MOODY'S
INVESTORS SERVICE

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

Global Credit Research - 08 Apr 2010

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	Stable
Issuer Rating	A3
Senior Unsecured -Dom Curr	A3
Commercial Paper -Dom Curr	P-2
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
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

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Opinion

Rating Drivers

Solid 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 the 720 MW Pecem thermo-power project

Evolving regulatory framework for electric utilities operating in Brazil

Corporate Profile

Headquartered in São Paulo, Brazil, EDP - Energias do Brasil S.A. (EDB) is a holding company controlled by EDP - Energias de Portugal (EDP, A3, stable) with activities in generation, distribution and commercialization of electricity. In 2009, its power distribution business represented around 53%% of consolidated EBITDA, the power generation business represented 45% and the commercialization of energy represented the remaining 2%. The two distribution subsidiaries, Bandeirante and Escelsa, distributed, together, 21,313 GWh in 2009 (approximately 5.5% of the electricity consumed in the Brazilian electricity integrated system). The generation businesses, including Investco S.A. (Investco), totaled 1,738.MW of installed capacity at year-end 2009 which accounted for approximately 1.6% of the country's electricity installed capacity. EDB reported consolidated net revenues of BRL 4,648 million (USD 2,656 million) and net profit of BRL 625 million (USD357 million) in 2009.

Recent Developments

In February 2010, Bandeirante and Escelsa signed an addendum to their concession agreements to introduce a change of the calculation for non controllable costs (Parcel A) in order to neutralize the effects of regulatory charges over demand volatility. These changes, requested by the regulator, are in line with changes in the concession agreements of other Brazilian utilities.

In December 2009, EDB successfully concluded the secondary public offering of 15,500,000 common treasury shares, equivalent to 9.9% of its total capital stock for BRL 441.75 million.

In July 2009, EDB announced the signing of long-term finance contracts with the Inter-American Development Bank (IDB) and the Brazilian Economic and Social Development Bank (BNDES) for the construction of the Porto do Pecem Geração de Energia S.A (Pecém I) thermal power plant, a 50% joint venture with the MPX group. The finance contract with the BNDES envisages a loan of BRL 1.4 billion with a total tenor of 17 years and a grace period for payment of both interest and principal until July 2012. The finance contract signed with IDB includes a direct loan (A Loan) of US$ 147 million, with a total tenor of 17 years and amortization of principal beginning in July 2012, and a further loan involving commercial banks (B Loan) of US$ 180 million with a total tenor of 13 years with amortization of principal also to begin in July 2012.The first cash disbursement in October 2009 was used to take out a bridge loan of approximately BRL 540 million (50% guaranteed by EDB), which enhanced the group's debt maturity profile.

On June 9, 2009, Moody's downgraded to A3 from A2 the issuer rating of Energias de Portugal S.A. (EDP) and changed the outlook to stable.

SUMMARY RATING RATIONALE

EDB's 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 relatively high 50% dividend pay-out ratio, a fairly sizeable capital expenditures program and the inherent risks associated with the completion of the 720MW Pecem I thermoelectric power plant project. EDB's Ba1 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

SOLID CREDIT METRICS

EDB has posted healthy profitability and stable cash generation on a consolidated basis in the past three years. This is evidenced by FFO over debt ratio, which has virtually remained unchanged during this period at around 32%. EDB has benefited from changes in regulatory assets during this period through the pass-through of incurred costs to tariffs, which further boosted internal cash generation. As a result, CFO before working capital over debt ratio has steadily hovered over 35% during this period. Going forward, this should have a limited impact on cash generation so that CFO before WC is most likely to be in tandem with FFO.

The 2009 and 2008 consolidated financial statements are to a certain extent not directly comparable given an asset swap transaction completed in September 2008 whereby EDB exchanged its participation in the distribution company ENERSUL for an increased stake in the capital of the generation holding company INVESTCO. As expected, this resulted in an increase in the operating margin because of the inherently higher operating margins of the generation business. EBITDA margin (not including interest income) was 30.5% in 2009 up from 29.6% in 2008. Moody's expected higher growth in the operating margin than what effectively EDB obtained in 2009; however, the lower growth achieved is mainly attributed to higher operating margins of the generation business in 2008, when EDB obtained extraordinary gains with the unusually high prices in the spot market.

Cash flows at the distribution businesses have been relatively stable as a result of positive tariff adjustments and recovery of sales volume in the second half of 2009. In 2009, sales volume decreased 4% from 2008, primarily driven by a lower demand of free customers in the service region of Escelsa. The lower volumes at the free market had a relatively minor impact on revenues since approximately two-thirds of the supply agreements are take-or-pay contracts that require a 180-day notice for cancellation. Despite lower volumes, EDB performance in 2009 benefited from positive tariff adjustments in 2008 at both Bandeirante and Escelsa that largely contributed to a 10% increase in the EBITDA of these two distribution companies in 2009.

Debt to Book capitalization improved to 36.5% in 2009 from 38.4% in 2008 and largely reflects the BRL 441.8 million equity proceeds from the secondary offering of treasury shares in December 2009. Cash interest coverage (CFO + Interest over Interest) also improved to 5.2x in 2009 from 3.9x in 2008, supported by the reduction of Brazilian base rate (from 13.75% to 8.75% per year) and the lower cost of new debt raised from the BNDES.

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 businesses with their stable and higher operating margins, which are expected to grow from being 48% of the group's cash generation as measured by EBITDA to around 55% within the next two years. Nevertheless, we expect a moderate increase of debt in 2010 driven by fairly sizeable capital expenditures of around BRL 800 million this year along with the continued distribution of significant dividends during this period.

Moody's preliminary projections indicate some increase in leverage as measured by the CFO pre-W/C to debt ratio, which Moody's estimates will still remain strong for the rating category at around 30% during the next three years. The debt to capitalization ratio is expected to stay around the 38-40% range during the same period. 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.

OWNERSHIP OF EDP PORTUGAL

The ratings assigned for the EDB group reflect the strong ownership of its parent company, EDP Portugal (A3; stable). 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 continues to support 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 2009, EDP reported consolidated EBITDA of EUR 3,363 million (USD 2,418 million), of which approximately 16% 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 would support its Brazilian subsidiaries if needed.

COMPLETION RISK OF PECEM PROJECT REMAINS A MAJOR CHALLENGE

The Pecem I thermoelectric power plant to be jointly constructed with the local group MPX Energia S.A (unrated by Moody's) represents a major challenge to EDB because of the technical risks associated with the completion of a sizeable project, which could cost as much as BRL 3.2 billion including approximately BRL 300 million of capitalized interest. In 2009, the long - term financing from the BNDES and IDB was approved which management has stated is expected to cover around 75% of total investment cost. The first cash disbursement occurred in October 2009 and was used to take out an existing bridge loan of around BRL 550 million (50% guaranteed by EDP) granted by a pool of local and international banks, which somewhat enhanced the group's debt maturity profile. Moody's notes, however, 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.

EVOLVING BRAZILIAN REGULATORY ENVIRONMENT

A major important factor constraining EDP's rating 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 a higher category in August 2008.

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 these factors 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

EDB's issuer rating is one notch lower than the subsidiary issuer ratings to reflect the structural subordination of any eventual debt at the holding company level to that of the operating companies where debt levels are expected to increase in the near term as a result of its investment plans. Lenders to operating subsidiaries generally have claims on cash flow that are superior to those of the holding company creditors, which can also restrict the financial flexibility of the holding company.

Liquidity

Moody's deems the liquidity standing of EDB on a consolidated basis as very adequate. On December 31, 2009, EDB reported a sizeable consolidated cash position of BRL1.1 billion boosted by a successful equity offer during the fourth quarter, when the company was able to raise BRL 441 million through the sale of treasury shares. This strong cash position along with estimated CFO of around BRL1,0 billion will support EDB's planned capital expenditures of BRL 800 million and dividends of BRL 392 million in 2010 (dividends payable as of 12/31/2009). Despite sizeable debt maturities in the short-term of approximately BRL 855 million, the refinancing risk is considered manageable. This debt is concentrated in the operating subsidiaries, where cash flows are expected to comfortably meet cash needs. Currently, there is no debt outstanding at the parent holding company level. Additionally, EDB has nearly BRL 1.3 billion pre-approved long-term loans from the BNDES, the EIB and the IDB to support its subsidiaries' capital expenditures in the near term including the 50% portion in the joint venture Porto do Pecem Geração de Energia S.A (Pecem I) thermoelectric plant.

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 Sao Paulo stock exchange, the company undertook several steps beyond what is legally required to adapt the US 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 RCF remains above 20% 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 efficient management of the Pecem project. Quantitatively, an upgrade could result from retained cash flow to total debt of above 25% and interest coverage above 4.5x 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 RCF over debt ratio below 15% and interest coverage below 3.5x 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 Regulated Electric and Gas Utilities Rating Methodology (August 2009), 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.

Rating Factors

EDP - Energias do Brasil S.A.

Regulated Electric and Gas Utilities	Aaa	Aa	A	Baa	Ba	B
Factor 1: Regulatory Framework (25%)					X	
Factor 2: Ability to Recover Costs and Earn Returns (25%)					X	
Factor 3: Diversification (10%)						
a) Market Position (5%)				X		
b) Generation and Fuel Diversity (5%)						
Factor 4: Financial Strength, Liquidity & Financial Metrics (40%) [1]						
a) Liquidity (10%)				X		
b) CFO pre-WC + Interest / Interest (7.5%) (3yr Avg)				X		
c) CFO pre-WC / Debt (7.5%) (3yr Avg)		X				
d) CFO pre-WC - Dividends / Debt (7.5%) (3yr Avg)		X				
e) Debt / Capitalization or Debt / RAV (7.5%) (3yr Avg)			X			
Rating:						
a) Methodology Implied Issuer Rating				**Baa2**		
b) Actual Issuer Rating					**Ba1**	

[1] based on historical data