

Global Credit Research - 12 May 2009

Brazil

## Ratings

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

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## Key Indicators

Investco S.A.	2008	2007	2006	2005
<b>ACTUALS</b>				
EBITA/ Interest Expense	4.2x	2.9x	1.8x	1.6x
EBITA/ Average Assets	11.1%	9.6%	9.2%	8.7%
FFO / Debt	38.4%	26.5%	16.6%	10.7%
RCF / Net Debt	35.6%	22.7%	16.8%	10.8%
Debt / EBITDA	1.6x	2.4x	3.0x	4.2x
EBITA Margin %	70.0%	67.8%	69.1%	65.9%

Note: For definitions of Moody's most common ratio terms please see the accompanying [User's Guide](#).

## Opinion

### Rating Drivers

Stable cash flow stream with limited operating risk

Credit strength of the guarantor, EDP- Energias de Portugal

Relatively weak contractual provisions

Debt subordination

## **Corporate Profile**

Investco S.A. (Investco) is a special-purpose company that was formed to construct and operate the 902.5 MW hydroelectric power plant of Luis Eduardo Magalhães (UHE Lajeado), located in Brazil's mid-western state of Tocantins. Fully operational since late 2002, the UHE Lajeado plant is leased to subsidiaries of economic groups with substantial electricity distribution activities in Brazil, namely EDP - Energias de Portugal S/A (EDP Portugal), Rede Energia S.A (Rede), Companhia Energética de Brasília - CEB and CPFL Energia S.A. All these groups participate in Investco's ownership structure with the exception of Rede. Accordingly, Investco's primary sources of revenues and cash flow are the lease payments received from its shareholders, which are tailored to cover the company's operating expenses and debt service.

## **Recent Events**

In September, 2008, EDP Energias do Brasil (EDB; Ba1 Corporate Family Rating, Stable) and Rede Energia S.A (Rede, Caa1 Corporate Family Rating; RUR-down) concluded an asset exchange agreement, which was signed in June 2008. The terms of this agreement consisted of an asset swap in which EDB received Rede's 53.7% equity share in Rede Lajeado and 2.2% in Investco, while Rede received EDB's controlling stake in Enersul. Lajeado Energia (formerly known as Rede Lajeado) holds 45.4% of Investco's voting capital and 39.28% of its total capital.

On March 4, 2009, Moody's upgraded EDB's local currency Issuer Rating to Ba1 from a Ba2 local currency corporate family rating and to a Aa2.br Brazil National Scale issuer rating from Aa3.br. The outlook for these ratings is now stable. The upgrade of EDB's ratings reflects the steady improvement in its credit metrics over the past two years and Moody's recent upgrade of the level of supportiveness of Brazil's regulatory environment (SRE) for regulated electric utilities. In addition, all ratings assigned for the EDB group reflect the strong ownership of its parent company EDP Portugal.

## **SUMMARY RATING RATIONALE**

The Ba1 Global Local Currency rating for Investco's 2011 subordinated debentures reflects the ultimate payment risk of EDP Portugal (A2 senior unsecured; Negative outlook) as the unconditional guarantor but also incorporates the fact that the indenture that documents the guarantee does not have sufficient provisions to ensure timely payment in a default situation. Moody's notes, however, that the documents provide adequate assurance of the validity and binding nature of the continuing guarantee.

The probability of needing to rely on the EDP Portugal guarantee has decreased over time, as the credit quality of the domestic shareholders/offtakers has improved. The creditworthiness of Investco's shareholders may become more important to the rationale for the global or national scale rating in the future. EDP- Energias do Brasil now directly and indirectly holds 75% of Investco's voting capital and approximately 37% of its total capital.

The Aa2.br national scale rating assigned to Investco's debentures reflects the standing of the company's credit quality relative to its domestic peers. Moody's National Scale Ratings (NSRs) are intended as relative measures of creditworthiness among debt issues and issuers within a country, enabling market participants to better differentiate relative risks. NSRs in Brazil are designated by the ".br" suffix. Issuers or issues rated Aa2.br demonstrate very strong creditworthiness relative to other domestic issuers. NSRs differ from global scale ratings in that they are not globally comparable to the full universe of Moody's rated entities, but only with other rated entities within the same country.

## **DETAILED RATING CONSIDERATIONS**

### **LIMITED OPERATING RISK**

The Lajeado plant operates under a long-term concession expiring in 2032. Investco's shareholders are entitled to 526,6MW (approximately 4,613 GWh) of the UHE Lajeado power generation contracted under a long-term lease/power purchase agreement (PPA). In 2008, total generation was 95.8% of the assured energy. Given the good water flow at the Tocantins River throughout the year, the plant availability was above the minimum required by the concession agreement of 89.6%. The operating risk of UHE Lajeado is further mitigated since it is part of the national energy grid - SIN that benefits from the energy reallocation mechanism - MRE for hydrologic risk sharing.

### **STABLE CASH FLOW STREAM**

INVESTCO owns UHE Lajeado's assets and proportionally leases the assured power to its shareholders/lessees. The monthly lease payments are set to cover 1.8 times the issuer's projected operating and financial expenses. Investco's ability to meet its obligations directly depends on the lease payments from its shareholders. The lease

contracts provide that in the event of a lessee's default on regular lease payments to Investco, or the bankruptcy of a lessee, such lessee loses its rights to the energy and its share in the concession which triggers an obligation of the remaining shareholders to cover the defaulted amount. Such an event is unlikely since the PPA is attractively priced.

#### CREDIT STRENGTH OF THE GUARANTOR

EDP Portugal (A2 senior unsecured; Negative outlook) is a vertically integrated utility company with a well-established position in its core market in Portugal and significant operations in Spain, Brazil and the United States. It is the largest generator, distributor and supplier of electricity in Portugal and the third largest electricity generation company in the wider Iberian market. EDP Portugal controls the Spanish electricity company, HC Energia and also operates in the gas sector in the Iberian Peninsula, through Naturgas Energía Grupo, S.A. in Spain and Portgás S.A. in Portugal. EDP Portugal entered the U.S. wind energy market in July 2007 and is currently considered the world's fourth largest generator of renewable energy. In December 2007, EDP Renováveis was incorporated to hold and operate EDP's European and North American renewable energy assets and activities through NEO - Nuevas Energías de Occidente S.A. and Horizon Wind Energy LLC respectively. In June 2008, EDP decreased its stake in EDP Renováveis to 77.5% through an IPO. EDP Portugal has interests in the Brazilian electricity market, through its 62.36% holding of EDP - Energias do Brasil (EDB, Ba1 Corporate Family Rating, Stable). EDP Portugal reported consolidated revenues of approximately EUR 13.9 billion in 2008.

#### RELATIVELY WEAK CONTRACTUAL PROVISIONS

The indenture that documents the guarantee does not have sufficient provisions to ensure timely payment in the event of a payment default by Investco, although documentation provides adequate assurance of the validity and binding nature of the guarantee. A late payment could result in a default event, even if such payment is subsequently made in full. The Ba1 rating reflects the low probability of loss associated with an expected payment by an A2 rated guarantor.

#### Structural Considerations

In the event of a default, the repayment of the rated debentures with proceeds from the PPAs would be subordinated to the repayment of loans granted by Banco Nacional de Desenvolvimento Econômico e Social - BNDES and Banco da Amazônia S.A. - BASA, of approximately BRL 213 million as of December 31, 2008 and equal to 68% of Investco total debt. The ratings for the debentures also incorporate the lack of access of the note holders to the operational assets of UHE Lajeado or to the underlying rights of Investco's shareholders in the concession, in the event of a default.

#### Rating Outlook

The stable outlook reflects the reliance of the rating on the guarantee provided by EDP Portugal, which currently has an A2 rating (senior unsecured) with a negative outlook and the implicit support of its major shareholder EDP - Energias do Brasil (EDB, Ba1 Corporate Family Rating, Stable).

#### What Could Change the Rating - Up

Given the reliance of the rating on the EDP guarantee, which does not have sufficient provisions to ensure timely payment in the event of a payment default, the ratings are unlikely to change unless the credit quality of domestic shareholders improves. Thus, an upgrade of the rating could result from a higher rating at EDB. The lease payments made by Investco's shareholders to cover operating costs and debt service do not provide much margin for improving the existing credit metrics, and therefore a positive impact on the rating or outlook from strengthened credit metrics is unlikely.

#### What Could Change the Rating - Down

The ratings could come under downward pressure if credit quality deteriorates at EDP, since it is the primary repayment source of the debentures. However, given the significant gap between the Ba1 global local currency rating of the debentures and the guarantor's A2 senior unsecured rating, a downgrade of the debentures due to deterioration in EDP credit fundamentals is unlikely to occur in the foreseeable future.



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