

Rating Action: Moody's upgrades Duke's debentures to Aa2.br and changes the Outlook to positive

Global Credit Research - 26 Aug 2010

Approximately BRL 340 million of debt instruments affected

Sao Paulo, August 26, 2010 -- Moody's América Latina Ltda (Moody's) upgraded to Ba1 from Ba2 on the global scale rating and to Aa2.br from Aa3.br on the Brazilian national scale rating the BRL 341 million debentures expiring in 2013 and 2015 issued by Duke Energy International, Geração Paranapanema S.A (Duke). At the same time, Moody's affirmed Duke's corporate family ratings at Ba1 on the global scale rating and Aa2.br on the Brazilian national scale rating. Moody's also changed the outlook of all ratings to positive from stable.

Upgrades:

Issuer: Duke Energy Int'l Geracao Paranapanema SA

Senior Unsecured Regular Bond/Debenture, Upgraded to Ba1 and Aa2.br from Ba2 and Aa3.br

Outlook Actions:

Issuer: Duke Energy Int'l Geracao Paranapanema SA

Outlook, Changed to Positive From Stable

RATINGS RATIONALE

The rating action was prompted by management's July 06th announcement that Duke issued amortizing 6-year unsecured BRL 500 million debentures whose proceeds were used to redeem more expensive secured BRL 441 million debt owed to the federally-owned holding company Eletrobrás, thereby eliminating any secured debt in the capital structure.

The debentures previously issued had been rated one notch below Duke's Ba1 local currency and Aa2.br national scale corporate family ratings because the debt owed to Eletrobrás represented a significant portion of Duke's debt and would likely rank above the debentures in the priority of claims. The priority arose because, although not secured by the pledge of assets, the debt owed to Eletrobrás was secured with future customer receivables.

This rating action also incorporates the credit implications of a potential capital split of BRL 360 million, which Duke has recently requested that the Brazilian electricity regulator ANEEL to approve. Moody's understands that this potential capital split is a one-off event and will have limited impact on Duke's key credit metrics and liquidity position. Moody's expects debt to marginally increase in the short-term as Duke will rely on its sizeable cash position to execute the split. Duke had around BRL 400 million of cash as of June 30, 2010.

The positive outlook reflects Moody's expectation that the strong operating performance posted by Duke over the past three years will continue in the foreseeable future. The positive outlook factors in Duke's fulfillment of its contractual obligation to expand capacity by 15%. Moody's estimates this would require capital expenditures of around BRL1.2 billion within three years. Duke would most likely finance part of these investments with long-term debt, thus causing some deterioration in credit metrics, which, however, Moody's expects will remain appropriate for the rating category.

An upgrade would require a resolution of the ongoing conversations with the state government with regard to the mandatory capacity expansion clause in Duke's acquisition contract. In addition, an upgrade would require on a sustainable basis a CFO pre-W/C minus Dividends to Debt ratio in the range of 15% to 20% and a cash interest coverage ratio, as measured by CFO pre-W/C to cash interest expense of above 4.0x.

Downward rating pressure could result from higher than expected capital expenditures, inability to secure adequate and timely funding or unexpected penalty associated with the contractual obligation to increase capacity by 15%, and/or dividend payments, such that the company's CFO pre-W/C minus Dividends to Debt ratio falls below 10% and cash interest coverage drops below 2.5x for an extended period of time. A deterioration in Duke's liquidity profile together with tighter than expected financial covenant compliance could also result in a rating downgrade.

Also, should there be evidence that capital splits are recurring events, Moody's will review their impact, along with other credit factors, on the company's creditworthiness, which could ultimately result in a negative rating action.

The last rating action for Duke was on August 28, 2008 when Moody's upgraded Duke's local currency corporate family rating to Ba1 from Ba2. In addition, Moody's upgraded Duke's Brazil National Scale corporate family rating to Aa2.br from A1.br. At the same time, Moody's assigned a Aa3.br Brazil National Scale rating and Ba2 local currency rating to the floating-rate, senior unsecured debentures expiring in 2013 and 2015 issued by Duke in the domestic market. The rating outlook was stable for all ratings.

The principal methodology used in rating Duke Energy Int'l Geracao Paranapanema SA was Unregulated Utilities and Power Companies rating methodology published in August 2009. Other methodologies and factors that may have been considered in the process of rating this issuer can also be found on Moody's website.

Duke is an electricity generation company controlled by Duke Energy Corporation (Baa2 Issuer Rating/Stable Outlook), which indirectly holds 99.0% of its voting capital and 94.8% of total capital. The company has an installed capacity of 2,307 MW in eight hydroelectric power plants along the Paranapanema River, which represents approximately 2.2% of Brazil's current total installed capacity. In the last twelve months ended June 30, 2010, Duke reported net sales of BRL808 million (USD 447 million) and net profit of BRL219 million (USD121 million).

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