemig's diversified portfolio of assets in the electricity generation, transmission, and distribution provides certain resilience to its operations.

We analyze the Cemig group on a consolidated basis, as we believe that it adopts an integrated financial strategy and that the holding company, Cemig, is active in managing the operations of Cemig D and Cemig GT. Therefore, the ratings on Cemig D and Cemig GT are the same as those on Cemig.

We apply our criteria for government-related entities (GREs) in our analysis of Cemig because the Brazilian state of Minas Gerais (global scale: BBB-/Stable/-- national scale: brAAA/Stable/--) controls 51% of the group. We believe that there is a "moderately high" likelihood of extraordinary support from the state government in the event of financial distress. This stems from our view of Cemig's:

- "Important" role to the government because Cemig provides essential public services to the state's residents. We believe that Cemig's distress would lead to a disruption of certain activities in the state and could harm different sectors of the economy.
- "Strong" link with the state government because it's the major shareholder, with a track record of providing support to Cemig in certain circumstances.

The "satisfactory" business risk profile is based on the group's exposure to regulations that, in our view, provide an adequate framework to develop the electricity sector on a sustainable manner. Also underpinning the rating is Cemig's strong market position due to its diversified portfolio of electricity assets. Cemig's operation in the distribution and transmission segments has mitigated the inherent volatility of the generation segment, which we view as a positive credit factor. Somewhat weighing negatively on Cemig is the legal disputes it maintains with the regulator, which can result in the expiration of concessions for three of its largest power plants: Sao Simão, Miranda, and Jaguara. (If concessions won't be renewed, Cemig will lose control of the three plants.) Nevertheless, we view that Cemig has enough flexibility to withstand such a scenario without jeopardizing its competitive position.

The Law 12783/2013, which was approved in early 2013, offered electric utilities with concessions coming due between 2015 and 2017 the option for an early renewal in exchange for significant reduction in prices and tariffs. After the approval of this law, Cemig considered that its Jaguara, Sao Simao, and Miranda plants didn't fit under these rules. The group believes that an automatic renewal of its concession contracts under the original condition should be granted. Cemig is currently in a legal dispute with the regulator regarding the Jaguara power plant, the first of the three power plants to have its concession ended (August 2013). On Aug. 30, 2013, the Higher Appeal Court granted an interim injunction to Cemig GT, giving it the right to remain in control of the Jaguara power plant, until the final judgment of the case.

The group's "significant" financial profile reflects Cemig's aggressive expansion strategy, which has led to higher debt to fund acquisitions and sizable investments in the electricity generation business. Cemig's consolidated credit metrics have remained fairly stable, and we expect it to maintain adjusted total debt to EBITDA of about 3.0x and funds from operations (FFO) to total debt at 20%-25% in 2013-2014 under our base-case scenario, which excludes the extension of the concessions of the three aforementioned power plants. We also excluded write-offs or termination value on those assets, and we assumed a significant reduction in EBITDA and FFO in 2015 due lower generation capacity, which may lead to a temporary deterioration in credit metrics that should recover in 2016. We also expect the company to carry out a capital reduction program at Cemig GT of about R$2.3 billion in December 2013.

Liquidity

Cemig's liquidity is "adequate," in our view. The group reported cash reserves of R$4.6 billion as of September 2013 and short-term debt of R$2.5 billion. Our liquidity assessment includes the following assumptions:

- The liquidity sources (including FFO and other cash sources) will exceed cash uses by about 1.25x during the next two years;
- Annual FFO generation of R$3.0 billion - R$3.1 billion in the next two years;
- The group has flexibility to adjust investments and dividend payments if necessary to preserve its "adequate" liquidity;
- Dividend payout of 80%-100% in the next two years;
- Capital reduction at Cemig GT for about R$2.3 billion; and
- The group has adequate financial flexibility with proven access to capital markets, as well as low-priced financing from development banks, such as the Brazilian Development Bank (BNDES).

Outlook

The stable outlook reflects our expectation that Cemig's financial risk profile will remain "significant" and its liquidity "adequate" despite the outcome of the legal disputes with the regulator related to the extension of concessions for three of its hydropower plants between 2013 and 2016. We could raise the ratings if Cemig's financial risk profile improves through less aggressive investments or more conservative credit metrics, with debt to EBITDA consistently below 3x and FFO to debt above 25%. This is likely if the group is granted a renewal of its concessions for Sao Simao, Mirannda, and Jaguara, which would allow it to post stronger credit metrics. We could lower the ratings if Cemig executes a more aggressive investment plan and high dividend payments that would lead to a "less than adequate" liquidity. We can also lower the rating if the adjusted total debt to EBITDA consistently exceeds 4x and FFO to adjusted total debt consistently is below 20%.

Related Criteria And Research

- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Methodology: Business Risk/Financial Risk Matrix Expanded, Sept. 18, 2012
- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Sept. 28, 2011
- Rating Government-Related Entities: Methodology And Assumptions, Dec. 9, 2010
- 2008 Corporate Criteria: Analytical Methodology, April 15, 2008
- 2008 Corporate Criteria: Ratios And Adjustments, April 15, 2008

Ratings List

Upgraded

	To	From
Companhia Energetica de Minas Gerais S.A.		
Cemig Geracao e Transmissao S.A.		
Corporate Credit Rating	BB+/Stable/--	BB/Stable/--
Brazil National Scale	brAA+/Stable/--	brAA-/Stable/--
Cemig Distribuicao S.A.		
Corporate Credit Rating	BB+/Stable/--	BB/Stable/--
Brazil National Scale	brAA+/Stable/--	brAA/Stable/--

Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at www.spcapitaliq.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column.