

FITCH AFFIRMS ISA CAPITAL'S IDRS AT 'BB+'; CTEEP'S NAT'L SCALE RATING UPGRADED TO 'AAA(BRA)'

Fitch Ratings-Sao Paulo-22 August 2016: Fitch Ratings has affirmed ISA Capital do Brasil S.A.'s (ISA Capital) Long-Term Foreign and Local Currency Issuer Default Ratings (IDRs) at 'BB+', and its National scale rating at 'AA+(bra)'. In addition, Fitch has affirmed the company's USD31.6 million outstanding senior secured notes at 'BBB-'. The Rating Outlook for the Foreign Currency IDR is Negative, and Stable for the Local Currency IDR and National Scale rating.

Concurrently, Fitch has upgraded Companhia de Transmissao de Energia Eletrica Paulista S.A.'s (CTEEP) National scale rating to 'AAA(bra)' from 'AA+(bra)', with a Stable Outlook. The rating action also applies to its first and fourth debenture issuances due in 2017 and 2021, respectively.

KEY RATING DRIVERS

CTEEP's upgrade reflects Fitch's view that the company will strengthen its financial profile in the coming years based on the receipt of additional compensation of estimated BRL5-6 billion mainly related to the early renewal of its main power transmission concession at the beginning of 2013. CTEEP will receive this amount over eight years starting in 2017 through its monthly tariff. The agency expects net leverage below 2.0x from 2018 absent acquisitions and investments in new projects.

CTEEP's strong credit quality is attributable to the low business risk of the power transmission sector in Brazil, with predictable operating cash flow. The ratings also factored in the company's necessity to maximize dividend distribution to help its controlling shareholder ISA Capital to meet its obligations, as well as the moderate regulatory risk of the Brazilian power sector.

ISA Capital's ratings reflect the credit profile of CTEEP, its sole operating asset and dividend source. ISA Capital's obligations are structurally subordinated to CTEEP's. The holdco only owns 37.3% of CTEEP's total capital and does not receive the full amount of dividends paid by the transmission company. Fitch considers that ISA Capital's financial flexibility may benefit from the market value of its CTEEP shares in case dividends received from CTEEP are not sufficient to meet its obligations. Our analysis also does not consider any support from ISA Capital's controlling shareholder Interconexion Eletrica S.A. E.S.P. (ISA) ('BBB+' / Negative Outlook).

The one-notch rating uplift for ISA Capital outstanding bonds reflects its enhanced recovery prospects due to the refinancing of the majority of its debt with (subordinated, debt-like) preferred equity. The 2017 bonds are currently overcollateralized. The USD31.6 million (BRL114 million) of outstanding bonds is secured by 66% of ISA Capital's shares of CTEEP, a stake which is currently valued at approximately BRL2.3 billion based on CTEEP's market cap value of BRL10.4 billion.

CTEEP's Robust Credit Metrics

Fitch expects CTEEP's financial leverage and liquidity to continuously improve as a result of growing cash generation from the additional compensation related to the early renewal of its main concession and grid reinforcement investments related revenue. Fitch views as positive the recent determination by the Ministry of Mines and Energy that the amount of complementary compensation for the concession renewal defined by the Brazilian regulatory agency for the power sector (ANEEL) should be paid for eight years, after the tariff review in July 2017. ANEEL has

already indicated an additional estimated minimum of BRL5 billion-6 billion (BRL3.9 billion as of 2012).

Net leverage should remain below 2.0x after 2017, also benefitting from the release of corporate guarantees to non-controlling subsidiaries. For the latest 12 months (LTM) ended June 30, 2016, CTEEP's total adjusted debt (including BRL1.4 billion guarantees to non-controlling subsidiaries) was BRL2.5 billion, leading to total adjusted debt-to-EBITDA ratio of 4.4x, or 3.7x considering net adjusted debt.

Increasing Operational Cash Flow

CTEEP's cash flow generation is very predictable, exhibiting the low business risk profile of a power transmission company. CTEEP's revenues are exempt from volumetric risk as its maximum permitted annual revenue (PAR) is based on the power transmission assets available to users, instead of the power transmitted. After a significant decrease in cash flow generation due to the company acceptance of the government proposal for early renewal of its main concession, cash flow has benefited from additional revenues from reinforcement investments. For the LTM ended June 30, 2016, net revenues reached BRL1.1 billion, with EBITDA of BRL566 million, according to Fitch criteria. In 2015, net revenues and EBITDA were BRL1 billion and BRL461 million, respectively.

Fitch expects CTEEP's free cash flow (FCF) to turn negative after 2016 due to high capex needs and an increase in annual dividends payout, following the receipt of the complementary compensation for the concession renewal. Also for the LTM ended June 30, 2016, cash flow from operations (CFFO) and FCF were BRL349 million and BR9 million, respectively. As of June 2016, the company had forecasted grid-reinforcement capex of BRL1 billion until 2019, which together with formerly realized investments since 2013 is expected to generate an increase of BRL800 million in revenues until 2019.

Low Business Risk

Fitch considers the transmission segment as the lowest-risk segment in the Brazilian power sector. CTEEP's credit profile benefits from its exclusive right to provide electricity transmission services through its multiple concessions. CTEEP currently participates in eight concessions in operation with an equivalent participation of 1.826 km. This reduces the company's exposure to the risks associated with the construction phase.

Structural Subordination

ISA Capital's credit quality reflects the company's structural subordination to CTEEP's obligations. ISA Capital owns only 37.3% of CTEEP's total capital and receives this proportional stake of the dividends paid by the transmission company. ISA Capital is expected to use the proceeds it receives from CTEEP, together with its cash on-hand (BRL21 million as of March 2016) to partially pay its debt. At the end March 2016, ISA Capital's debt was BRL906 million, mostly comprised of the remaining portion of its 2017 bonds (BRL114 million) not tendered during 2010 and the obligations to redeem its preferred shares of BRL792 million.

Fitch believes that ISA Capital will have to raise additional cash to meet debt obligations, since dividends flow from CTEEP in 2016 should not be sufficient. Annual dividends from the transmission company are expected to increase only after the complimentary compensation for the concession renewal is received (after July 2017). In 2016, ISA Capital's controlling shareholder has repaid a BRL86 million Intercompany loan, which added to its liquidity. ISA Capital has also lengthened its preferred share repurchase schedule with the preferred shareholders. The program

of acquiring the BRL891 million of preferred shares was extended to 2020 with a two-year grace period (2016-2017).

KEY ASSUMPTIONS

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

- Current transmission tariffs adjusted by inflation annually;
- Dividend payments of BRL110 million in 2016, BRL294 million in 2017 and BRL325 million in 2018;
- Annual average capex of BRL361 million from 2016 to 2019;
- Corporate guarantees to non-controlling subsidiaries fully released until the end of 2017.

Fitch's key assumptions for ISA Capital within the rating case include:

- Dividend receipts of BRL41 million in 2016, BRL109 million in 2017 and BRL120 million in 2018.

RATING SENSITIVITIES

Future developments that may individually or collectively lead to a negative rating action at CTEEP includes:

- Sizeable investments or acquisitions currently not in the company's business plan that could lead to net leverage consistently above 3.5x;
- CFFO + Cash and equivalents/short-term debt ratio below 1.5x.

Future developments that may individually or collectively lead to a negative rating action at ISA Capital includes:

- A downgrade of CTEEP's rating;
- Difficulty in meeting its obligations based on lower dividends to be received from CTEEP or failure of potential alternative cash inflows;
- A downgrade of the sovereign rating should trigger a downgrade of the foreign currency IDR.

An upgrade in ISA Capital's ratings is not likely in the medium term. If the Outlook for the sovereign rating is revised to Stable from Negative, the Outlook on the company's foreign currency IDR should also follow the same movement.

LIQUIDITY

CTEEP's financial profile benefits from its robust liquidity position. As of June 30, 2016, as per Fitch methodology, cash and cash equivalents of BRL426 million was sufficient to cover short-term debt of BRL255 million by 1.7x. Liquidity should improve based on the potential complementary compensation due after July 2017. CTEEP also had comfortable short-term debt coverage when considering FFO + cash and cash equivalents)/short-term debt at 3.0x. ISA Capital's liquidity was reduced by BRL21 million in March 2016.

FULL LIST OF RATING ACTIONS

Fitch has upgraded the following ratings:

Companhia de Transmissao de Energia Eletrica Paulista S.A. (CTEEP)

- National Scale rating to 'AAA(bra)' from 'AA+(bra)';
- National Scale rating Debentures 1st issuance due in 2017, to 'AAA(bra)' from 'AA+(bra)';
- National Scale rating debentures 4th issuance due in 2021, to 'AAA(bra)' from 'AA+(bra)'.

The Rating Outlook is Stable.

Fitch has affirmed the following ratings:

ISA Capital do Brasil S.A. (ISA Capital)

--Long-Term Local Currency Issuer Default Rating (IDR) at 'BB+; Outlook Stable
--Long-Term Foreign Currency IDR at 'BB+'; Outlook Negative;
--National Scale rating at 'AA+(bra)'; Outlook Stable;
--Senior secured notes outstanding USD31.6 million at 'BBB-'.

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Applicable Criteria

Corporate Rating Methodology - Including Short-Term Ratings and Parent and Subsidiary Linkage
(pub. 17 Aug 2015)

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