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Summary:
DRAFT: Neoenergia S.A.

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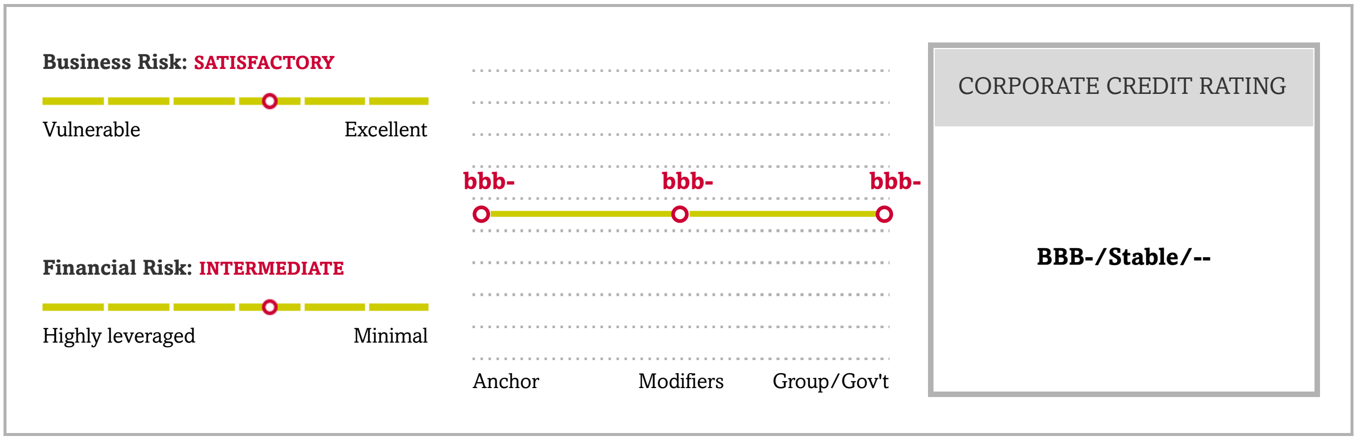

Rationale

We analyze the Neoenergia group on a consolidated basis, as we believe that it adopts an integrated financial strategy and that the holding company, Neoenergia, is active in managing the operations of each of its core subsidiaries--Companhia de Eletricidade do Estado da Bahia (COELBA), Companhia Energetica de Pernambuco (CELPE), and Companhia Energetica do Rio Grande do Norte (COSERN).

Business Risk: Satisfactory	Financial Risk: Intermediate
• Strong growth prospects in the distribution companies' concession areas, which contributed more than 75% of the group's EBITDA in 2013 • A high percentage of low-income customers and vast rural areas in the concession area with significant energy losses and provisions for those who delay electric bill payments (PDDs) • Aggressive investment plan for the next five years to more than double power generation capacity, which we view as positive in terms of business diversification.	• Resilient cash flow generation despite increased costs from thermal dispatch in energy purchases and the negative effect of the third tariff review cycle in 2013 • Relatively comfortable financial ratios despite the aggressive investment plan • Strong cash position and smooth debt amortization schedule.

Outlook: Stable

The outlook is stable, based on our expectation that the group will maintain "adequate" liquidity, with a minimum cash balance of R$2 billion and minimum funds from operations (FFO) of about R$2 billion in the next two years. The outlook incorporates the group's aggressive investment plan for the next five years and the group's weaker cash generation following the third tariff review on COELBA. The outlook factors in the recovery in credit metrics after 2015, following the ramp-up of the Teles Pires project, which is expected to contribute higher cash generation amid lower capital expenditures.

Downside scenario

We could downgrade Neoenergia and its subsidiaries if the distribution companies are unable to reduce debt or if they present higher-than-expected dividend payouts, which could further weaken the group's financial flexibility, resulting in a debt to EBITDA of more than 3.5x and FFO to debt and 25% in 2014 and 3.0x and 30%, respectively, in 2015.

Upside scenario

At this point, an upgrade is unlikely given the sovereign credit quality.

Standard & Poor's Base-Case Scenario

Assumptions

- Reduction in PDDs in the next few years, due to the group's active client management
- Ramp-up of energy generation projects, which will start operating in 2015
- Moderate dividend distribution.

Key Metrics

	2013A	2014E	2015E
EBITDA margin (%)	23	23-25	23-25
Debt/EBITDA (x)	3.0	2.5-3.0	2.0-2.5
FFO/debt (%)	28.6	30-35	35-40

All figures adjusted by Standard & Poor's.

A--Actual. E--Estimate

Business Risk: Satisfactory

Neoenergia's "satisfactory" business risk profile reflects the group's "satisfactory" competitive position, due to monopoly rights in large electricity distribution areas, and a proven and favorable regulatory framework, which we assess as adequate. It also reflects Neoenergia's "strong to adequate" scale, scope, and diversity based on its robust size and geographic asset diversification of its distribution business.

We view the distribution business as highly regulated and limited in scope, which brings more stability and predictability to future performance. The main risks are related to demand trends, but there are significant growth opportunities given the demographics in the group's concession areas that are located in the country's northeast.

These positive factors are partially offset by Neoenergia's weaker operating efficiency, as it present significant level of energy losses and provisions for those clients who delay electric bill payments (PDDs). In addition, the distribution companies are non-compliant with certain quality of service ratios, as defined by the local regulator, Aneel – Agencia Nacional de Energia Elétrica. Despite higher investments to expand its generation capacity, we expect the distribution segment's contribution to continue to represent the majority of revenues and cash generation for the group

Financial Risk: Intermediate

Neoenergia's "intermediate" financial risk profile mainly reflects the group's resilient operating cash flows, smooth debt amortization schedule, and "adequate" liquidity. The partly offsetting factor is the aggressive investment plan, which depletes the group's strong operating cash generation and somewhat limits the rating.

The group generated more aggressive credit metrics in 2013, with debt to EBITDA of 3.0x and FFO to debt of 21.6%, as a result of approximately R$3 billion in capital expenditures and R$2.6 billion in dividend payments. Our base-case scenario projects debt to EBITDA improving to less than 3.0x in 2014 and 2.5x in 2015 and FFO to debt increasing to 30%-35% in 2014 and to 35%-40% in 2015, reflecting a prudent financial policy with lower debt and moderate dividend distribution.

Liquidity: Adequate

We assess Neoenergia's liquidity as "adequate." As of Dec. 31, 2013, the group had a cash position of R$2 billion, which was more than sufficient to cover its R$1.3 billion in short-term maturities. We assume the group will maintain a minimum cash position of R$2 billion while it implements its growth strategy. In general, Neoenergia has good financial flexibility, enjoying frequent access to capital markets.

Principal Liquidity Sources	Principal Liquidity Uses
- FFO of about R$2 billion in 2014; - The Brazilian Development Bank (BNDES) committed credit lines to fund more than 50% of the group's investments; and - Minimum cash position of R$2 billion.	- Minimum working capital outflows; - Capex to reach R$3 billion (approximately 60% in generation) in 2014; and - Dividend payments to remain at 35%-50% to cope with the planned investments and remaining in line with the group's dividend policy.

Other Modifiers

All modifiers are neutral and have no impact on the final rating.

Caixa de Previdencia dos Funcionarios do Banco do Brasil – PREVI (not rated) controls 49.01%, Iberdrola S.A. (BBB/Stable/A-2) 39.00%, and Banco do Brasil S.A. (BBB-/Stable/A-3) 11.99%. We believe Neoenergia has independence with regard to decision-making and cash segregation from its shareholders, such that it is considered an Insulated subsidiary. Therefore, the rating of Neonergia only reflects its stand-alone credit profile.

Group Considerations

We assess Neoenergia's group credit profile (GCP) as 'bbb-', based on the consolidated cash flows and debt at the level of ultimate holding company. We view COELBA, CELPE, and COSERN as Neoenergia's "core" subsidiaries because of their growing contribution to group earnings, deep integration, and focus on strategic activities such as energy distribution.

National Scale Rating

We also rate Neoenergia at 'brAAA' on the Brazilian national scale.

Related Criteria And Research

- Methodology And Assumptions: Liquidity Descriptors for Global Corporate Issuers
- Corporate Methodology, Nov. 19, 2013
- Corporate Methodology: Ratios and Adjustments, Nov. 19, 2013
- Group Rating Methodology, Nov. 19, 2013
- Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- Ratings Above the Sovereign – Corporate and Government Ratings: Methodology and Assumptions, Nov. 19, 2013
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012

Business And Financial Risk Matrix

	Financial Risk Profile					
Business Risk Profile	Minimal	Modest	**Intermediate**	Significant	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	a-/bbb+	bbb	bb+	bb
Satisfactory	a/a-	bbb+	**bbb/bbb-**	bbb-/bb+	bb	b+
Fair	bbb/bbb-	bbb-	bb+	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-