

Tele Norte Leste-S.A. (TNLP4)

Rating	NEUTRAL*
Price (24 May 11, R\$)	29.90
Target price (R\$)	30.00 ¹
52-week price range	30.60 - 23.30
Market cap. (R\$ m)	13,631.24
Enterprise value (R\$ m)	24,353.12

*Stock ratings are relative to the relevant country benchmark.
¹Target price is for 12 months.

Research Analysts

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COMMENT

When dust settles, focus will return to fundamentals

- **Action:** The sharp rise in TNE's share price today (+13%) was likely warranted by the accretive nature of the proposed restructuring (i.e., merger with BTM, a low multiple asset), a simplified ownership structure, and a more efficient capital structure. We believe this restructuring was badly needed and represents a major step forward for the company.
- **Investment Case:** The simplification of the ownership structure does not change in any meaningful way the fundamental trends in TNE's business nor our Ebitda estimate for this year (R\$9.9bn). We continue to see a challenging outlook for the company as it struggles to restart growth in highly competitive markets for wireless, fixed broadband and pay TV. FCF should still decline meaningfully this year.
- **Catalysts:** For the short-term, we believe attention will be focused on the next steps of the corporate restructuring, which should include creation of special committees to represent TNE, TMAR and BTM during the restructuring process. The company estimates the process should conclude in about six months.
- **Valuation:** Our view is that TNE shares already reflect the benefits of the restructuring. We estimate the combined company is trading at 4.2x EV/Ebitda on a proforma basis. At this level, the shares are trading roughly in line with TSP/VIV, even though we believe a premium is warranted for TSP based on its stronger market position, lower leverage, higher FCF yield, and higher ownership % held by its controlling shareholder.

Share price performance



On 05/23/11 the Ibovespa (USD) index closed at 38166.62

Quarterly EPS	Q1	Q2	Q3	Q4
2010A	1.30	1.48	1.46	0.34
2011E	0.76	0.76	0.76	0.76
	0.85	0.85	0.85	0.85

Financial and valuation metrics

Year	12/10A	12/11E	12/12E	12/13E
Revenue (R\$ m)	29,480.2	29,349.7	30,288.1	30,344.9
EBITDA (R\$ m)	10,195.1	9,863.7	10,227.4	10,318.9
EBIT (R\$ m)	5,235.0	4,239.3	4,623.4	4,775.1
Net income (R\$ m)	1,749.8	710.4	1,477.9	1,563.5
EPS (CS adj.) (R\$)	4.58	1.52	3.16	3.35
Dividend yield (%)	—	1.1	6.1	11.3
P/E (x)	5.8	17.4	8.3	7.9
P/B (x)	0.85	0.87	0.82	10.3
ROE stated - return on equity	14.8	5.0	9.9	10.8
ROIC (%)	12.86	7.82	7.80	8.18
Net debt (R\$ m)	18,788	13,610	11,895	10,333
Net debt/equity (12/11E, %)	94.1	50.3	41.6	34.8
Capex (R\$ m)	3,093	5,243	5,108	4,814

Source: Company data, Credit Suisse estimates.

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TNE announces sorely needed restructuring

This morning (24), TNE announced that its controlling shareholder plans to collapse the three listed companies that comprise Telemar: Tele Norte Leste (TNE), Telemar Norte Leste (TMAR5) and Brasil Telecom (BTM), into a single company. The mechanism for this transaction will be share swap whereby BTM incorporates TNE and TMAR5 and would be the surviving entity. Shareholders in TNE and TMAR5 are to receive shares of BTM at ratios that approximate the average trading prices since the completion of Telemar's capital increase in March.

Exhibit 1: Telemar – share prices and proposed exchange ratios for main share classes

Figures in R\$ millions, unless otherwise stated

Ticker	Current price	Ticker	Current price	Ratio	Implied value per share	Current premium (discount)
TNLP4	\$29.90	BRT04	\$16.77	1.81	\$30.32	-1.4%
TNLP3	\$35.75	BRT03	\$17.98	2.03	\$36.48	-2.0%
TMAR5	\$60.70	BRT04	\$16.77	3.74	\$62.73	-3.2%

Source: Company data, Credit Suisse estimates

The deal is essentially an all stock transaction. One kicker that applies only to BTM shareholders is that BTM plans to distribute R\$1.5bn in cash (R\$2.54/share) to its shareholders prior to incorporating the other Telemar companies (with ratio to be adjusted accordingly). This is essentially a dividend (yield of about 15%) to reward BTM holders in the event the transaction moves forward. The payment of this dividend leads to a slight increase in the new company's consolidated leverage. For holders of TNE and TMAR5, they will receive all shares of the newco.

Although the company has put forward exchange ratios for all the share classes, the company must still complete a process before they can be put to shareholder votes. In particular, the three companies will create independent committees to negotiate terms and make recommendations to their respective boards. The committees will also oversee the hiring of banks to perform independent valuations on their respective assets. Our base case is that the transaction will be completed at ratios that are similar to the ratios announced yesterday. The company estimates shareholders should vote on these exchange ratios in about six months.

Exhibit 2: Telemar – key financial figures before and after merger

Figures in R\$ millions, unless otherwise stated

		Adjustments	Proforma
Revenues	29,350	0	29,350
Ebitda	9,864	0	9,864
Net income	710	579	1,290
Net debt	13,610	735	14,345
Net debt/Ebitda	1.38x	0.07x	1.45x

Source: Company data, Credit Suisse estimates

The merger of TNE, TMAR and BTM at close to market prices is accretive for the combined entity, mostly because it includes BTM, which was trading at a low EV/Ebitda multiple of only about 2.5x for 2011. This accretion, however, was fully offset by the sharp increase in share prices yesterday. Based on our estimate of the new company's post-transaction market cap, we estimate the new BTM is trading at 4.2x EV/Ebitda. We

estimate the new company should have about 1.6mn shares outstanding, although this is only an estimate, as some PN holders may receive a mix of PN and ON shares rather than only PN shares.

Exhibit 3: Telemar – estimated EV/Ebitda multiple post-restructuring

Figures in R\$ millions, unless otherwise stated

Newco shares outstanding ⁽¹⁾	1,600
BRT04	\$16.77
Market cap	\$26,832
Net debt	\$14,345
EV	\$41,177
Ebitda	9,864
EV/Ebitda	4.2x

Source: Company data, Credit Suisse estimates

(1) Note: new BTM shares are estimated; the exact figure will depend on how many PN shares are exchanged to ON shares.

Our view is that the transaction is clearly positive for Telemar by clearing up a Byzantine organization structure and also because it joins together all cash generation into a single entity that is more efficient for servicing debt. As an integrated operator, we believe the company's closest comparable becomes Telesp/Vivo. We would argue for a premium for Telesp. Telesp is the number one mobile operator in Brazil (Oi is number three), has the wealthiest fixed line region in the state of Sao Paulo, has lower financial leverage, and its controller has a higher ownership stake. We maintain our Neutral rating on Telemar.

Exhibit 4: Telemar – corporate template

BASICS			
Sector	Telecom	Ticker	TNLP4
Price (R\$)	29.90		
Target (R\$)	30.00	Target (US\$)	18.00
Recommendation			NEUTRAL
Mkt. cap. (R\$ mn)			13,963
Free Float (R\$ mn)			10,882

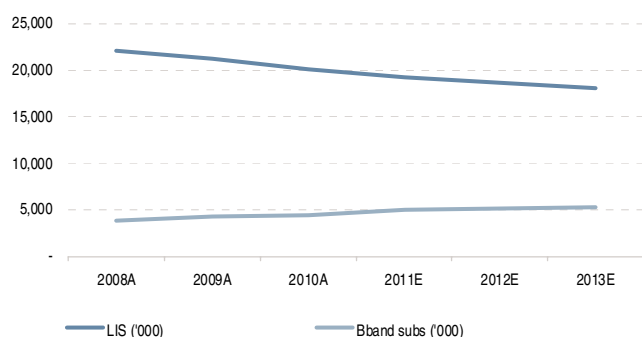
COMPANY DESCRIPTION
TNL is a telecom company with fixed-line and mobile operations in all of Brazil.

POSITIVES
Strategic alliance with PT
Present in every region of Brazil
High FCF yield

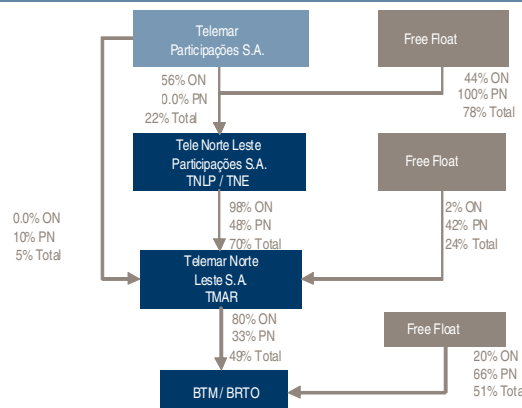
SHAREHOLDERS (estimated)	ON	PN	TOTAL
Telemar Part.	103	56%	0%
Free Float	81	44%	283
TOTAL	184	100%	283

NEGATIVES
Low growth in TNE's fixed line
Strong competition from cable
Inefficient shareholder structure

Subscribers (2008-2013E)



OWNERSHIP STRUCTURE (estimated)



FINANCIALS (R\$ mn)	2008A	2009A	2010A	2011E	2012E	2013E
Revenues	29,947	29,881	29,480	29,350	30,288	30,345
COGS	19,938	20,033	19,285	19,486	20,061	20,026
EBIT	5,117	3,238	5,235	4,239	4,623	4,775
EBIT margin	17.1%	10.8%	17.8%	14.4%	15.3%	15.7%
EBITDA	10,009	9,848	10,195	9,864	10,227	10,319
EBITDA margin	33.4%	33.0%	34.6%	33.6%	33.8%	34.0%
Adj. EBITDA	6,300	6,498	6,932	5,737	5,981	6,035
Net financial expenses	405	2,228	2,104	2,567	1,326	1,323
Taxes	1,075	862	136	425	1,078	1,129
Net income	1,265	(434)	1,750	710	1,478	1,563
Net margin	4.2%	-1.5%	5.9%	2.4%	4.9%	5.2%
# shares (millions)	382	382	382	467	467	467
EPS (R\$)	3.31	(1.14)	4.58	1.52	3.16	3.35
NOPAT	3,582	2,267	3,665	2,968	3,236	3,343
Depreciation	4,902	5,705	4,960	5,624	5,604	5,544
Capex	7,320	5,107	3,093	5,243	5,108	4,814
FCFE	(1,153)	163	3,617	1,091	1,974	2,293
Dividends / IOE	3,150	2,650	-	139	750	1,398
Total assets	60,502	60,925	75,138	81,329	83,459	84,478
Cash	14,223	8,025	11,276	14,828	16,515	18,078
Current Assets	25,127	18,386	22,205	26,382	28,451	30,036
Current Liabilities	34,980	38,286	41,590	40,452	40,560	40,489
Net debt	11,176	21,893	18,788	13,610	11,895	10,333
Book value	15,354	7,994	11,815	14,237	14,965	15,130
Market cap.	13,963	13,963	13,963	13,963	13,963	13,963
EV adj.	23,127	31,916	29,369	24,685	23,485	21,196
Invested capital	26,530	29,887	30,603	27,847	26,860	25,463

OPERATING METRICS	2008A	2009A	2010A	2011E	2012E	2013E
LIS ('000)	22,066	21,293	20,025	19,224	18,590	18,106
Bband subs ('000)	3,821	4,211	4,354	4,929	5,126	5,280
Mobile subs ('000)	29,995	36,112	39,302	43,792	45,740	47,319

LEVERAGE	2008A	2009A	2010A	2011E	2012E	2013E
Net debt / EBITDA	1.1	2.2	1.8	1.4	1.2	1.0
Net debt / Equity	0.7	2.7	1.6	1.0	0.8	0.7
Capex / Operat.Cash Flow	1.0	0.7	0.3	0.8	0.7	0.6

RETURN / YIELD	2008A	2009A	2010A	2011E	2012E	2013E
ROIC	12.0%	0.2%	12.9%	7.8%	7.8%	8.2%
WACC	8.3%	8.3%	8.8%	8.9%	9.1%	9.2%
Cost of Equity (ke)	11.5%	11.5%	11.5%	11.5%	11.5%	11.5%
ROE	8.2%	-5.4%	14.8%	5.0%	9.9%	10.3%
FCF Yield	-8.3%	1.2%	25.9%	7.8%	14.1%	16.4%
Div. Yield	22.6%	19.0%	0.0%	1.0%	5.4%	10.0%

VALUATION	2008A	2009A	2010A	2011E	2012E	2013E
Adj. EV / Adj. EBITDA	3.7	4.9	4.2	4.3	3.9	3.5
Adj. EV / IC	0.9	1.1	1.0	0.9	0.9	0.8
P/E	9.0	n.m.	6.5	19.7	9.5	8.9
P/B	0.9	1.7	1.2	1.0	0.9	0.9

Source: Company data, Credit Suisse estimates

Companies Mentioned (Price as of 24 May 11)
 Brasil Telecom S/A (BRTO4, R\$16.77, NEUTRAL, TP R\$16.00)
 Tele Norte Leste-S.A. (TNLP4, R\$29.90, NEUTRAL, TP R\$30.00)
 Telemar Norte Leste S/A (TMAR5, R\$60.70, NEUTRAL, TP R\$56.00)
 Telesp (TLPP4, R\$44.18, OUTPERFORM, TP R\$52.00)
 Vivo Participacoes (VIVO4, R\$68.41, RESTRICTED)

Disclosure Appendix

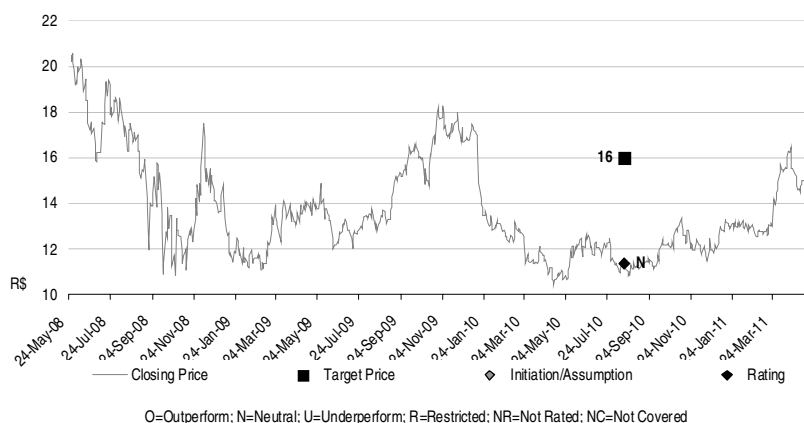
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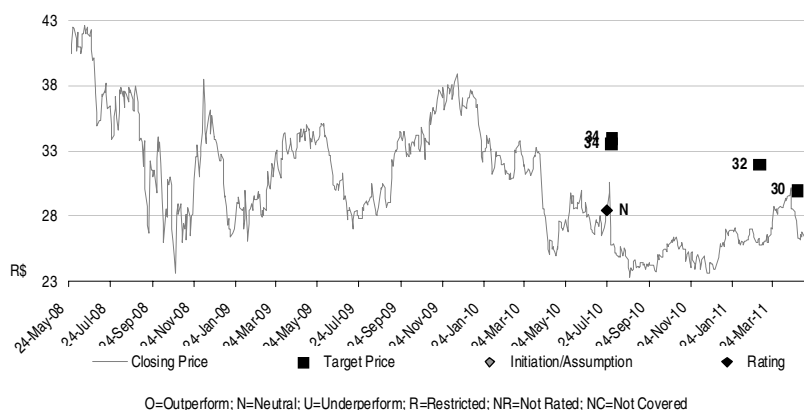
3-Year Price, Target Price and Rating Change History Chart for BRTO4

BRTO4	Closing Price (R\$)	Target Price (R\$)	Initiation/ Rating Assumption
18-Aug-10	11.36	16	N



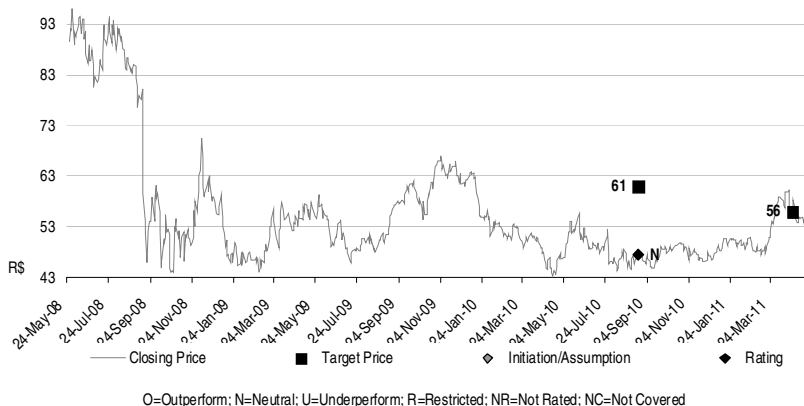
3-Year Price, Target Price and Rating Change History Chart for TNLP4

TNLP4	Closing Price (R\$)	Target Price (R\$)	Initiation/ Rating Assumption
23-Jul-10	28.46		N
29-Jul-10	25.84	33.6	
30-Jul-10	25.75	34	
4-Mar-11	25.84	32	
29-Apr-11	26.27	30	



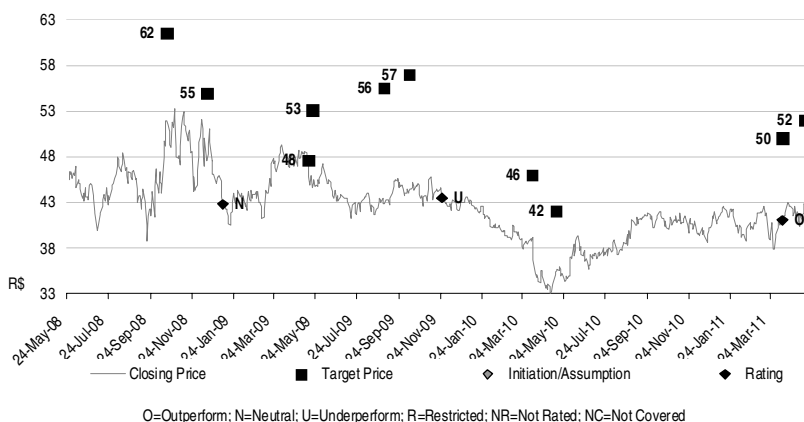
3-Year Price, Target Price and Rating Change History Chart for TMAR5

TMAR5	Closing Price (R\$)	Target Price (R\$)	Initiation/ Rating	Assumption
10-Sep-10	47.5	61	N	
25-Apr-11	57.05	56		



3-Year Price, Target Price and Rating Change History Chart for TLPP4

TLPP4	Closing Price (R\$)	Target Price (R\$)	Initiation/ Rating	Assumption
17-Oct-08	52	61.5		
15-Dec-08	47.55	54.9		
7-Jan-09	42.79		N	
13-May-09	47.51	47.6		
19-May-09	44.67	53.1		
1-Sep-09	42.77	55.5		
8-Oct-09	44.18	57		
25-Nov-09	43.48		U	
7-Apr-10	39.25	46		
12-May-10	35.35	42		
10-Apr-11	41.05	50	O	
12-May-11	42.8	52		



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Price Target: (12 months) for (BRTO4)

Method: Our R\$16/share target price for Brasil Telecom S/A is based on a discounted cash flow (DCF) analysis of Brasil Telecom Participacoes with a WACC of 11% and a terminal growth rate of 1%.

Risks: Risks to our R\$16/share target price for Brasil Telecom S/A are: (i) the lack of dividend payments, (ii) competition from telecommunications authorized service providers, and, (iii) a proposal of a new swap ratio between TMAR and BRTO shares.

Price Target: (12 months) for (TNLP4)

Method: Our R\$30/share target price is based on a DCF method with WACC of 11% and 1% growth at perpetuity.

Risks: Risk to our R\$30/share target price includes (i) higher than expected fixed to mobile substitution, (ii) increase in civil liabilities, and, (iii) higher competition from the government in the broadband offer due to the national broadband plan.

Price Target: (12 months) for (TMAR5)

Method: Our R\$56 target price for Telemar Norte Leste S/A is based on a sum-of-the-parts and discounted cash flow (DCF) analysis of Tele Norte Leste-S.A., its holding company, and an implied 20% discount due to liquidity and other risks inherent to Telemar's current organizational structure. For Tele Norte Leste-S.A. we use a DCF method with WACC of 11% and 1% growth at perpetuity.

Risks: Risks to our R\$56 target price for Telemar Norte Leste S/A are similar to those of its holding company, Tele Norte Leste-S.A., and include (i) higher than expected fixed to mobile substitution, (ii) increase in civil liabilities, and, (iii) higher competition from the government in the broadband offer due to the national broadband plan.

Price Target: (12 months) for (TLPP4)

Method: Our discounted cash flow (DCF) analysis, based on an estimated 10.1% weighted average cost of capital (WACC) and a 3% nominal terminal growth rate, supports our R\$52/share target price.

Risks: Risks to our R\$52/share target price for Telesp include: 1) corporate governance; 2) competition from VoIP on its voice business; 3) fixed-to-mobile voice substitution; 4) consolidation of the other Telefonica assets (Vivo) in Brazil; and 5) competition from Net Servicos on its broadband product.

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