

**Moody's Investors Service**

Rating Action: Embratel S.A. ("Embratel").

MOODY'S ASSIGNS EMBRATEL A B1 GLOBAL LOCAL CURRENCY RATING AND A Baa1.br BRAZIL NATIONAL SCALE RATING

São Paulo, August 20, 2003 -- Moody's America Latina Ltda. assigned the following ratings for Embratel S.A. ("Embratel"):

- Brazilian National Scale Issuer Rating: Baa1.br
- Global Local Currency Scale Issuer Rating: B1

The rating outlook is stable for both ratings.

Embratel's Baa1.br Brazil national scale rating indicates an issuer with average creditworthiness relative to other Brazilian issuers. National Scale Ratings rank Brazilian issuers relative to each other, and are intended primarily for use by domestic investors. National Scale Ratings carry a country-identification extension, such as the "br" notation for Brazil, and are not comparable to Moody's global ratings. National Scale Ratings are not opinions on absolute default risks; rather, the national scale ratings isolate systemic risks. Accordingly, they do not address the loss expectation that can be associated with systemic events that could affect all issuers in a particular country - even those issuers that receive the highest ratings on the national scale.

The B1 rating on Moody's Global Local Currency Scale compares the issuer to all other issuers in the world and addresses the ability to meet obligations in local currency, incorporating all Brazil risks, including the potential volatility of the Brazilian economy, but excluding foreign exchange convertibility risk. Specifically, the rating incorporates the operating strength of Embratel, but also recognizes the macroeconomic risks inherent in operating exclusively in an emerging economy.

The assigned ratings reflect the company's moderate leverage and medium-term refinancing risk, as well as its high exposure to volatile sales and margins in its long distance business segment. The ratings are constrained by: i) the increasingly competitive operating environment for long distance services; ii) a hedging policy that heretofore has resulted in a relatively high level of exposure to exchange rate variations; iii) Embratel's inability to disconnect customer lines and resulting high exposure to delinquency and bad debt risk; iv) Contingent tax liabilities and unfunded pension and medical care plan deficits that slightly increase the company's adjusted leverage and could result in increased refinancing risk; and v) the short track record for stable revenue and cash flow growth.

Moody's believes that a significant amount of business risk stems from the increasingly competitive business environment in which Embratel operates. The erosion of Embratel's market share as incumbent local exchange carriers (ILECs) expand their competitive long distance and data services to the national and international markets is likely to continue. While Moody's recognizes that Embratel has made rapid progress in the higher margin local services market by offering attractive pricing to corporate customers, the rating agency believes that the barriers to entry are much greater for companies developing a local exchange strategy than they are for companies entering the long distance market.

The ratings are supported by the company's current market leading position in the inter-regional and international long distance market, its status as the only nationwide data, long distance and local service provider in Brazil and its brand leadership, especially in the corporate sector. Finally, the ratings are supported by a favorable regulatory environment, which may support the company's initiatives to compete in the local service segment on a national basis and reduce interconnection costs.

The outlook is stable because Moody's expects that Embratel will be able to largely compensate for sales contraction in the long distance market with growth in its data and local service businesses. Moody's also believes that Embratel will be able to maintain its present liquidity profile through a combination of free cash flow generation, cash balances and timely refinancing. Embratel may suffer ongoing market share erosion in inter-regional and international voice long distance services and on certain lucrative short-haul data routes, but capital scarcity and perceived limited growth opportunities will likely limit competition for many of Embratel's network service offerings. Additionally, Embratel's

ongoing investments in its brand have created a barrier to entry for new non-ILEC entrants to the long distance market.

Future positive rating actions or changes in outlook could result from the company's demonstrated ability to defend its revenues in the long distance market, in combination with sales growth in the data and local service segments. Future negative rating actions or changes in outlook could result from continued revenue decreases without significantly higher margins or acquisitions that result in a more leveraged capital structure in terms of projected Free Cash Flow to Total Debt. While Embratel has made considerable progress in bringing its interconnection costs and bad debt expenses under control, without opportunities for meaningful revenue growth, potential margin expansion is likely to be constrained.

The most significant macroeconomic risks facing companies operating exclusively in emerging economies are devaluation risk and refinancing risk. Moody's recognizes Embratel's progress in hedging its foreign currency denominated debt against further devaluation of the Real and migrating debt to local currency denomination, but the current exposure of R\$ 2.37 billion (57.6% of total debt) remains meaningful. More than 80% of Embratel's debt is foreign currency denominated, and managing this risk is a function of the company's propensity to use hedges as well as the general market availability of hedging instruments. The rating agency also recognizes that the recent debt rescheduling extended maturities and thus focused refinancing risk out to 2005. Regarding refinancing risk, very little long-term debt is available to companies in Brazil. As a result, the majority of debt has maturities of less than three to five years.

Embratel generated free cash flow of R\$ 458 million in 2002, equal to approximately 9% of its total debt as of December 31, 2002. Free cash flow as a percentage of total debt is expected to strengthen in 2003 due to debt pay down and lower exposure to bad debt and resulting elevated working capital investment. The drop in bad debt resulted from the company's investments in its customer database and a significant increase in the number of lines blocked from using Embratel's PIC code. EBITDA less Capex to interest expense was approximately 1.0x in 2002 and is expected to strengthen to more than 2.0x in 2003, partially because of a significant reduction in Capex.

Embratel S.A., based in Rio de Janeiro, Brazil, is the incumbent long distance service provider in Brazil and offers a wide array of advanced communications services over its own state-of-the-art network. Service offerings: include telephony, advanced voice, high-speed data communication services, Internet, satellite data communications, corporate networks and local voice services for corporate clients.

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