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Assunto: VOTORANTIM SALES COMMENTARY: Meeting with Excelência Energética Consultoria

VOTORANTIM SALES COMMENTARY

This is a Sales commentary and should be interpreted as such.

Meeting with Excelência Energética Consultoria

Yesterday we had a meeting with Mr. José Said de Brito, Mr. Érico Henrique Garcia de Brito and Mr. Erik Eduardo Rego from the electrical consulting firm Excelência Energética Consultoria.

The most important topics discussed in our meeting were the following:

- i) **Renewal of concessions:** the consultants believe that 2011 is the deadline year to decide on the renewal (or not) of electric companies' concessions. However, in order for the renewals to take place, Brazil's legal system must change. Given the importance of settling this issue for the industry, the use of Provisional Measures by the government is not off the table. The "moral ceiling" for prices of dams to be renewed would be those of the public auctions for the Madeira River and Belo Monte hydroelectric projects.
- ii) **Expectations for Dilma's government:** the newly-elected Brazilian President tends to adopt the same posture that she had when she was the Minister of Mines and Energy and the Chief of Staff of President Lula. Therefore, the new government tends to be more centralized and with more interference. However, the consultants don't see a distinction being made between state-controlled companies, such as CEMIG, CESP and COPEL, and those under the federal government's umbrella. Moreover, the decisions are likely to have a more technical nature, though the possibility that government-controlled companies will be favored to the detriment of private companies cannot be disregarded.
- iii) **Sector expansion:** the consultants believe that the government ought to seek balance between return on investment and tariff modicity in order not to drain the generation of resources, especially for government-owned enterprises. Although new technologies (such as wind energy) have emerged as more viable ventures lately, they still need the back-up of hydroelectric plants, as their energy generation is directly dependent on winds. Furthermore, they also mentioned studies showing that, despite the increase in installed capacity, the capacity of reservoirs is not increasing, since the plants are built with run-of-river reservoirs. Therefore, the government's tool is to bid the energy from both new and existing government-owned generation plants, with a clear benefit to tariff modicity, giving up some of the cash generation of the companies. However, the consultants do not believe that the industry will deteriorate since there seems to be a clear interest by private investors, including foreign agents, and the government itself will probably move its resources to expand the offering of supply through large enterprises, seeking tariff modicity.

- iv) Periodic rate review:** the consultants see that since the first periodic rate review cycle, the expectation of generating resources by distributors is very tied to the regulatory WACC defined by ANEEL, which mostly accompanies the interest rate trend in the market. Therefore, they believe that the margins of the distribution segment are likely to be tight. Since energy generation is not as regulated as energy distribution, they see it with more room to move away from such squeeze. In each tariff cycle, ANEEL is increasingly limiting the management of the distribution segment, which reduces the upside of the business and the ability to generate resources for this segment.

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