FitchRatings

Fitch reduces its ratings for Cemig and subsidiaries to ‘A(bra)’, with Outlook negative.

Fitch Ratings – Rio de Janeiro, July 12, 2016: Today, Fitch Ratings reduced its Brazilian Long-term ratings for Companhia Energética de Minas Gerais (Cemig) and its wholly-owned subsidiaries Cemig Distribuição S.A. (Cemig D) and Cemig Geração e Transmissão S.A. (Cemig GT), and for their debenture issues, from ‘AA–(bra)’ (AA minus (bra)) , to ‘A(bra)’. The Outlook for these corporate ratings is Negative. The complete list of the rating decisions is at the end of this bulletin.

MAIN FUNDAMENTALS OF THE RATINGS

The downgrade reflects expectation of weakening of Cemig’s consolidated credit profile in the coming years, arising from lower operational cash flow in the generation segment, lower consumption of electricity in the concession area of Cemig D, and continuing growth of the debt. Fitch believes that the consolidated financial leverage, calculated by its own criteria, will remain above 4.0 times in the next three years, and that deleverage will be possible only if based on disinvestment in significant volumes.

The Negative outlook reflects the challenges that the Cemig group faces in improving the profile of its debt, which has a significant volume maturing in the short term, and strengthening its liquidity position. Fitch believes that the company has carried out high investments, including payment of BRL2.3 billion for the grant of the concessions for 18 hydroelectric plants, at a moment of scarcity of credit lines, and of high financing cost, which pressures its ratings.

The ratings take into account the consolidated risk of the group, and are based on the credit quality of Cemig as an integrated electricity company, operating in generation, transmission, distribution and trading. The group benefits from its diversified and significant base of assets and investments, as a means of diluting business risk. The existence of political risk was also taken into account, reflecting its stockholding control by the public sector, and also the moderate regulatory and hydrological risks that are inherent to the electricity sector.

Expectations of Worsening Financial Indicators

On a consolidated basis, we expect Cemig’s net financial leverage to deteriorate to levels between 4.0 and 5.0 times, in the next three years. This is due to the termination of important generation concessions by 2017, the impact of the negative macroeconomic scenario on the electricity distribution sector, and the new debts contracted to finance its investment plan.

For the period of 12 months to March 31, 2016, the company reported levels of leverage, as measured by: {Total debt / (Ebitda plus dividends received)}, and {Net debt / (Ebitda + dividends received)}, of 3.4 times and 2.9 times, respectively. The adjusted levels of total and net leverage, which add guarantees of BRL6.2 billion given for the non-consolidated investments, were 4.7 times and 4.3 times, respectively.

Fitch expects Cemig’s consolidated net debt to grow by BRL1.5 billion by the end of 2016, and by a further BRL1.5 billion by the end of 2018. It will be possible to avoid this scenario if the disinvestment plan is successful. On March 31, 2016, the company’s total consolidated debt was BRL15.3 billion — BRL1.8 billion higher than at the end of 2014. The holding company does not have any debt, which contributes to it having the same rating as the operational companies. After March 2016, the debt was pressured by the payment of BRL820 million for the second payment of the Grant Fee for the hydroelectric plants, the concessions of which were acquired at the end of 2015. There may be further disbursements resulting from the put option in FIP Parati (BRL1.6 billion), and also from the company's recurring investment plan.

Challenge of Improving the Debt and Liquidity Profile

Fitch views as negative the weakening of the short-term debt coverage indices, and also the high concentration of debt of the Cemig group with maturities in the coming years. On March 31, 2016, Cash and financial investments, of BRL2.0 billion, covered only 0.4 times the short-term debt, of BRL4.9 billion, and this, together with new disbursements on investments, has called for significant and successive rounds of funding. On that date, the ratio { Cash plus Cash flow from operations (CFFO) / Short-term debt}, of 1.1 times, was modest.

Although the group has satisfactory access to raising of funds in the bank and capital markets, even in more challenging credit scenarios, and although it has already rolled over part of the short-term debt reported at the end of March 2016, the Agency adopts a negative view in evaluating Cemig's debt profile. The amortization timetable of the consolidated debt, which has average tenor of 2.8 years, includes maturities of BRL11.2 billion by 2018, equivalent to 74% of the total debt.

Lower Contribution from the Generation Segment

Cemig's consolidated operational cash flow will be considerably impacted as from 2016, due, mainly, to weakening of the results from the generation segment. The probable return to the concession-granting power of important hydroelectric plants by 2017, lower prices in the spot market, and less favorable conditions for the 18 hydroelectric plants the concessions of which were renewed at the end of 2015, will result in a significant reduction in Ebitda.

Fitch estimates that the Ebitda of the generation segment will be below BRL2.0 billion in the next three years, in comparison to BRL2.5 billion in the 12 months to March 2016, BRL3.5 billion reported for 2015 and BRL4.4 billion reported for 2014. In those years, Cemig benefited from significant amounts of revenue arising from de-contracting of its generation capacity in a scenario of high electricity prices in the spot market. However, the group gave priority to payment of dividends and maintenance of an aggressive plan of investments, without adapting its capital structure to a lower level of cash flow, which was foreseen with the termination of important concessions.

Distribution Company Makes Beneficial Contribution to Cash Flow in 2016

The Agency estimates that the group's free cash flow (FCF) will be between BRL500 million and BRL800 million from 2017 through 2020, due to high disbursements on interest and on the investments, with which the Agency projects to be between BRL1.5 billion and BRL1.7 billion per year. In 2016, we expect FCF to be positive in the amount of approximately BRL800 million, benefiting from receipt of part of the compensation of BRL1.0 billion relating to the balance of regulatory assets incorporated into the tariff of Cemig D. We expect this amount to mitigate the lower contribution from the generation segment, and the fall in the volume of electricity invoiced in the distribution company's concession area, which Fitch estimates at 3.5%. We also expect Cemig D to face pressures arising from increased losses and default, due to the strong tariff increases that have taken place since 2014.

We expect Cemig D, in contrast to the majority of Brazilian distribution companies, to correctly adapt its electricity purchase contracts to within the limit established by the regulations (i.e. 105% of its demand), in 2016. In the 12 months to March 2016, on a consolidated basis, the Ebitda of Cemig was

BRL4.0 billion, and BRL4.5 billion including the BRL502 million in dividends received in the period. In the same period, consolidated CFFO was BRL3.2 billion and consolidated FCF was BRL1.3 billion. Fitch assesses as positive the company's reduction of the level of distribution of dividends, begun in 2015, compared to the aggressive amounts of BRL3.9 billion and BRL4.6 billion paid in 2014 and 2013, respectively.

MAIN ASSUMPTIONS

The main assumptions which Fitch adopts for the scenario in making this rating of the issuer are:

-- Return of the *Jaguara*, *São Simão* and *Miranda* plants to the concession-granting power by 2017.

-- Cemig D successfully adapts its contracting of electricity to within 105% of the electricity demand of the market in which it operates.

-- Reduction of 3.5% in electricity consumption in Cemig D's concession area in 2016; growth of 0.7% in 2017; and growth of 1.0% in 2018.

-- No new significant acquisitions within the horizon of our forecast.

-- No entry of funds from sale of assets.

SENSITIVITIES OF THE RATINGS

Rating upgrades are improbable in the short term. The revision of the Outlook of the corporate ratings to Stable will depend on a significant improvement in the group's debt profile, with lower pressures for raising of funds.

Developments which could, individually or collectively, lead to a negative rating movement include:

-- Consolidated net leverage consistently at levels above 4.5 times.

-- Continuing weak consolidated net liquidity indicators, with debt coverage, measured by the ratios {Cash and cash investments / Short-term debt} and {Cash and cash investments plus CFFO / Short-term debt} consistently at levels below 0.7 times and 1.4 times, respectively.

-- New investments in significant amounts that result in additional pressures on liquidity and addition of debt.

Fitch has issued the following rating changes:

Cemig:

- Long-term Brazilian Rating reduced to 'A(bra)', from 'AA–(bra)' (AA minus (bra)).

Cemig D:

- Long-term Brazilian Rating reduced to 'A(bra)', from 'AA–(bra)' (AA minus (bra)).
- Long-term Brazilian Rating of the second debenture issue, in the amount of BRL400 million, reduced to 'A(bra)', from 'AA–(bra)' (AA minus (bra)).
- Long-term Brazilian Rating of the second debenture issue, in the amount of BRL1.615 billion, reduced to 'A(bra)', from 'AA–(bra)' (AA minus (bra)).

Cemig GT:

- Long-term Brazilian Rating reduced to 'A(bra)', from 'AA–(bra)' (AA minus (bra)).

- Long-term Brazilian Rating of the third debenture issue, in the amount of BRL1.35 billion, reduced to ‘A(bra)’, from ‘AA–(bra)’ (AA minus (bra)).
- Long-term Brazilian Rating of the fourth debenture issue, in the amount of BRL500 million, reduced to ‘A(bra)’, from ‘AA–(bra)’ (AA minus (bra)).

The Outlook of the corporate ratings is Negative.

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REGULATORY INFORMATION:

This publication is a credit risk rating report, for the purposes of complying with Article 16 of CVM Instruction 521/12.

The source of the information used in the analysis of this issue is Cemig.

Fitch takes all the measures necessary for the information used in the rating of credit risk to be sufficient, and to be sourced from reliable sources, including, when appropriate, third-party sources. Fitch does not, however, carry out auditing services, and is unable to carry out verification or independent confirmation of the information received in every case.

For its analysis, Fitch used financial information available up to July 4, 2016.

Ratings History:

Cemig

First-ever issue of rating on Brazilian scale: May 13, 2003.
Most recent update of rating on Brazilian scale: July 15, 2015.

Cemig D:

First-ever issue of rating on Brazilian scale: March 9, 2007.
Most recent update of rating on Brazilian scale: July 15, 2015.

Cemig GT:

First-ever issue of rating on Brazilian scale: March 9, 2007.
Most recent update of rating on Brazilian scale: July 15, 2015.

The entity evaluated has been advised of the risk rating, or of the parts of it that relate to the entity, and the rating attributed has not been changed by reason of this communication.

The ratings attributed by Fitch are reviewed, at least, annually.

Fitch publishes the list of real and potential conflicts of interests in Appendix XII to its Reference Form, available on its website, at:
https://www.fitchratings.com.br/system/pages/299/Fitch_Form_Ref_2016.pdf

For information on possible alterations in the credit risk rating see the item: *Sensitivities of the Ratings*

There is further information at: www.fitchratings.com or www.fitchratings.com.br .

Fitch Ratings Brasil Ltda. has provided the service of subscription to the entity subject of the rating, or to third parties related to it, in the 12-month period prior to the date of this present credit rating. However, the provision of this service does not constitute any conflict of interest in relation to the credit risk rating.

Fitch Ratings was paid to determine each credit rating listed in this Rating Action Commentary by the obligor being rated or the issuer, a person other than the obligor being rated or the issuer, underwriter, depositor, or sponsor of the security or money market instrument being rated.

Methodology Applied and Related Research:
-- 'Corporate Ratings Methodology – Including Short-term Ratings and Links between Head Offices and Subsidiaries' (August 17, 2015);
-- 'Methodology of Brazilian Scale Ratings' (October 30, 2013).

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