

Credit Opinion: Bandeirante Energia S.A.

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Sao Paulo, Brazil

Ratings

Category	Moody's Rating
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
Ult Parent: Energias de Portugal, S.A.	
Outlook	Negative
Issuer Rating	A2
Senior Unsecured -Dom Curr	A2
Commercial Paper -Dom Curr	P-1
Parent: EDP - Energias do Brasil S.A.	
Outlook	Stable
Issuer Rating -Dom Curr	Ba1
NSR LT Issuer Rating -Dom Curr	Aa2.br

Contacts

Analyst	Phone
Jose Soares/Sao Paulo	55.11.3043.7300
Richard Sippli/Sao Paulo	
William L. Hess/New York	1.212.553.1653

Key Indicators

Bandeirante Energia S.A.

ACTUALS	1Q09 LTM	2008	2007	2006
(CFO Pre-W/C + Interest) / Interest Expense [1][2]	6.3x	6.2x	7.7x	2.6x
(CFO Pre-W/C) / Debt [1][3]	80.8%	63.3%	82.3%	21.8%
(CFO Pre-W/C - Dividends) / Debt [1][3][4]	27.4%	13.1%	75.5%	18.7%
(CFO Pre-W/C - Dividends) / Capex [1][4]	98.7%	59.9%	315.9%	114.6%
Debt / Book Capitalization [3]	40.9%	47.5%	46.2%	52.0%
EBITA Margin %	18.3%	17.8%	19.0%	18.8%

[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 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

Strong credit metrics

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

Resilient access to the local banking and capital markets

Group's significant capital expenditures program, including the 720 MW Pecém project

Improved Regulatory framework for electric utilities operating in Brazil

Corporate Profile

Bandeirante Energia S.A., headquartered in São Paulo, Brazil, is an electricity distribution utility fully controlled by EDP - Energias do Brasil that serves around 1.4 million clients in the eastern portion of the industrialized state of São Paulo. In 2008, Bandeirante reported net revenues of BRL 2,070 million (USD 1,125 million) on sales of 13,554 GWh, representing some 3.5% of the electricity consumed in Brazil's integrated system.

SUMMARY RATING RATIONALE

The Baa3 rating for Bandeirante reflects the stable and predictable cash flows from the regulated distribution business, and the company's status as an essential service provider in a relatively wealthy service area in the state of Sao Paulo, along with strong credit metrics for its rating category. The ratings also incorporate the overall investment grade credit profile of the group, EDP- Energias do Brasil, its resilient access to the local capital markets and the strong ownership by its parent company EDP - Energias de Portugal (A2; negative). The ratings are constrained by the high dividend pay-out ratio, relatively sizeable capital expenditures within the group in Brazil and the evolving Brazilian regulatory environment.

DETAILED RATING CONSIDERATIONS

STRONG CREDIT METRICS

Bandeirante has posted healthy profitability and solid cash generation in the past five years driven by the relatively stable nature of its regulated business. Cash drains mainly consisted of capital expenditures and distribution of dividends, which, however, have been in line with the company's internal cash generation. This is evidenced by a significant reduction in leverage as measured by Debt to EBITDA ratio of 1.3x in 2008 from 2.6x in 2004. With the recent increase of the dividend payout ratio in the last twelve months ending March 30, 2008, cash flow leverage as expressed by Retained Cash Flow (RCF) to Debt deteriorated to 27,4% from over 40% in the previous three-year period. Nevertheless, Moody's expects that RCF to Debt should remain in the mid twenties for the next three years largely because of the continuation of high distribution of dividends. Moody's forecasts some reduction in internal cash generation in 2009 fueled by lower demand from industrial consumers, which should be partly offset by the recent 14.5% tariff increase granted in September 2008 and some increase in electricity demand from commercial and residential consumers. As a result, Free Cash Flow tends to range from slightly negative to breakeven in the medium term horizon, which might result in an increased level of indebtedness but still compatible with the Baa3 rating category.

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.

PECÉM PROJECT REPRESENTS A MAJOR CREDIT CHALLENGE

The Pecém 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, but also because approximately 80% of the already negotiated long-term financing with BNDES is still pending formal approval. The remaining 20% of the long-term funding with IDB has already been approved. 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 Pecém, jointly but not severally guaranteed by shareholders EDB and MPX in proportion to their 50% individual participation in the joint venture company. Moody's sees EDB's commitment to this project with its significant capital investments in the medium term horizon as an additional demand to upstream cash from its other operating subsidiaries, which could pressure Bandeirante's retained cash flow metrics.

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 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.

Liquidity

Bandeirante's liquidity position is deemed adequate. The upcoming BRL 230 million promissory notes along with expected long-term funding from BNDES and European Investment Bank (BEI), estimated at around BRL 100 million in 2009, should provide the company with sufficient financial resources to meet the company's main cash requirements, pay off the existing debt maturities in the next 12 months of BRL 173 million and further enhance its liquidity position. The major downside risk to this assumption is higher-than-expected distribution of dividends, which would affect leverage but have less of an impact on liquidity.

The liquidity of EDB on a consolidated basis is considered adequate despite sizeable consolidated debt due in the short-term of around BRL 1.1 billion. The bulk of this debt is concentrated in the operating 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. This loan was taken out in October 2008 to pay off BRL 312 million associated with a share 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 potentially be faced with payment on their 50% share (approximately BRL 270 million) bridge loan to the joint venture with MPX that matures in July (rolled over from April) should the expected take-out long-term loans from BNDES and IDB for some reason are not granted.

EDB has been showing 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 plus a EUR 90 million credit facility granted by an European Investment Bank for capital expenditures within the next 2 years.

Corporate Governance

Bandeirante's rating considers that EDB has corporate governance practices that are above the average of Latin American issuers.

Rating Outlook

The stable outlook derives from Moody's expectation that Bandeirante's level of indebtedness will not change dramatically over the medium horizon because any additional cash generated by operations is bound to be distributed to its parent company. Conversely, Moody's expects that Bandeirante will maintain its current strong credit metrics during this period with the relatively stable and predictable cash flow derived from its electricity distribution business. The stable outlook also reflects Moody's expectation that EDB on a consolidated basis 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 ratings of Bandeirante could be upgraded if the supportiveness of the regulatory environment for Brazilian electric utilities improves, or as a result of greater clarity as to the size and financing of EDB's consolidated capital expenditures that improves the creditworthiness of EDB group. Quantitatively, an upgrade of EDB could result from achieving 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 of Bandeirante could be triggered by a downgrade of EDB's ratings, which could occur if the consolidated CFO over debt ratio is below 20% and interest coverage is 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 for Bandeirante and EDB.

Other Considerations

The principal methodology used in rating EDB and Bandeirante was Global Regulated Electric Utilities Rating Methodology (March 2005), which can be found at <http://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.

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