Credit Opinion: EDP - Energias do Brasil S.A.

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Sao Paulo, Brazil

Ratings

Category	Moody's Rating
Outlook	Stable
Issuer Rating -Dom Curr	Ba1
NSR LT Issuer Rating -Dom Curr	Aa2.br
Parent: Energias de Portugal, S.A.	
Outlook	Negative
Issuer Rating	A2
Senior Unsecured -Dom Curr	A2
Commercial Paper -Dom Curr	P-1
Bandeirante Energia S.A.	
Outlook	Stable
Issuer Rating -Dom Curr	Baa3
Senior Unsecured -Dom Curr	Baa3
NSR Senior Unsecured -Dom Curr	Aa1.br
NSR LT Issuer Rating -Dom Curr	Aa1.br
Espirito Santo Centrais Eletricas - ESCELSA	
Outlook	Stable
Issuer Rating -Dom Curr	Baa3
Senior Unsecured -Dom Curr	Baa3
Subordinate -Dom Curr	Ba1
NSR Senior Unsecured -Dom Curr	Aa1.br
NSR LT Issuer Rating -Dom Curr	Aa1.br
NSR Subordinate -Dom Curr	Aa2.br

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Key Indicators

EDP - Energias do Brasil S.A.

ACTUALS	3Q08 LTM	2007	2006	2005
(CFO Pre-W/C + Interest) / Interest Expense [1][2]	**4.5x**	**4.2x**	**2.2x**	**1.9x**
(CFO Pre-W/C) / Debt [1][3]	**45.0%**	**40.0%**	**15.1%**	**12.3%**
(CFO Pre-W/C - Dividends) / Debt [1][3][4]	**37.1%**	**34.1%**	**10.3%**	**10.0%**
(CFO Pre-W/C - Dividends) / Capex [1][4]	**151.4%**	**180.2%**	**44.4%**	**28.2%**
Debt / Book Capitalization [3]	**32.6%**	**38.9%**	**42.9%**	**43.2%**
EBITA Margin %	**19.5%**	**21.6%**	**23.0%**	**20.8%**

[1] CFO pre-W/C, which is also referred to as FFO in the Global Regulated Electric Utilities Rating Methodology, is equal to net cash flow from operations less net changes in working capital items. [2] Interest expenses exclude the non cash items such as gains and losses from monetary variation. [3] Total Debt is adjusted to include pension fund liabilities. [4] CFO pre-W/C-Dividends, is also referred to as retained cash flow (RCF) in the Global Regulated Electric Utilities Rating Methodology.

Note: For definitions of Moody's most common ratio terms please see the accompanying User's Guide.

Opinion

Rating Drivers

Resilient credit metrics

Strong ownership of its parent company, EDP - Energias de Portugal

Resilient access to the local banking market

Sizeable capital expenditures program, including construction risks associated with new 720 MW Pecim project

Improved Regulatory framework for electric utilities operating in Brazil

Corporate Profile

EDP - Energias do Brasil S.A. (EDB), headquartered in Sco Paulo, Brazil, is an integrated utility group controlled by EDP - Energias de Portugal (EDP, A2, negative) with activities in generation, distribution and commercialization of electricity. In the last nine months ended September 30, 2008, its power distribution business represented around 58% of consolidated EBITDA, the power generation business represented 39% and the commercialization represented the remaining 3%. The two distribution companies Bandeirante Energia S.A. (Bandeirante, Issuer Rating Baa3/Aa1.br, stable) and Espmrito Santo Centrais Elitricas S.A. (Escelsa, Issuer Rating Baa3/Aa1.br, stable) distributed together 22,206 Gwh of electricity in 2008 (approximately 6% of the electricity consumed in Brazil). The generation businesses, including Investco S.A. (Investco, Gtd Subordinated Ba1/Aa2.br, stable), totaled 1,702MW of installed capacity in 2008 which accounted for approximately 1.7% of the country's electricity generation capacity. EDB reported consolidated net revenues of BRL 4,791 million (USD 2,796 million) in the last twelve months ended September 30, 2008.

SUMMARY RATING RATIONALE

EDB's Ba1 issuer rating reflects the group's overall investment grade credit metrics, resilient access to the local capital markets and the strong ownership of its parent company EDP The ratings are constrained by the high 50% dividend pay-out ratio, a relatively sizeable capital expenditures program and the inherent risks associated with the completion of the 720MW Pecim thermoelectric plant project. EDB's Issuer Rating is one notch lower than the Baa3 Issuer Rating of its subsidiaries, Bandeirante and Escelsa, to reflect the structural subordination of its debt to the existing debt at the level of its operating subsidiaries.

DETAILED RATING CONSIDERATIONS

CONSISTENT IMPROVEMENT IN EDB'S CREDIT METRICS

EDB has been posting a gradual and consistent improvement on a consolidated basis in its credit metrics. These were first boosted by its IPO back in 2005, when the company raised BRL1.1 billion consisting of BRL 500 million in new money and a BRL 650 million debt conversion into equity by EDP Portugal coupled with the 450MW Enerpeixe hydroelectric plant coming on stream in mid-2006. Along with the stable cash flow from the distribution business, which until recently was generated by three electricity distribution companies, these major events have allowed the group to strengthen internal cash generation, maintain a high dividend pay-out ratio, while reducing leverage during the period 2004 through 2008 to a very healthy level. For example, the Funds From Operations (FFO) over debt ratio improved from just 8.9% in 2004 to 39.7% as of September 30, 2008. During the same period, the debt to capitalization ratio decreased to 32.6% from 61.7%.

FINANCIAL LEVERAGE TO INCREASE MODERATELY IN LIGHT OF CAPITAL EXPENDITURES

Moody's expects that EDB will continue to post healthy cash generation over the medium term horizon. This stems from the growing contribution of the generation business with its stable and higher operating margins, which are expected to grow from being 40% of the group's cash generation to around 50% within the next three years. Nevertheless, higher interest expenses and an increased level of debt driven by sizeable capital expenditures that are expected to average BRL 1 billion per annum coupled with the continued distribution of significant dividends during this period will temper overall improvement. As a result, Moody's expects some increase in leverage as measured by the FFO over debt ratio, which Moody's estimates will average 25% within the next three years while the debt to capitalization ratio grows to slightly above 40% by 2011. When the new generation projects commence operations after 2012, Moody's expects that the forecasted increase in internal cash flow will allow these ratios to improve.

The current economic downturn is bound to have a negative impact on the cash flow of the distribution business over the short-term, in light of an expected reduction in the electricity consumption of industrial consumers, mainly in the concession area of Escelsa. Moody's believes that the impact should be relatively limited because of the regulated nature of the distribution business, the take or pay conditions of the long-term electricity supply contracts of EDB's generation business, which are primarily dedicated to the regulated market, and the expectation that the Brazilian economy will still grow in 2009, albeit at a slower pace.

OWNERSHIP OF EDP PORTUGAL

The ratings assigned for the EDB group reflect the strong ownership of its parent company, EDP Portugal (A2; negative). While EDP does not guarantee EDB's debt, the parent expects that its subsidiaries will remain financially self sustainable, as stated in its policies, Moody's believes that the Brazilian operations of EDP play an important role in the group's growth strategy which supports a one notch of uplift of the rating on the global scale. EDP is Portugal's dominant electricity generator and distributor with significant interests in the pan-Iberian conventional generation market. In the last twelve months ended September 30, 2008, EDP reported consolidated EBITDA of EUR 2,949 million (USD 4,428 million), of which approximately 18% was generated at its Brazilian subsidiary. The track record of EDP supporting its Brazilian subsidiaries was evidenced, for example, by the debt conversion of BRL 650 million into equity at the local subsidiary level in 2006. Moody's believes EDP will continue to support its Brazilian subsidiaries.

PECIM PROJECT REPRESENTS A MAJOR CREDIT CHALLENGE

The Pecim thermoelectric plant to be jointly constructed with the local group MPX Energia S.A (unrated by Moody's) represents a major challenge to EDB not just because of the technical risks associated with the completion of a sizeable project, which could be over the USD 1.2 billion reported by EDB back in 2007, but also because the already negotiated long- term financing with BNDES and IDB is still pending formal approval. Management has stated that funding from these sources is about to be released and will be used to take out an existing bridge loan of around BRL 550 million granted by a pool of local and international banks. The borrower of this loan is the joint venture Porto de Pecim, jointly but not severally guaranteed by shareholders EDB and MPX in proportion to their 50% individual participation in the joint venture company. Moody's notes that while MPX currently maintains a cash balance sufficient to cover its share of the total forecasted equity contribution through 2012, an additional downside risk that needs to be closely monitored is the fact that EDB could eventually take over the whole project should any unexpected events occur.

IMPROVEMENT IN THE BRAZILIAN REGULATORY ENVIRONMENT

The most important factor constraining the EDB's ratings in the recent past has been the Brazilian regulatory framework, which has a history of being unpredictable but has undergone substantial change over the past several years. The electricity regulatory model implemented in 2004 has mitigated the uncertainties brought about by constant changes in the Brazilian regulatory framework over the past two decades. The current model provides a more supportive environment for acceptable rates of return since the current rules for electric utilities are transparent and technically driven, thus increasing predictability of return on invested capital. In light of this relevant improvement, Moody's lifted the Brazilian regulatory framework to Category 3 from 4 in August 2008, which underpinned the upgrade of EDB's global scale rating to Ba1 from Ba2 on March 04, 2009.

Despite the upgrade in the supportiveness of the local regulatory environment, we still believe there is a lower assurance of timely recovery of costs and investments in Brazil since the new framework has not yet experienced a prolonged period of high inflation, exchange rate devaluation or electricity rationing. In our evaluation of this factor we also took into consideration potential future electricity shortages due to a tight reserve margin, limited independence of the regulator and minimal jurisprudence backing the new regulatory framework.

Structural Considerations

Moody's has withdrawn all corporate family ratings for the EDB group due to the investment grade profile of the group on a consolidated basis, although EDB's holding company retains a speculative grade rating due to structural considerations.

Liquidity

EDB4s liquidity is deemed adequate despite expected sizeable consolidated short-term debt of around BRL 1 billion. The bulk of this debt is concentrated in the subsidiaries, where cash flows are expected to comfortably meet cash needs. The only debt at the parent holding company level is a BRL 250 million loan due December 2009. The loan was taken out in October 2008 to pay off BRL 312 million associated with a shares buy-back to satisfy the rights of minority shareholders derived from an asset swap transaction with the local group Rede in 2008.

In addition, EDB could eventually be faced with payment on their 50% share (approximately BRL 270 million) bridge loan to the joint venture with MPX that matures this coming April should the expected take-out long-term loans from BNDES and IDB for some reason are not granted.

EDB has shown it has resilient access to the banking market. Not only did it obtain the above mentioned BRL 250 million borrowing during one of the most critical liquidity crunch periods in recent history but also recently obtained a BRL 900 million long-term facility granted by BNDES to be available within the next five years to fund the group's capital expenditures.

Corporate Governance

EDB has corporate governance practices that are above the average of Latin American issuers. EDB is a publicly listed company with shares traded on the Novo Mercado of Bovespa. While its shares are only traded on the Sco Paulo stock exchange, the company undertook several steps beyond what is legally required to adapt the Sarbanes-Oxley act as part of its commitment of practicing superior standards of corporate governance, but also due to the fact that the shares of its controlling shareholder, EDP, are traded on the New York Stock Exchange.

EDB's Board of Directors is made up of eight members, of which four are considered independent (two appointed by minority shareholders). The board relies on three support committees: Audit, Sustainability and Corporate Governance, and Compensation. The Audit and the Sustainability Committees are permanent in nature and are comprised of three members where at least one is independent. There is also a Fiscal Council composed of three members and three alternates elected for a maximum term of one year; however, it is non-permanent and convened only when requested by shareholders.

Rating Outlook

The stable outlook reflects Moody's expectation that EDB will continue to prudently manage capital expenditures in tandem with its cash flow capacity and efficiently handle its liquidity position so that FFO remains above 25% of total debt on a consistent basis.

What Could Change the Rating - Up

The rating or the outlook could be upgraded as a result of greater clarity as to the size and financing of future capital expenditures and, more specifically, the efficient management of the Pecim project. Quantitatively, an upgrade could result from retained cash flow to total debt of above 25% and interest coverage above 4.0x on a sustainable basis along with Moody's expectation that EDP Portugal will continue to support its Brazilian subsidiaries.

What Could Change the Rating - Down

A downgrade could be triggered by a fall in the CFO over debt ratio below 20% and interest coverage below 3.0x on a sustainable basis. Deterioration in the level of supportiveness of the Brazilian regulatory environment for regulated utilities could also prompt a negative rating action.

Other Considerations

The principal methodology used in rating EDB, Bandeirante and Escelsa was Global Regulated Electric Utilities Rating Methodology (March 2005), which can be found at www.moodys.com in the Credit Policy & Methodologies directory, in the Ratings Methodologies subdirectory. Other methodologies and factors that may have been considered in the process of rating this issuer can also be found in the Credit Policy & Methodologies directory.