

Energias do Brasil

Quality Play in the Electricity Sector

EQUITY RESEARCH

Estimates

R\$ million	2004A	2005E	2006E
Net Revenues	3,703	4,017	4,254
EBIT	550	712	867
EBITDA	775	973	1,156
Net Earnings	108	270	357

Equity and Debt	2004A	2005E	2006E
Total Debt	3,566	3,503	3,566
Net Debt	2,592	3,182	3,363
Net Debt/EBITDA	3.3	3.3	2.9

2004A	Bandeirante	Escelsa	Enersul
Area (th km ²)	9.6	41.4	28.0
Population (mm)	4.0	3.1	2.2
Municipalities	28.0	70.0	73.0
Clients (th)	1,300	983	640
Employees	1,232	1,231	898
Clients/Employees	1,055	799	713
Energy Distr (GWh)	12,189	7,178	3,029
Energy Sold (GWh)	8,812	5,311	2,832
% Industrial Clients	49%	47%	21%
Market Share (%)	3.2%	1.9%	1.0%

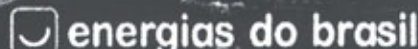
Generation	2005E	2006E	2007E
Installed Capacity	508	706	854
Assured Energy	315	431	515

Energias do Brasil is one of the largest private companies in the Brazilian electricity sector, with a 6% market share in the energy distribution market, through its subsidiaries Bandeirante, Escelsa and Enersul. In the generation segment, the company has an installed capacity of approximately 508MW, which should increase 68% in the next 2 years. It also operates in the fast-growing commercialization business, through Enertrade.

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Energias do Brasil is one of the largest private companies in the Brazilian electricity sector, with a 6% share in the energy distribution market (through Bandeirante, Escelsa and Enersul), an active commercialization arm (Enertrade) and an installed generation capacity of approximately 508 MW (0.6% of Brazilian Capacity).

We believe Energias do Brasil is an attractive investment vehicle that gathers quality assets, efficient management, strong controlling company (EDP Portugal) and high corporate governance.

(+) Generation business – expected capacity growth of 68% from 2005 to 2007 with most of its energy already contracted (about 85%). We believe the company should be able to benefit from new investment opportunities in this segment given its expertise and commitment to the sector.

(+) Distribution business – located in regions of high economic growth (average 5.5% sales growth in the past 2 years) with high operating efficiency. We believe this segment should provide stable and strong cash generation to foster new investments or acquisitions in the sector. In addition, there is a hidden option related to upcoming tariff revisions (specially for Bandeirante and Escelsa).

(+) Commercialization business – 2nd largest trading company in Brasil, with a very active role in retaining and capturing new free clients. In our opinion, this company should benefit from a forecasted free-market growth of about 36% p.a. from 2004 to 2009.

(+) Synergy gains – the ongoing restructuring process of the Group should provide room for operating synergies among the distribution assets as well as other benefits such as a more efficient cash management.

(-) Financial leverage – with an US\$415 million net exposure to US\$ and an estimated Net Debt/EBITDA 2005 level of 3.3x, we believe that an ideal ratio for the company should be between 2.0 to 2.5x. It is worth noting that EDP Portugal committed to capitalize Energias do Brasil about US\$200-300 million until March 31st, 2006, bringing it to its ideal capital structure.

(-) Universalization CAPEX – the company should invest a relatively high amount in the universalization program for distribution companies (about R\$334 million in the next 4 years). Although we consider this CAPEX to be neutral to the company's profitability, we believe it increases the risk that Anel will not be considering the entire amount invested in determining future tariff revisions.

For all these reasons, we believe that Energias do Brasil is a premium company in the sector. Given its strong EBITDA CAGR of 14% from 2004 to 2009, adequate capital structure going forward, low income tax rate, low regulatory/operational risk profile and differentiated management, we believe it deserves a premium of FV/EBITDA over the sector average.

SUMMARY

Energias do Brasil is one of the largest private companies in the Brazilian electricity sector, with a 6% share in the energy distribution market¹ and an installed generation capacity of approximately 508 MW² (0.6% of Brazilian Capacity). The company operates in the distribution (Bandeirante, Escelsa and Enersul), generation, and commercialization (Enertrade) business segments.

The company's energy generation capacity shall increase by approximately 68% from 2005 to 2007. This increase, coupled with its contracts structure and the positive impact of market sales growth in the distribution segment, should provide a consolidated EBITDA growth of approximately 14%p.a. from 2004 to 2009.

The companies' distribution assets are located in regions of high economic growth and have experienced an average 5.5% sales growth³ in the past 2 years. The ongoing restructuring process of the Group should provide room for operating synergies among the distribution assets as well as other benefits such as centralized procurement, reduced overhead costs a more efficient cash management.

According to CCEE, Energias do Brasil trading arm – Enertrade – is the second largest energy trading company in Brazil, second only to CPFL Brasil. This company plays an important role in capturing free clients for Energias do Brasil Portfolio, within a market that is expected to grow approximately 36% p.a. from 2004 to 2009⁴.

Controlled by EDP (Energias de Portugal) – the 2nd largest non-financial group in Portugal and the 10th largest European energy company, with quality assets and efficient management – we believe the company should benefit from the improvements in the electricity sector that should translate into risk-perception reduction; as well as from new investment opportunities in the generation business.

Regarding the company's exposure to regulatory risks, we believe that it is now on the upside. Most of the company's existing and new generation capacity (85%) is already long-term contracted. On the distribution side, remains the lack of a final definition on Bandeirante and Escelsa regulatory asset bases (RAB) – expected for next August and October.

Given our view that Aneel has changed its attitude towards distributors regarding the 2005 tariff revision process, and that the parameters used by Aneel on these companies were also conservative, we believe additional positive aspects could emerge from the process, though we are not considering it in our estimates.

In our view, the electricity sector, after many regulatory and financial uncertainties, is going through a structural change, which is caused mainly by:

- (1) Recovery of companies' financial situation
- (2) Reduction in distribution companies' risk due to the conclusion of tariff revision processes – The "Kelman Effect"
- (3) Good Energy Sales Growth observed so far in 2005 (7.0% versus GDP growth of 2.9%)
- (4) The implementation of the sector new model. We believe it will help to reduce the sector's regulatory and systematic risks, creating a system with stable and balanced rules.

Looking at Energias do Brasil 2004 and 2003 financials, we can observe a similar trend with a good EBITDA growth. We project an EBITDA CAGR of approximately 14% for the company from 2004 to 2009.

¹ According to Aneel

² Considering 51% of Costa Rica and not including 12.7 MW from thermal plants, which should be shut down in the short term. If we were to consider 100% of Costa Rica (16 MW) and the thermal plants, total installed capacity would reach 529.0 MW

³ Total Distributed Energy

⁴ According to Abraceel Estimates

As can be seen in the next exhibit, we see long term marginal cost in Brazil as at least R\$109.0/'000 shares this value compares to the implied price of R\$87.0/'000 shares from the existing energy auctions (next exhibits). This price curve is distorted by the fact that only 23% of the incremental distribution companies demand for 2008 and 2009 was met. Therefore, we believe that in the next energy auctions, when the Federal Government is to contract all distributors demand, an upward shift in this curve should occur. This should reduce risk perception towards the sector.

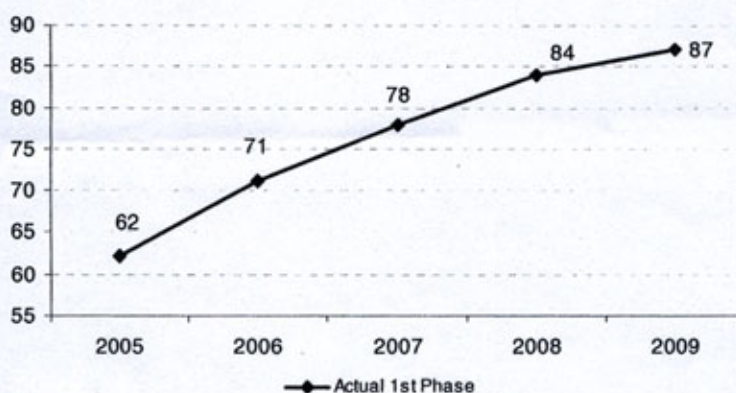
Exhibit 65: Marginal Cost Calculation

Construction Cost (R\$/KW)	4500	4500	4500
WACC*	10%	11%	12%
Costs (R\$/MWh)			
Operating Costs + Maintenance Capex	13.0	13.0	13.0
Deductions	8.9	9.8	10.4
Cost of Capital	77.1	86.2	92.6
Total (R\$/MWh)	99.0	109.0	116.0

* Real

Source: Pactual Research

Exhibit 66: Implied Price Curve from Existing Energy Auctions



Source: Pactual Research

(3) Tariff Revision - The "Kelman" Effect:

Too early to assume gains in next tariff revisions but significant risk decrease

This is probably the most important issue to follow going forward: improvements in the regulatory front. As we have been stating, since Mr. Kelman became the general director of Aneel this year, we perceive a clear improvement in regulation, as the agency has been taking more technical decisions as opposed to those more politically oriented in the past.

In our view, the result of this policy is a significant improvement in the financial situation of the companies, better predictability of results and, consequently, a positive change in their valuations. To name a few, we have some good examples ranging from Cemig (that had an extraordinary tariff increase of about 7% - retroactively to 2003), Coelce and Celpe (with relatively high nominal tariff increase in the Northeast region), and CPFL that had a neutral result. Last but not least, we also had Light's tariff increase in which Mr. Kelman should have played an important role to revert the previous very negative decision (please refer to our report "Electricity Sector: Positive Surprise on Light's Extraordinary Tariff Readjustment" published on February 2nd).

Energias do Brasil é uma das maiores empresas privadas no setor brasileiro de energia, com ações de 6% no mercado de distribuição de energia, através de suas subsidiárias Bandeirante, Escelsa e Enersul. No segmento de geração, a empresa tem uma capacidade instalada de aproximadamente 508MW, que deverá crescer 68% nos próximos 2 anos. Ela também opera no negócio de comercialização de crescimento rápido, pela Enertrade.

(3) Revisão Tarifária – o Efeito “Kelman”:

Cedo demais para assumir ganhos nas próximas revisões tarifárias além da queda de risco significativa.

Esse é provavelmente o assunto mais importante a seguir: melhoras no marco regulatório. Como falamos, desde que o Sr. Kelman se tornou o diretor-geral da Aneel esse ano, nós percebemos uma melhora clara na regulação, assim que a agência vem tomando mais decisões técnicas ao contrário daquelas que, no passado, tinham mais orientações políticas.

Na nossa opinião, o resultado dessa política é um crescimento significativo na situação financeira das empresas, melhor previsibilidade de resultados e, conseqüentemente, uma mudança positiva nas suas avaliações. Só para citar, nós temos alguns bons exemplos como a Cemig (que teve um aumento extraordinário de tarifa de 7% - retroativos a 2003), Coelce e Celpe (com aumento de tarifa nominal relativamente alto na região Nordeste), e CPFL que teve um resultado neutro. E por último, mas não menos importante, nós também tivemos o aumento de tarifa da Light no qual o Sr. Kelman teve um papel muito importante para reverter a muito negativa prévia decisão (favor referir a nossa matéria “Setor Elétrico: Surpresa Positiva no Reajuste Extraordinário de Tarifa da Light” publicado em 2 de fevereiro).

(2) Redução de risco nas empresas de distribuição devido a conclusão dos processos de revisão tarifária – o “Efeito Kelman”