

## Utilities/Services

Brazil

Maintained (since 29/08/07)

## ISA Capital

Buy

A growth story

Moody's/S&amp;P/Fitch

Bloomberg: ISABR

NR/BB/BB

- **ISA Capital reported strong 1Q08 results: adjusted EBITDA for non-recurring events was US\$182m, up 50.7%, and the EBITDA margin was 84.1%, up 23ppt YoY.**
- **The company's credit statistics are solid: LTM interest coverage 7.2x and net debt/EBITDA 2.1x for 2007.**

**ISA Capital – the holding company of CTEEP – reported strong results for 1Q08.** Adjusted EBITDA for non-recurring events was US\$183m, up 50.7%, and the EBITDA margin was 84.1%, up 23ppt YoY. The company continues to deliver exceptional EBITDA margins, ~10ppt above our initial 75% forecast for the year. We adjust upwards our forecast for 2008-09 to 83%, as we consider that this margin is sustainable through this period. The results were driven by operational gains as management reduced personnel expenses at CTEEP's level. ISA Capital's 1Q08 consolidated financial statements recorded US\$8.7m of non-recurring operational gains from actuarial changes in CTEEP's pension fund liabilities.

**Operational company CTEEP's plans to continue growing.** The company will participate through a consortium in the auction of three major lines to interconnect the isolated state of Amazonas with the national grid or SIN, and on a stand-alone basis, in less relevant transmission lines. The auction will be held on 27 June. CTEEP has room to add debt in order to fund its expansion plan, as our forecast 2008 net debt to EBITDA ratio of 0.9x is well below the 3.0x threshold set up in the notes' indentures.

**ISA '12 and ISA '17 credit rating is capped by its subordination to CTEEP's debt.** The recent upgrade of Brazil to investment grade by S&P will not have an impact on the notes due to its subordination to CTEEP's debt, in our view. Even if Colombia and Brazil gain investment grade status from two major credit rating agencies, we believe that the notes will continue to be rated a notch below, ie, BB+. ISA Capital's current credit statistics are comparable with an investment-grade utility company.

**We reiterate our BUY recommendation on ISA's '12 and '17 notes.** ISA 7.875% due 2012 and ISA 8.8% due 2017 are trading 48bp and 17bp from our target spread. The notes are attractively priced versus their BB-rated Brazilian peers.

## Summary financials 1Q08

	Δ QoQ	Δ YoY
Revenue (%)	11.5	50.7
EBITDA (%)	19.7	107.8
EBITDA margin (bp)	578	2,313
Interest coverage (x)	3.7	3.8
Net debt/EBITDA (x)	(0.3)	(1.6)
Cash (US\$m)	(29)	(193)
Net debt (US\$m)	40	439

Source: Company data

## ISA Capital US\$ bonds outstanding

Maturity	Jan-12	Jan-17
Amount (US\$m)	200	354
Coupon (%)	7.875	8.800
Price (US\$)	106.35	108.50
Target price 12-m (US\$)	108.01	109.64
Total return 12-m (%)	9.4	9.8
YTW (%)	5.93	7.45
Target YTW (%)	9.44	9.85
Spread to US-T (bp)	348	367
Target spread US-T (bp)	300	350

Source: Bloomberg, ING  
Indicative prices as of 20 May 2008

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**Fig 1 ISA Capital consolidated financial summary (US\$m)**

	2006	2007	LTM	1Q07	2Q07	3Q07	4Q07	1Q08	2008F	2009F
Revenues	304	680	752	143	160	183	194	216	828	886
<b>EBITDA</b>	<b>180</b>	<b>522</b>	<b>616</b>	<b>88</b>	<b>104</b>	<b>178</b>	<b>152</b>	<b>182</b>	<b>687</b>	<b>735</b>
EBITDA margin (%)	59.2	76.7	81.9	61.0	64.9	97.7	78.4	84.1	83.0	83.0
Interest expenses	(17)	(82)	(85)	(16)	(18)	(20)	(28)	(20)	(72)	(118)
Capex	(217)	(217)	(217)	(99)	(53)	(65)	(1)	(39)	(420)	(449)
<b>Free cash flow</b>	<b>(54)</b>	<b>223</b>	<b>313</b>	<b>(28)</b>	<b>33</b>	<b>94</b>	<b>123</b>	<b>123</b>	<b>195</b>	<b>169</b>
Short-term debt	371	105	115	249	92	83	105	115	106	106
Gross debt	371	1,037	1,048	803	704	744	1,037	1,048	1,529	1,606
Cash	244	143	114	307	130	54	143	114	122	238
<b>Net debt</b>	<b>127</b>	<b>894</b>	<b>934</b>	<b>496</b>	<b>575</b>	<b>690</b>	<b>894</b>	<b>934</b>	<b>1,406</b>	<b>1,368</b>
<b>Interest coverage (x)</b>	<b>10.5</b>	<b>6.4</b>	<b>7.2</b>	<b>5.3</b>	<b>5.9</b>	<b>9.1</b>	<b>5.4</b>	<b>9.1</b>	<b>9.6</b>	<b>6.2</b>
EBITDA-capex/int. exp. (x)	10.5	6.4	7.2	5.3	5.9	9.1	5.4	9.1	3.7	2.4
Gross debt/EBITDA (x)	2.1	2.0	1.7	2.3	1.7	1.0	1.7	1.4	2.2	2.2
<b>Net debt/EBITDA (x)</b>	<b>1.1</b>	<b>1.5</b>	<b>1.1</b>	<b>3.1</b>	<b>2.3</b>	<b>1.2</b>	<b>1.9</b>	<b>1.5</b>	<b>2.0</b>	<b>1.9</b>
Receivable days (#)	46	65	72	51	51	61	57	63	63	63

**Assumptions**

ISA Capital stand-alone debt										
Bonds outstanding							554	554	554	554
Interest and currency swap							167	167	170	170
Interest expenses (%)									8.60	8.60
FX EOP (R\$/US\$)							1.78	1.78	1.75	1.75

Source: Company data, ING estimates

**Fig 2 CTEEP financial summary (US\$m)**

	2006	2007	LTM	1Q06	2Q06	3Q06	4Q06	1Q07	2Q07	3Q07	4Q07	1Q08	2008F	2009F
Revenues	561	680	752	127	128	165	141	144	160	183	194	216	828	886
<b>EBITDA</b>	<b>325</b>	<b>526</b>	<b>620</b>	<b>66</b>	<b>74</b>	<b>112</b>	<b>73</b>	<b>89</b>	<b>119</b>	<b>150</b>	<b>168</b>	<b>183</b>	<b>687</b>	<b>735</b>
<i>EBITDA margin (%)</i>	<i>57.8</i>	<i>77.4</i>	<i>82.5</i>	<i>52.1</i>	<i>57.2</i>	<i>68.0</i>	<i>51.6</i>	<i>61.5</i>	<i>74.6</i>	<i>82.1</i>	<i>86.9</i>	<i>84.6</i>	<i>83.0</i>	<i>83.0</i>
Interest expenses	(8)	(17)	(25)	(2)	(2)	(2)	(2)	(2)	(2)	(4)	(9)	(9)	(56)	(62)
Capex	(217)	(217)	(157)	(62)	(54)	(42)	(58)	(99)	(53)	(65)	(1)	(39)	(420)	(449)
<b>Free cash flow</b>	<b>100</b>	<b>291</b>	<b>438</b>	<b>2</b>	<b>17</b>	<b>68</b>	<b>13</b>	<b>(13)</b>	<b>64</b>	<b>81</b>	<b>158</b>	<b>134</b>	<b>211</b>	<b>225</b>
Short-term debt	0	74	87	5	0	4	0	100	75	85	74	87	75	74
Gross debt	0	300	371	5	0	5	0	100	87	108	300	371	774	851
Cash	241	107	114	273	223	242	241	99	130	54	107	114	86	201
<b>Net debt</b>	<b>(241)</b>	<b>192</b>	<b>258</b>	<b>(268)</b>	<b>(223)</b>	<b>(238)</b>	<b>(241)</b>	<b>1</b>	<b>(42)</b>	<b>54</b>	<b>192</b>	<b>258</b>	<b>688</b>	<b>650</b>
<b>Interest coverage (x)</b>	<b>41.6</b>	<b>30.1</b>	<b>24.9</b>	<b>31.5</b>	<b>34.9</b>	<b>60.9</b>	<b>41.8</b>	<b>47.0</b>	<b>48.7</b>	<b>39.2</b>	<b>18.0</b>	<b>19.6</b>	<b>12.3</b>	<b>11.8</b>
EBITDA-capex/int. exp. (x)	13.8	17.7	18.6	2.0	9.1	38.0	8.3	(5.7)	27.1	22.3	18.0	15.4	4.8	4.6
Gross debt/EBITDA (x)	0.0	0.6	0.6	0.0	0.0	0.0	0.0	0.3	0.2	0.2	0.4	0.5	1.0	1.1
<b>Net debt/EBITDA (x)</b>	<b>(0.7)</b>	<b>0.4</b>	<b>0.4</b>	<b>(1.0)</b>	<b>(0.8)</b>	<b>(0.5)</b>	<b>(0.8)</b>	<b>0.0</b>	<b>(0.1)</b>	<b>0.1</b>	<b>0.3</b>	<b>0.4</b>	<b>0.9</b>	<b>0.8</b>
Receivable days	50	65	72	53	53	42	50	51	56	71	57	63	60	60
<b>Assumptions</b>														
<b>Cash (flow)</b>													<b>86</b>	<b>201</b>
<i>Accounts receivable</i>	77	122	149										136	146
<i>Op. expenses</i>	315	243	226										248	266
AR/revenues (%)	13.7	17.9	19.9										16.4	16.4
AR (days)	50	65	72										60	60
<i>Inventory</i>	17	18	19										20	21
Inventory/operating exp (%)	5.5	7.4	8.2										7.9	7.9
Inventory (days)	39	72	98										29	29
<i>Accounts payable</i>	63	16	18										20	22
AP (days)	73	25	30										30	30
Dividend payments	53	335	NA										412	368
Dividend payments (%/EBITDA)	16.3	63.8	NA										60.0	50.0
<b>Revenues</b>														
Growth YoY (%)	17.8	21.1											10.1	7.7
EBITDA margin (%)	57.8	77.4	82.5										83.0	83.0
<b>CTEEP stand alone debt</b>														
Avg. interest rate - fees & taxes (%)													8.0	8.0
BNDDES loan													436	433
Bank debt													75	74
Debt increase													189	269
Average (R\$/US\$)	2.18	1.95	NA										1.75	1.76
FX EOP (R\$/US\$)	2.14	1.78	NA										1.75	1.76

Source: Company data, ING estimates

# Disclosures Appendix

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