

Rating Action: Telemar Norte Leste S.A.

Moody's assigns Baa3 to Telemar's proposed notes

Approximately USD 1.5 billion in debt securities affected

Sao Paulo, September 02, 2008 -- Moody's Investors Service has assigned a Baa3 foreign currency rating to the proposed issuance of approximately USD 1.5 billion in senior unsecured notes by Telemar Norte Leste S.A. ("TMAR"). The notes will be issued in three tranches with maturities in 2014, 2019 and 2038, with respective sizes to be determined during the course of the placement. The Baa3 foreign currency rating is constrained by Brazil's foreign currency ceiling of Baa3, and is one notch below TMAR's Baa2 local currency issuer rating. The outlook for all ratings is stable.

The net proceeds of the issuance will be primarily used to partially fund the acquisition of Brasil Telecom Participações S.A. (not rated; holding company for Brasil Telecom S.A. rated Baa3 / outlook stable), which is pending approval of the telecommunications industry regulator and of anti-trust authorities. The assignment of the Baa3 rating assumes that the final transaction documents will not be materially different from draft legal documentation reviewed by Moody's and assumes that these agreements are legally valid, binding and enforceable.

TMAR's Baa2 local currency issuer rating is supported by its incumbent wireline operations with a dominant market position in its concession territory, which has driven its relatively stable EBITDA margins and cash flow. The rating also considers the company's prudent financial policies and track record for maintaining solid liquidity, which are complemented by its strong debt protection metrics.

At the same time, the rating is principally constrained by ongoing challenges to offset declining high-margin fixed-line telephony revenues with mobile and broadband segment growth without sacrificing margins or cash flow. The rating additionally considers the substitution effect from fixed-line into wireless and the fierce competition in the overall Brazilian telecom sector from existing players and new technologies. The rating takes into account the expectation that increasing competitive pressure and erosion of its traditional higher-margin fixed-line business will continue to pressure overall margins. Although the Brazilian regulatory environment is still evolving, in Moody's view, changes in the regulatory framework have so far been supportive to the maintenance of adequate returns for investments in the sector.

Furthermore, the rating also incorporates the potential acquisition by TMAR of Brasil Telecom Participações S.A. for a total consideration of about BRL 13 billion (approximately USD 8 billion at current exchange rate). The conclusion of the deal is subject to a change in the laws governing Brazil's telecommunications sector post-privatization structure and to the approval of the regulator and anti-trust authorities. The company expects that this approval process will be concluded by the end of 2008.

Although the timing for the change in the regulatory framework and approval by the regulator and anti-trust is fairly uncertain, Moody's expects approval is likely to occur without major restrictions. From an operational point of view the acquisition of Brasil Telecom is accretive because it adds scale to TMAR's existing operations and strengthens its geographic coverage, with additional potential for synergies primarily related to joint equipment purchases, marketing and interconnection expenses.

Although TMAR's overall debt protection metrics on a consolidated basis pro-forma for the acquisition of Brasil Telecom are expected to deteriorate in view of substantial additional debt to fund the acquisition, we note that credit metrics should remain commensurate with its current rating category. Moody's expects that TMAR will use cash flow to delever its balance sheet after the acquisition, placing the company's consolidated credit metrics more strongly in the Baa rating category.

The stable outlook reflects Moody's expectations that TMAR will continue to report strong operating margins while integrating BrT, while maintaining prudent financial management including adequate liquidity and moderate dividends. The stable outlook also considers that, following the acquisition of Brasil Telecom, TMAR will delever its balance sheet to move towards its target of reducing Total Adjusted Debt to EBITDA to below 2.0x.

Given the challenges arising from the announced acquisition, which, if materialized, would include the successful integration of BrT's operations and increased indebtedness, an upgrade of TMAR local currency rating is unlikely to occur in the near term. On the other hand, difficulties in integrating BrT and/or an intensifying competitive environment could pressure the local currency rating. Specifically if Total Adjusted

Net Debt to EBITDA were to be above 2.5x for an extended period of time, or Funds From Operations less Dividends to Total Adjusted Debt ratio were to fall below 25% on a consistent basis, the ratings or outlook may come under downward pressure. Given that TMAR does not have committed standby credit facilities, as is the case for most Latin American issuers, Moody's expects that the company will consistently maintain full coverage of short term debt with cash and free cash flow.

The Baa3 foreign currency rating for the proposed notes would be upgraded if Brazil's Baa3 foreign currency country ceiling is upgraded. If Brazil's foreign currency country ceiling is downgraded, the rating for the proposed notes would be downgraded to the same level.

Based in the city of Rio de Janeiro, Brazil, Telemar Norte Leste S.A. is the country's largest incumbent local exchange carrier by number of subscribers (13.9 million at June 30, 2008). The company also provides wireless services and broadband services with 20.3 million and 1.8 million subscribers, respectively, having reported net revenues of BRL 18 billion (about USD 10.1 billion converted by the average exchange rate) in the last twelve months ended on June 30, 2008.

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