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## **HOW HAS EDC AND CANTV BEEN OPERATING UNDER GOVERNMENT CONTROL?**

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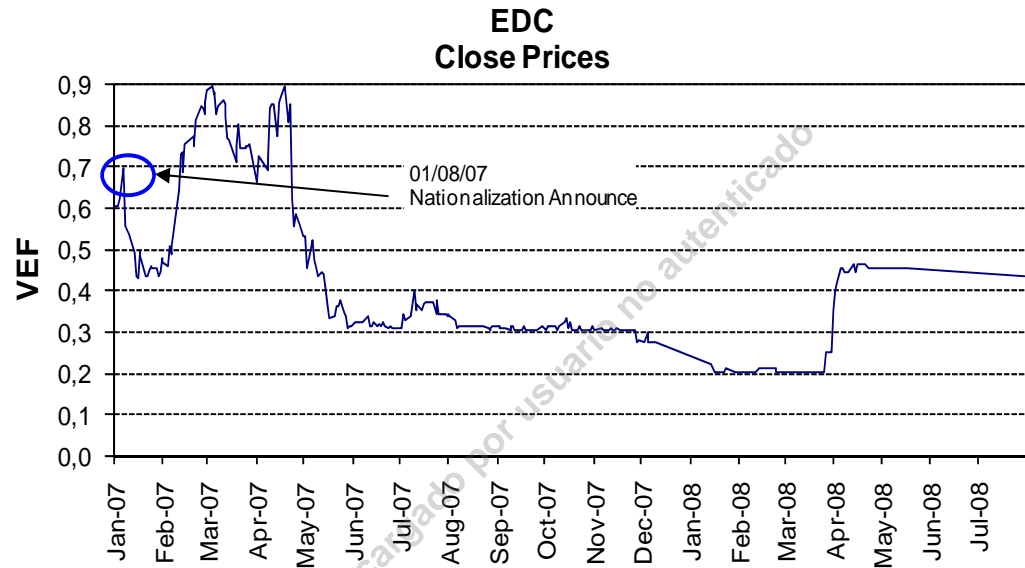
At the beginning of last year, the Government began its wave of nationalizations. This was part of Governments plan to take over industries that it considers to be of “strategic” value for carrying out its socialist project. The first companies that caught President Chávez’ eye and were taken over under this premise were the Compañía Anónima Teléfonos de Venezuela (CANTV) (Telephone company) and Electricidad de Caracas (EDC) (Electric power company), as well as all the oil companies participating as strategic associations working on the Orinoco Oil Belt. Now, a little over a year since the Government began to deliberately take over a good part of the country’s private production apparatus, we have decided to take this opportunity to analyze the financial statements of two of these companies: EDC and CANTV.

**It all began with  
EDC...**

After having threatened to expropriate EDC on February 8 last year, the Government, through PDVSA, signed a memorandum of intent with the U.S. Company, AES Corp. The agreement announced the intent to purchase 82.14% of EDC’s social capital for US\$ 739.20 million, which translated to an implicit price of US\$ 900 million, in other words, US\$ 0.2735 per share. It we add the VEB 78 per share dividend that

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shareholders received, the total price would reach US\$ 1.02 billion, or US\$ 0.3096 per share. Initial news of the expropriation had a quite a negative effect on the populations expectations, which is quite natural. It was received as a significant deterioration in the market value of the company's shares.



Sources: Reuters and Ecoanalítica

## Company results haven't been very favorable

It looks like the nationalization of *Electricidad de Caracas* has not been very favorable in terms of producing positive financial statements for the company. Company operation revenues for the first semester 2008 were at VEF 777.0 million, much lower than the VEF 829.40 taken in during the same period in 2006. These figures reflect a 38.9% real drop in one year. It's important to point out here that ADC's main source revenue comes from the sale of electric power, and that these prices have been frozen (in nominal terms) for the last three years.

Operation spending reached VEF 496.70 million during the first half of this year, a real drop of 23.4% compared to the same period in 2006. Given that the drop in spending, was not enough to compensate for the drop in revenues, these figures resulted in a significant loss in profits for EDC. For the first semester 2008, profits were at VEF 280.40 million, down 55.1% compared to the first semester 2006, in real terms.

**EDC's Financial Results**  
VEF Millions

	1S06	1S08	Nominal Var	Real Var
<b>Operatin Incomes</b>	829,4	777,0	-6,3%	-38,9%
<b>Operantig Expenses</b>	422,5	496,7	17,5%	-23,4%
<b>Operating Profit</b>	406,8	280,4	-31,1%	-55,1%
<b>Operating Profit Margin</b>	49,1%	36,1%	-26,4%	-52,1%
<b>Net Profit</b>	147,8	-13,8	-109,3%	-106,1%

Sources: CANTV and Ecoanalítica

**Then came CANTV**

In May, 2007, the Government, through the Ministry of Telecommunications, made its first move towards purchasing CANTV. Signing the memorandum of intent, the Government acquired Verizon's shareholder package (28.5%) for US\$ 572.20 million. The amount equaled a payment of US\$ 17.85 for each American Depositary Share (ADS) acquired, which represented 224,410,604 of the shares negotiated.

With this offer, CANTV's value, set by the Government, was at a little over US\$2.0 billion. However, given the company's strategic value, its market position, and if the TELECOM regulations in Venezuela were like they are in most other Latin American countries, CANTV's true value would have been around US\$ 4.0 billion. So, the Government acquired the company at half its true value.

**This case hasn't been quite so dramatic**

CANTV's financial statements for the first semester 2008 highlight that the company's revenues are at VEF 4.54 billion, which reflects a significant increase of 49.7% if compared to revenues from the first semester 2006. Since the first semester 2006, most of the company's revenues came from operations dealing with its fixed line (land line) telephone sector, but this tendency has been quite different since then. In fact, the revenue coming from the cell phone sector increased by 11.1% between the first semesters of 2008 y 2006; while those coming from fixed line decreased by 16.7%.

**Despite a poor performance in terms of investment**

During the first semester 2008, investment in fixed assets and information technology systems were at VEF 419.60 million, down by 32.3% compared to what was invested during the first semester 2006.

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So revenues have increased mainly due to strategies implemented to capture new clients, with special focus given to people from the low income sector. So, Movilnet, CANTV's subsidiary for the mobile phone sector, through offering cell phones at very low prices to communal council members and the public sector, has attracted around 1.4 million new subscribers.

By the other side, Company spending carrying out operations also reflected a light real reduction. First semester 2008 spending was at VEF 4.13 billion, down by 1.3% compared to spending during the first half of 2006. A significant part of this spending was due to settling workers collective bargaining agreements as well as settling amounts owed to retired personnel and other pending worker benefits.

An important fact to point out is that available cash has dropped significantly. For the first semester 2008, available cash flow and cash in banks closed at VEF 175.20 million, down by 72% compared to the first semester 2007.

CANTV's Financial Results				
VEF Millions				
	1S06	1S08	Nominal Var	Real Var
<b>Cash</b>	185,1	175,2	-5,3%	-38,3%
<b>Operating Incomes</b>	3.033,6	4.540,2	49,7%	-2,4%
<i>Fixed telephony services</i>	1.517,2	1.939,4	27,8%	-16,7%
<i>Celular telephony services</i>	1.387,1	2.363,6	70,4%	11,1%
<i>Others</i>	129,3	237,3	83,5%	19,6%
<b>Operating Expenses</b>	2.723,8	4.124,4	51,4%	-1,3%
<b>Fixed Assets Investment</b>	403,8	419,6	3,9%	-32,3%
<i>Fixed telephony services</i>	158,9	156,9	-1,3%	-35,6%
<i>Movil telephony services</i>	244,9	262,7	7,3%	-30,1%
<b>Operating Profit</b>	309,8	415,8	34,2%	-12,5%
<b>Net Profit</b>	279,5	655,4	134,5%	52,8%

Sources: CANTV and Ecoanalítica

## And profits from operations dropped

Another point that stands out is that profits for the first semester 2008 were at VEF 415.80, a figure that for the last two years reflects a 12.5% point drop compared to the first semester 2006. However, net profits, which take other revenues and spending into account, which don't have anything to do with operations, was at VEF 655.40 which translates to an

average growth rate of 53% between the first semester 2006 and the first semester 2008.

## Imposing its ideology could become very expensive for the Government

The financial statements from these companies are evidence that the nationalization process may not be producing any benefits for the Government, not politically or economically. The current Administration should understand that by trying to impose their ideology in this way, in the long run, it could become even more expensive than the initial expense. The Government should understand that no matter how socialist it wants to be, companies have to be run efficiently in order for them to turn a profit. But, prior experience and history shows us, barring a few exceptions, that the State is not is not very good at doing this.

## Economic Tips

**Inflation keeps down.** For third consecutive month, the National Consumer Prices Index (INPC) registered a deceleration against the previous month; in August, the INPC grew by 1,8%, less than the growth of 1,9% and 2,4% of July and June, respectively. The accumulated inflation rate for the first eight months of this year is 19.4%.

**75% of taxes have been collected.** During the first eight months of the year, VEF 102.50 billion in taxes have been collected which is equal to 75% of the taxes estimated to be collected in all of 2008 (VEF137.50 billion). In oil taxes, VEF 43.0 billion of the VEF 51.70 billion budgeted have been collected, which represents 83%. It's important to point out that this significant amount of oil tax collected is due to the fact that the price of a barrel of oil for the National Budget was set at US\$35.00 per barrel while the actual price of the Venezuelan oil basket has been at an average of price of US\$ 103.00, generating extraordinary revenues which are mostly used at the Administration's discretion.

**Budgeted spending.** Between January and the middle of the month of August, the Administration has decreed VEF 32.50 billion in supplementary appropriations, which added to what was budgeted for 2008, adds up to total spending equaling VEF 170.00 billion. So, the Administration has spent 60% of the budget during the aforementioned period, in other words it has spent VEF108.00 billion.

**International reserves at high levels.** Up until August 2008, international reserves have increased by US\$4.0 billion. Chávez announced that the adequate level for the Venezuelan international reserves was at US\$32.80 billion, 2.82% more than

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the adequate level which was set in 2007 (US\$31.90 billion), so US\$ 5.0 billion will be transferred to FONDEN in 2009. The President said that everything that is over the adequate level must be transferred to FONDEN.

**More notes to be auctioned.** Unofficial sources have let it be known that the Ministry of Economy and Finances is preparing to auction a part of the US\$ 650 million in structured notes that FONDEN still has in its investment portfolio since the unofficial exchange price for the US-dollar has been going up recently. There is still no word on the exact date of the auction or any information concerning the amount which will be auctioned.

**Structured note deadline approaching.** The Minister of Finance, Rodríguez Araque, announced that the end of September is the deadline for all banks to sell all the structured notes they are holding (this does not include FONDEN's holding). He also announced that certain banks may be allowed an extension, that this would be decided depending on each banks individual case, just like we informed in our report a few weeks ago.

**Central Bank of Venezuela Law reform being discussed.** The Government is studying presenting before the National Assembly a new reform of the Central Bank of Venezuela Law. The adjustments have to do with the entities legal framework and are focused on adapting it to some of the Organic Laws for Public Sector Finance Administration concerning how special funds are managed.

### OIL TIPS

**Started to drop again.** Now that the fears caused by the possibility of tropical storms in the Gulf of Mexico causing damage to oil installations has passed, the price for the Venezuelan crude oil and oil by-products basket dropped US\$4.24 per barrel, with the average price per barrel for the first week of September settling at US\$105.15. The average price per barrel for the year is at US\$103.90, in other words, 60% over the average price for 2007.

**WTI drops.** October delivery U.S. light crude oil dropped US\$ 1.66 to close out at US\$106.23 per barrel, the lowest it's closed since April. The barrel of WTI has dropped almost US\$40.00 (27% of its value) since it peaked at US\$147.27 on July 11.

**PDVSA gets a new debt.** This week Venezuela signed a new loan of US\$ 1,200 million with the Japanese Bank for International Cooperation. According to the Minister Rafael Ramírez, this loan will be used to buy part of the needed machinery to begin the modernization of El Palito and Puerto La Cruz Refineries, located at Carabobo and Anzoátegui states, respectively.

**New board of directors.** According to presidential decree, President Chávez ratified Rafael Ramírez as president of the company, Eulogio del Pino, as vice-president of the company, and Asdrúbal Chávez, Eudomario Carruyo, and Iván Orellana, as directors. In our opinion, the changes that were made at the administrative council level in no way change the company's ideological and strategic development pattern as set forth by Minister Ramírez during the last five years.

**The OPEC decides to reduce production levels.** By means of the quotas' strict fulfillment of the quotas established to his countries members, the OPEC tries to reduce his real oil offer at levels of 28,8 MMBD. The decision was taken because of the recent falls in the prices, inclusive below the US\$ 100 by barrel. The world current overproduction is estimated in approximately 520 thousand daily barrels.

**Indonesia says goodbye.** The OPEC announced the suspension of Indonesia's full membership in the Organization, after which the Asian country made official his retirement. The decision answers to Indonesia's production, which is insufficient even to satisfy his internal demand; reason why this country turned into a clear importer of oil.

**Energy agreements.** During Chávez' visit to South Africa, a number of energy agreements were signed of which no information regarding their content has been released.

**CITGO requests emergency supply.** According to Reuters, CITGO, U.S. subsidiary of PDVSA, requested 250,000 barrels of emergency supply for its strategic oil reserves for the refinery in Lake Charles in Louisiana.

**Law on fuel market.** The Commission for Energy and Mines of the National Assembly made some adjustments to the Organic Law for the Reordering of the Domestic Fuel Market in order for it to be discussed. The Commission's modifications considered the intermediation activity regarding the supply of liquid fuels not only as a public service but as a strategic service too.

**60 days to comply.** Before the National Assembly decision, the assets of companies subject to the State's reserves now form part of a national transportation company. A period of 60 days has been granted to company owners to negotiate their assets with PDVSA. No extensions will be granted and after the period expires, assets will be expropriated.

**Invitation to Brazil.** The Brazilian Minister of Mines and Energy, Edison Lobao, announced last Wednesday, September 3, that Iran, one of the world's largest oil producers, invited Brazil to join as a member of OPEC. The Minister indicated that the invitation would be analyzed by the Government and that the decision to join or not would be in the hands of the National Council for Energy Policies of Brazil.

**PDVSA to finance Argentina.** The Integral Cooperation Agreement between Argentina and Venezuela stipulates that as a mechanism for financing that 20% of the value of fuel shipments received must be paid by Cammesa, Enarsa, or the mixed company Enarsa-PDV, whichever the case may be, within a maximum period of 45 day, and at market prices, and the remaining 80% of the bill owed must be guaranteed by Cammesa, Enarsa, or PDV-Enarsa through the issue of 12 titles with monthly, consecutive maturity starting the following month from the deposit date made by the beneficiary, with a 2% yearly interest rate on the balance.

**"Mega-Companies" in crisis.** The Western world's largest oil producing companies' capacity to produce oil has been steadily dropping over the last few years. It has been increasingly difficult for them to find new clients despite their enormous profits and their drive to expand. The reality is that the oil giants that used to dominate the international markets have lost most of their influence, and along with it, their ability to increase the supply.

**Invitation to London.** The British Prime Minister, Gordon Brown, announced the possibility of inviting Libyan Head of State, Gadafi, and President Chávez, to an international summit on oil which could take place in the middle of December in London.

## BUSINESS SECTOR TIPS

**Credit Card Law approved.** The National Assembly approved the Credit Card Law which established that "in future, issuing entities may not refuse to grant a card to people requesting one solely on the basis of having had a delinquent account in the past." It also established that no commissions may be charged for balance

payments, maintenance, card renewal or issue, and the issue of balance statements. Banks have also been given 90 days to install ATMs for people with handicaps.

**It will also affect merchants.** The Credit Card Law also establishes that merchants may not continue to charge their clients surcharges for using a credit card to pay for merchandise. They may also not fix a minimum purchase value to be able to use a credit card, or eliminate discounts with the use of a card, or to exclude clients from specials being offered if they use a credit card.

**It only affects 7% of bank revenues.** According to figures released by the Superintendent of Banks, the new Credit Card Law only affects 7% of bank revenues. This year (until August), revenues received due to bank commissions reached VEF 791.84 million.

**Venezuela to join Mercosur.** Brazilian Foreign Affairs Minister, Celso Amorim, announced that it is possible and desirable that in November, after Venezuela's regional elections, that the country's membership to join Mercosur be approved. The Parliaments of Uruguay and Argentina gave their approval a few years ago, but Brazil and Paraguay's answer is still pending.

**CADIVI US-dollars.** The president of CADIVI, Manuel Barroso, announced that within the framework of making authorizing foreign currency for imports more flexible by allowing amounts of US\$ 50,000 or less to be processed without all previous CADIVI requirements, as announced by the President, it has received more than 3,000 requests, for the acquisition of items, capital goods, and raw materials. The total figure requested is more than US\$100 million.

**CADIVI authorizations.** The president of CADIVI also announced that during the last 8 months, the amount of foreign currency authorized by the entity reached US\$ 31.70 billion, up by 21% compared to the same period in 2007. Of this amount, US\$18.20 billion was for imports, with the food sector being granted US\$3.10 billion, followed by the commerce sector with US\$2.80 billion granted, and the automotive sector with US\$2.50 billion.

**Food prices go up.** During the months of August, the food basket was at VEF1,401, up by 3.6% compared to its value during the month of July. The price variation for the year is at VEF 468.42 or up by 50.2% its original value at the beginning of the year. This information released by CENDA implies that the minimum wage is able to cover just 57% of the food basket.

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**Rice costs will be reviewed.** The Ministry of Agriculture and Lands plans to review the costs of rice production along with all the sectors involved in order to study the possibility of increasing the subsidy it is granted.

**Transportation increases the cost of meat.** The superintendent of Silos, Warehouses, and Agriculture Storage Areas (SADA) has begun an investigation in order to determine what part of the production chain generates the most price increase. Results pointed to the transportations sector being the culprit since transportation didn't used to be charged.

**International market price increase of sugar affects local markets.** Price increases due to production problems in foreign countries will have a significant impact on the domestic market. This is taking place at a moment when sugar imports are increasing and local production and supply is dropping.

**Off-budget resources to solve housing problems.** According to information from the Minister of Housing, Farruco Sesto, the Government has assigned US\$ 1.0 billion towards finishing the construction of 39,000 houses that were pending delivery and promised during previous periods.

**Electric power generation insufficient.** In a report sent by the Ministry of Energy and Petroleum to the National Assembly, stemming from the blackout which occurred last April 29, points out that historically, the yearly increase in demand for electric power in Venezuela is at between 3% and 4%; however, during the last five years, yearly growth in demand has been around 6%. This has caused the network to be saturated and for the energy reserve generated by the National Electric Power System to be used.

**Electric power solution has no quick solution.** The president of the College of Engineers, Enzo Betancourt, denied the information released by President Chávez when he said that by the end of the year, the electric power problem that has been plaguing the country will be resolved by increasing the national power system by 1,335 megawatts. He argued that the Tocoma hydroelectric project is just barely beginning construction, while the La Vueltoosa and Uribante-Caparo projects are still in the awarding building contracts stage. He also pointed out that the Planta Centro facility, far from being up to standard, has not been the beneficiary of any of the supposed investments projected by the current Cadafe administration, and the installations are deteriorating.

**Private construction sector increased more than public sector.** Despite the fact that the public sector has more resources and more works to carry out, the

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private sector is the one which is reflecting higher growth figures. During the second quarter 2008, public sector construction growth was at 1.5%, while private sector construction growth as at 23.2%.

**Non-oil public sector construction down.** Public sector construction growth was down mainly due to non-oil public sector economic slowdown which shrank by 20% due to the deterioration of the electric power system (drop in investment by Cadafe and Enelven) and the delays in carrying out the railway system project.

**Sales slow in shopping centers.** During the first semester 2008, shopping center sales growth was at 7% and 10%, down by 50% compared to the growth registered during the same period last year which was at 15%. The main cause for this is attributed to the Government's policies to restrict liquidity and credit card interest rate increases.

**No VAT for public transportation.** A decree published in the GO No. 36.389 exonerates all sales operations and imports of public transportation units and auto parts made by assembly plants and chassis and vehicle-body factories from VAT. Certain types of taxis, off-road vehicles, minibuses, and busses, will also be exonerated from VAT upon import. The resolution says that the import and sales of spare parts are not subject to this new benefit.

**Only 40.4% of the vehicle production goal has been met.** The 230,000 unit goal estimated by the MILCO to be produced this year will be impossible to achieve given this sector's performance so far this year. Up until August 2008, 93,021 vehicles have been produced, in other words, 136,979 vehicles would have to be produced during what's left of the year for the goal to be achieved. This translates to a monthly average for the rest of the year of 34,244 vehicles per month.

**Restrictions to continue.** The Minister of Light Industry and Trade, William Contreras, announced that import restrictions for vehicles that have been applied by the Government this year will continue given that they are necessary to cutback on the people's dependency on foreign made cars and thereby promote locally assembled vehicles.

**More help for PYMES.** A new instrument called "*fianza bursátil*" (stock bond) was created by the National Society for Reciprocal Guarantees for Medium Sized and Small Industry (SOGAMPI) in order to cover the risk of issuing securities carried out by small and medium sized companies (PYMES) on the Caracas Stock Exchange, authorized by the National Securities Commission, announced Ángel Betancourt, president of SOGAMPI.

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**Industry dropping.** Industry sector growth dropped 1.2 percentage points during the first semester of the year and closed at 1.7% compared to the same period in 2007, explained Miguel Pérez Abad, president of FEDEINDUSTRIA. This organization expects sector growth to at least reach 3.2% by the close of the year.

**Hotel occupation stable.** Hotel occupation for the first semester of the year was at 75.12%, up slightly from the same period last year which was at 75.08%, according to the Ministry of Tourism.

**Tourism up.** According to the Ministry of Tourism, so far this year, over 31 million people have moved around the different regions of the country, up from the 28 million people traveling last year during the same period. The figures also show that people have been traveling more within the country than to foreign destinations. People traveling to destinations outside of Venezuela totaled 731,459. The figures show that Bolívar state was the most popular destination for tourists (84.02%) which matches results from last year.

### Political Tips

**Another fraud by the opposition claims Chávez.** President Chávez, in his latest broadcast of his Sunday television show, classified as an “attempt at legal fraud” regarding the opposition’s complaints with respect to the laws approved at the last minute through the Special Powers Law. He explained, “one thing is that they were not approved to be included in the Constitution, and another thing is that it is done in Law.”

**Rodríguez Chacín steps down.** Minister of Interior and Justice, Ramón Rodríguez Chacín, announced that he had informed the President that he was stepping down from his office due to purely personal reasons. The position will be filled by Tarek El Aissami, until he is officially appointed to the position or some one else is appointed.

**Colombian crime boss detained in Venezuela.** Due to an intelligence operation, a Colombian crime boss was detained in Zulia state. Allegedly involved in drug trafficking, Marcos José Orozco Wilches, wanted by Interpol, was moved to Caracas in custody of the CICPC, where his deportation to Colombia is being coordinated.

**Venezuela, a Russian warplane parking lot.** Russian sources have informed that the Russian Government plans to temporarily park submarine attack planes in

Venezuela given the tensions provoked by the presence of NATO warships near the Russian coast on the Black Sea due to the conflict in Georgia.

**Conflict nears Venezuela.** Analysts are of an opinion that the presence of the Russian Fleet in Venezuela, during this period when the United States is in a conflict with Russia due to the situation in Georgia, threatens to bring that conflict to Venezuela.

**CNE won't finance election campaign.** Due to the complexity of the regional election process where 603 offices are up for election, the rectors of the Electoral Power refused to change the finance scheme and institutional control that was used during the constitutional referendum campaign in 2007 when it assumed the cost of publicity and at the same time was in charge of controlling that the content included in said publicity followed the established regulations before being released in the media.

## Other Tips

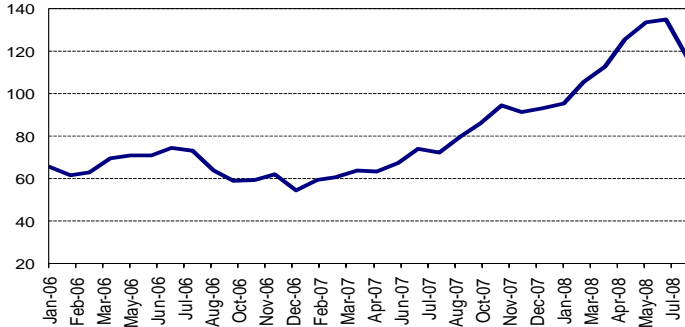
**Stock Exchanges around the world improve.** Asian and European stock exchanges opened for trading this Monday with significant up-swings after receiving the good news that the U.S. Government had decided to take control of two important mortgage loan companies: Fannie Mae and Freddie Mac.

**Modest Impact.** The vice-president and Minister of Economy of Spain, Pedro Solbes, stated that the international financing crisis is having a "modest impact" in Latin America in comparison to other regions around the world. Solbes recommended that future growth strategies consider "greater diversification and that they generate quality jobs, thereby reducing poverty." He concluded by saying that the current situation offers "an opportunity to modernize, diversify, and improve" growth patterns so that they may be more sustainable and generate greater well-being and social cohesion."

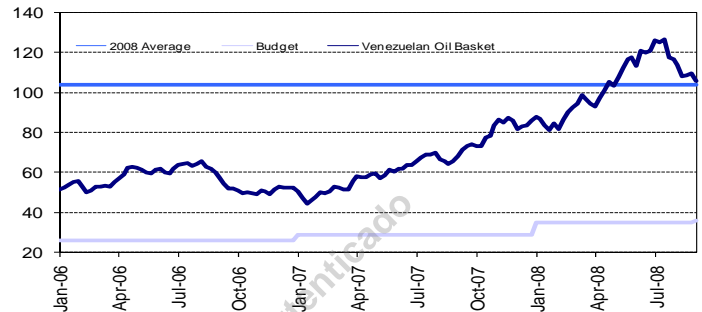
**Significant strides forward Telefónica.** *Telefónica* has reached over 150 million clients in Latin America, stated José M<sup>a</sup> Álvarez-Pallete, general director for *Telefónica Latinoamérica*, during his speech at the *XXII Encuentro de Telecomunicaciones* (telecommunications conference) hosted by UIMP held in Santander. This figure means that the company has fulfilled its 2009 goals for the Region, which were announced at this very conference last year, one whole year in advance.

## ECONOMIC OVERVIEW

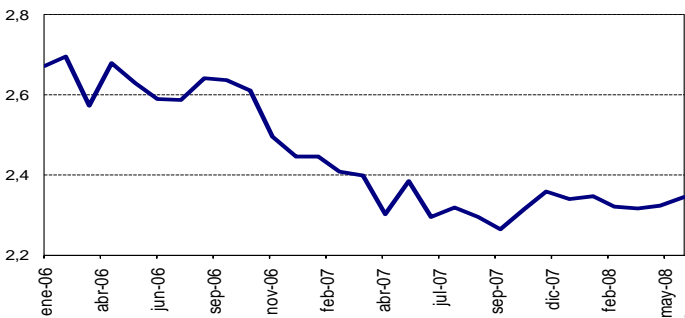
**Oil Prices (WTI US\$pb)**



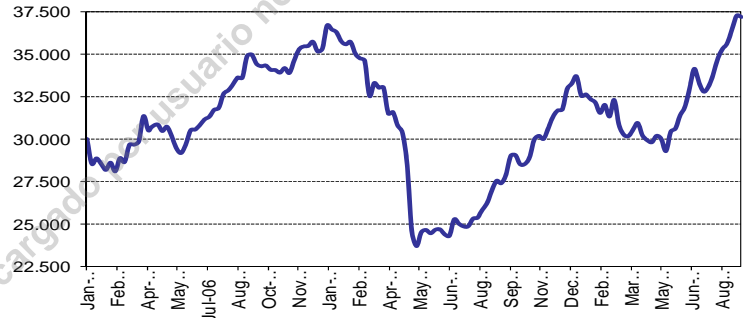
**Oil Price (Venezuelan Basket US\$/pb)**



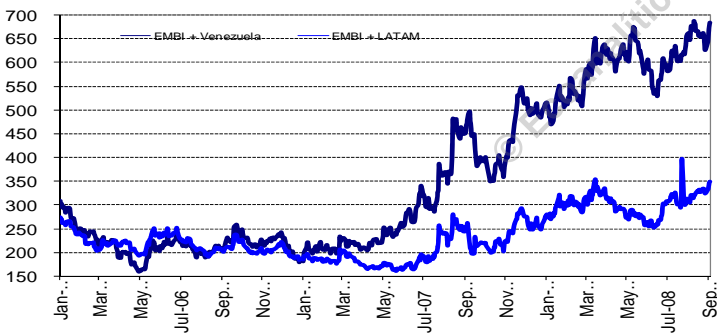
**Oil Production MMBD**



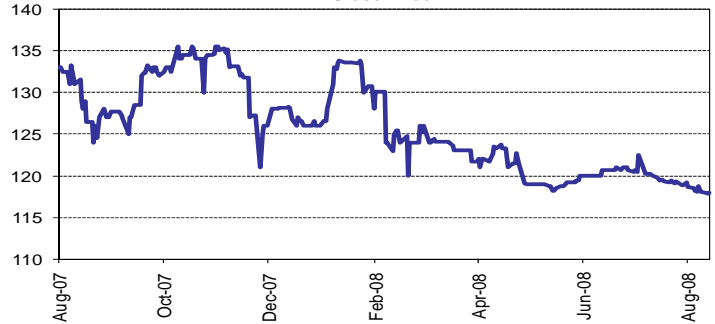
**Fx Reserves - BCV (US\$ Million)**



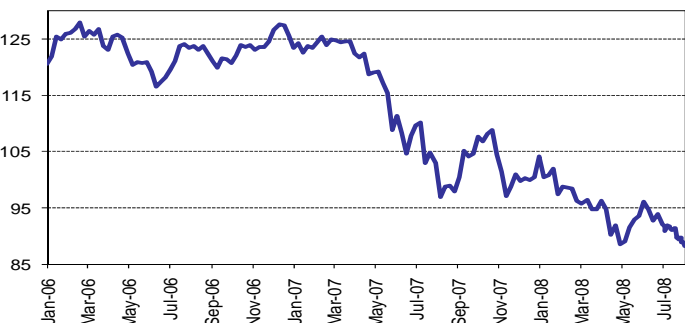
**EMBI +**



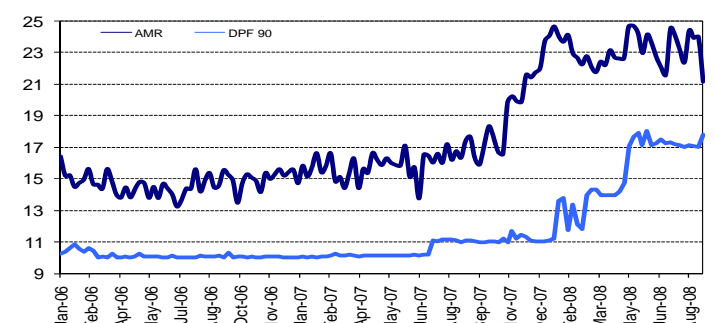
**Venezuelan Global 18 Close Price**



**Venezuelan Global 27 Close Price**

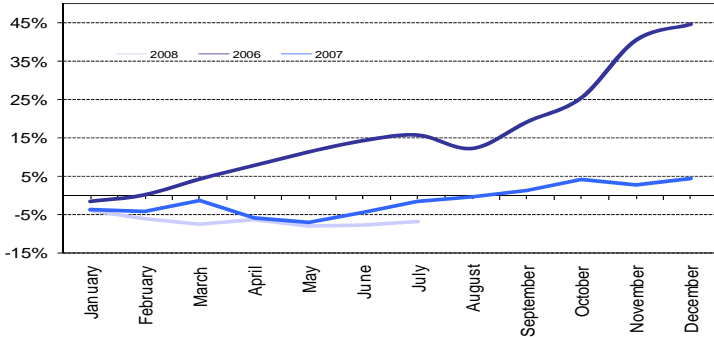


**Interest Rate (Six Principal Banks)**

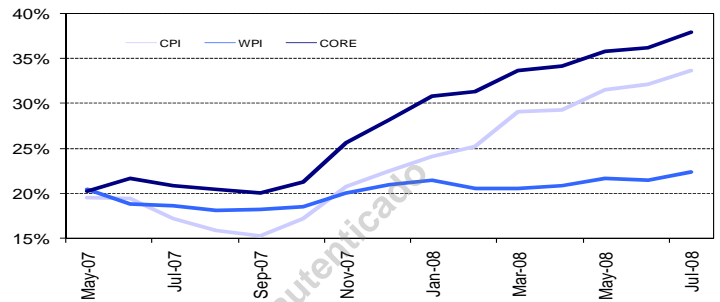


## ECONOMIC OVERVIEW

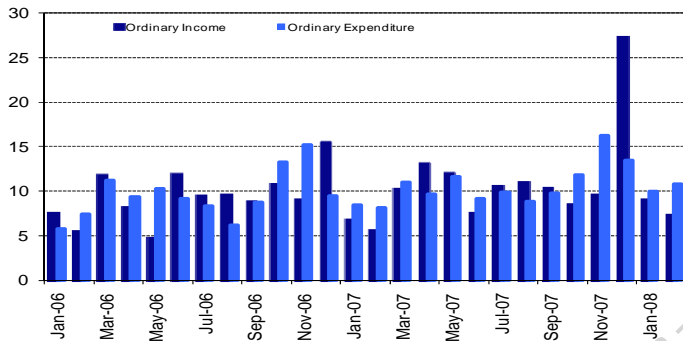
**Real Expansion (M2)**



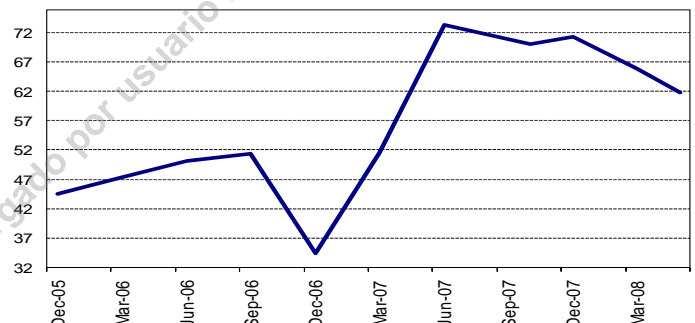
**Inflation (Last 12 Months)**



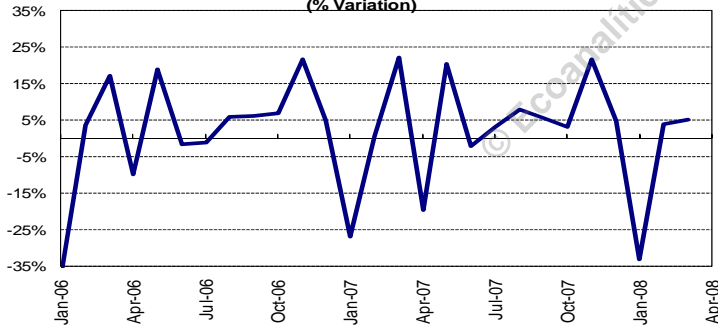
**Central Government (VEB Billion)**



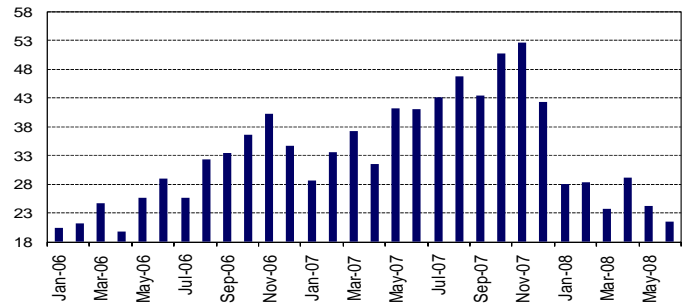
**Resources of the State (US \$ MM)**



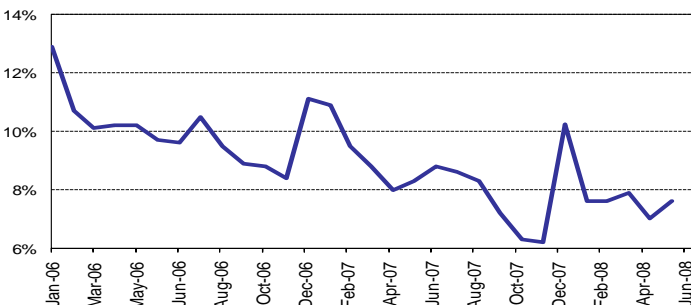
**Volume of Sales (% Variation)**



**Sale of Vehicles (Thousands of Sold Units)**



**Rate of unemployment (% Variation)**



**Disbursement (US\$ Million)**

