



Moody's Investors Service

## Rating Action: **Moody's confirms the rating of Sanepar but changes outlook to negative**

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Global Credit Research - 23 Jul 2009

### **Approximately BRL 170 million of debt securities affected**

Sao Paulo, July 23, 2009 -- Moody's confirmed the Ba3 local currency and A3.br on the Brazilian National Scale rating for the existing BRL166 million unsecured debentures due 2012 issued by Companhia de Saneamento do Paraná - Sanepar ("Sanepar") but changed the outlook to negative. This concludes the review for possible downgrade that was initiated on December 12, 2008.

The negative outlook reflects Moody's growing concerns with the impact of the continuing tariff freeze implemented by the Government State of Paraná since 2005 on the company's cash flow, the uncertainties about the designation of the existing BRL 789 million of advances for future capital increase and the ongoing shareholder dispute.

The review of Sanepar's ratings was prompted by the announcement of its board of directors last December to convert around BRL 789 million in intended advances for future capital increase into debt. This decision was, in Moody's opinion, a response by the major shareholder, the State Government of Paraná, which was not allowed to convert these resources into capital. The equity conversion, primarily planned to be approved in a shareholders meeting scheduled for 10/20/2008, did not occur in the face of a court decision that prevented the state government from further increasing its equity participation in the company. The court decision was in response to the request of the minority shareholder, Dominó Holdings S.A ("Dominó") which was another step in a long judicial dispute that dates back to 2003 between the State Government and Domino on a shareholders agreement to control Sanepar.

Another shareholders meeting to approve a capitalization of around BRL 340 million was scheduled for July 16, 2009; however, once again Dominó obtained a court injunction to prevent the capitalization until the dispute over the shareholders agreement is resolved. While the conversion of the advances into debt does not seem to be in the best interest of any of the shareholders, Moody's does not rule out that such a decision will be enforced if the State Government of Paraná and Dominó do not reach a definite agreement on the control of Sanepar's capital. There also remain uncertainties as to the final maturity, amortization schedule and interest rates in case these advances for future capital increase effectively become debt and the impact this would have on the company's liquidity position.

The tariff freeze in place since 2005 also poses additional concerns on the company's ability to generate adequate cash flow in the face of a relatively sizeable capital expansion program. Preliminary projections indicate that despite lower operating margins stemming from no tariff adjustment in the past four years, Sanepar should still post healthy operating margins in 2009 while maintaining leverage at satisfactory levels compatible with the current Ba3 rating category. Nevertheless, operating margins and metrics will continue to weaken which could create downward rating pressure in 2010, particularly if expansion plans continue.

The last rating action on Sanepar was December 12, 2008 when all ratings were placed under review for possible downgrade.

Sanepar's ratings were assigned by evaluating factors believed to be relevant to its credit profile, such as i) the business risk and competitive position of Sanepar versus others within its industry or sector, ii) the capital structure and financial risk of Sanepar, iii) the projected performance of Sanepar over the near to intermediate term, and iv) Sanepar's history of achieving consistent operating performance and meeting financial plan goals. These attributes were compared against other issuers both within and outside of Sanepar's core peer group and Sanepar's ratings are believed to be comparable to ratings assigned to other issuers of similar credit risk.

Headquartered in Curitiba, Brazil, Companhia de Saneamento do Paraná - Sanepar ("Sanepar") is majority owned and controlled by the government of the State of Paraná. Sanepar provides water treatment and distribution to 8.8 million consumers, and sewage service to 5.2 million consumers in 344 municipalities in the state of Paraná and one municipality in the state of Santa Catarina. In the last twelve months ending March 31, 2009, SANEPAR reported net earnings of BRL131 million (USD66 million) on BRL1, 301 million (USD 656 million) in net revenues.

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