

Issuer Comment: Telemar's rating unaffected by alliance with Portugal Telecom

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Moody's Investors Service commented that the Baa3 rating for Tele Norte Leste Participações S.A. ("TNL") and Baa2 rating for Telemar Norte Leste S.A. ("TMAR") , hereby referred to collectively as Telemar, are unaffected by the announced alliance with Portugal Telecom ("PT"; rated Baa2, outlook stable). The transaction, as announced, includes a capital increase of up to BRL 12 billion in Telemar, which should allow the company to reduce its leverage and position its debt protection metrics more strongly in the Baa rating category.

The announcement of the alliance with Telemar follows PT's agreement with Telefônica (Baa1, outlook stable) to sell its 50% interest in Brasilcel NV (unrated; holding company for Brazil's leading wireless operator Vivo) for some EUR 7.5 billion. PT will use part of the proceeds from the disposal of Brasilcel to acquire direct and indirect stakes in TMAR representing some 22.4% of the company's total shares. The deal as announced includes an equity injection of up to BRL 12 billion in TNL and TMAR. The transaction is expected to be concluded during the fourth quarter of 2010 and is subject to the approval of the regulators and anti-trust authorities, which we believe will be granted without major conditions.

Moody's expects Telemar will use the proceeds from the equity injection to a large extent to acquire a 10% stake in PT and reduce leverage. Moody's current ratings for Telemar factor in our expectation that, following the largely debt-funded acquisition of Brasil Telecom in early 2009, the company would focus on reducing leverage and position its debt protection metrics more strongly in the Baa rating category. While leverage as measured by Total Adjusted Debt to EBITDA has declined to 2.8x as of March 2010 from 3.3x as of March 2009, we anticipate the equity infusion will help the company reduce leverage further to around 2.0x with the protection of a robust cash position.

We view the recent developments as a credit positive through the reduction in leverage and possible synergies resulting from the increased negotiating power and economies of scale of the alliance. However, the near term reduction in leverage to around 2.0x is, in our view, on its own not sufficiently positive for upward pressure in the rating. Before considering a possible upgrade to the ratings, we would need to see continued improvement in cash from operations (BRL 6.9 billion LTM March 31st 2010) and positive free cash flow generation (BRL -1.9 billion LTM March 31st 2010) as well as an improvement in operating margin. Furthermore, the usage of the additional cash and possible strategic investments of the company and its capital structure management remain relevant issues to monitor.

Portugal Telecom SGPS, SA is the leading telecommunications operator in Portugal, servicing 4.3 million fixed lines (which include 1 million ADSL retail connections) and approximately 7.2 million mobile phone customers as of March 2010. In addition to its investments in Brazil, the company also has operations in Morocco, Guinea Bissau, Cape Verde, Mozambique, Timor, Angola, Kenya, China, São Tome and Príncipe, and Namibia, having reported EUR 6.9 billion in revenues in the least twelve months ended on March 2010.

Headquartered in the city of Rio de Janeiro, Tele Norte Leste Participações S.A. is the holding company for Telemar Norte Leste S.A., Brazil's largest incumbent local exchange carrier by number of subscribers (21.3 million as of December 31, 2009). The company also provides wireless services and broadband services to 36.1 million and 4.2 million subscribers, respectively. The company reported net revenues of BRL 29.8 billion (about USD 15.9 billion converted by the average exchange rate) in the last twelve months ended on March 2010.

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