



**AMERICAN DEPOSITARY RECEIPTS – THE ELETROBRAS CASE**

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## **DEDICATION**

I dedicate this paper to my parents.

## **SPECIALS THANKS**

To God.

To my sister, Renata Ruiz, who was always by my side.

To my aunt Argelia, by encouraging and representing for me an example of ethical and competent professional.

To my friends Hugo Vedana, Leonardo and Sofia Elguero by spending most of this time with me and other colleagues, in some way, helped in the realization of this paper

To Eletrobras, for believing in my work.

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## 1 INTRODUCTION

Finance literature cites among the main advantages of a joint-stock company the ease of ownership transfer (which a joint-stock company can perform quickly and more simply than can other types of partnerships) as well as the ease and agility of raising funds. These advantages are due mainly to the existence of organized financial markets (capital markets) which play an important role in the finances of joint-stock companies “The capital market, as with any market, is simply a way to unite buyers and sellers” (Rossi, 2003, p. 48).

In this manner, financial markets provide the setting in which suppliers, borrowers and investors can freely negotiate. Stock exchanges are the backbone of the capital market (Gitman, 2003). Inside the financial market, negotiating the shares of these companies takes place in stock markets as well as in over-the-counter markets.

These operations occur in the internal market (the country of origin of the company). However, as we have seen, an increasing number of Brazilian joint-stock companies have tried to enter others – such as the American. The foreign company does this through an American Depositoy Receipts program (ADR program).

Depository Receipts (DRs) can be understood as variable rate securities, issued by a foreign bank (depository bank) which represents one or various ordinary or preferential shares (or rights over shares) of a company from another market, outside that in which the investor is. These shares have all the characteristics of those they represent and the acquired shareholder rights of the country of origin (Andrezo & Lima, 1999, p. 227).

Bruni (2002, p. 9) defines ADRs as “instruments of negotiation, issued in the United States by a depository bank, representing ownership of foreign North American real estate. ADRs are, as such, considered American securities.”

The literature discusses the effects of issuing ADRs. Moel (2000) for example, argues that ADR programs bring to emerging markets the advantages of increased liquidity, transparency and ease of negotiation that characterize the American

market. Also, when international investors begin to trade with ADRs, capital market agents and local market regulatory authorities come under pressure to modernize their operations to improve the standards of information transparency and to reinforce the legal aspects of protecting the investor.

According to Koeckner (1997) issuing ADRs is also a way companies become known in the international market; therefore, companies see the associated costs as an investment with an eye on future benefits.

Today, this argument touches on the high costs associated with high risk to companies resulting from the new requirements of the North-American capital markets. According to Zanette (1995) access to international markets makes it possible for companies to diversify risk and to leverage the return on their portfolios.

As the Brazilian stock market is under development, resources to meet offers resulting from large issuances by companies may not be enough to meet demand.

The objective of this paper is to analyze the positive and negative arguments from the point of view of a company wanting to raise capital by participating in an ADR program in the North American market.

This study seeks to answer the following question: What is the impact on a Brazilian company entering the North American stock market?

## **2 METHODOLOGY**

The methodology used is based on literature reviews and current legislation contained in relevant journals as well as data contained in financial reports. It also draws on the author's experience as part of a process-level change involving ADRs of Eletrobrás.

### **3 BIBLIOGRAPHY REVIEW**

This section defines ADRs, ADR programs, how to set one up and the ADR negotiation process.

#### **3.1 ADRs DEFINED**

The antecessor of J.P. Morgan, Morgan Guarantee Trust, created ADRs in 1927. Over time, ADRs have gained importance Today they are in wide use by American investors as a long-term international diversification instrument. They cross borders in mergers and acquisitions using the ADRs as a currency of acquisition as well as of global privatizations adding value to the dividend, which makes restructuring and orders throughout the world possible.

According to the 2005 ADR Reference Guide, ADRs are representative certificates of shares issued in the U.S. stock market. They give investors property rights over the shares (held in Brazil) of the company issuing them. ADRs are quoted and traded in dollars and are established according to the procedures that regulate the American market. They enable investors to invest in non-American securities of foreign companies and, in addition, offer the same economic, corporate and voting rights as those of domestic shareholders of non-American companies. ADRs are considered American securities.

If an issuing company adopts U.S. Generally Accepted Accounting Principles (USGAAP) as its accounting standard, its ADRs can be listed on any American stock market, such as the New York Stock Exchange (NYSE) and the American Stock Exchange (AMEX) or be quoted on the National Association of Securities Dealers Automated Quotation System (NASDAQ). Currentley, the companies can adopt the International financial Reporting Satndards (IFRS)

If an issuer retains its domestic accounting and reporting standards and does not meet all accounting, reporting and disclosure obligations of the Securities and Exchange Commission (SEC), the company can have its capital securities (Pink Sheets) traded in the over-the-counter market (OTC). ADRs can be privately placed

and negotiated on the site (NASD's private offer, resale and trading via automatic links) connected to Qualified Institutional Buyers (QIBs) under Rule 144A published under the Securities Act of 1993 and amended as the "Securities Act."

	<b>Level I Not Listed</b>	<b>Level II Listed</b>
<b>Objective</b>	Create an American investor base.	Increase American investor base with existing shares
<b>Accounting</b>	Financials from the location of origin	USGAAP/IFRS
<b>Required Reports</b>	Rule 12g3-2 (b) of conformity	Form 20-F
<b>SEC Registration</b>	FORM F-6	Form F-6
<b>Form of Negotiation</b>	Over-the-Counter	NYSE, AMEX or NASDAQ
<b>Estimated time to Launch</b>	5-9 weeks	14 weeks

	<b>Level III Not Listed</b>	<b>Rule 144 A Privately Placed</b>
<b>Objective</b>	Increase capital by issuing shares in the U.S.	Increase capital between qualified institutional investors (QIB)
<b>Accounting</b>	USGAAP/IFRS	Reports from the location of origin
<b>Required Reports</b>	Form 20-F	None
<b>SEC Registration</b>	FORM F-1 & F-6	None
<b>Form of Negotiation</b>	NYSE, AMEX or NASDAQ	Site
<b>Estimated time to Launch</b>	14 weeks	7 weeks

#### Negotiation of ADRs

Source: 2005 ADR Reference Guide

Bankers Trust (1999) adds that American investors have increasingly shown more interest in foreign markets because of their higher returns when compared with the

American market in recent years. The main advantages to the American investor are:

- A convenient way to hold foreign investments;
- Simplification of negotiating and liquidating foreign shares;
- Lower trading and management costs when bought direct from abroad;
- Recognition of ADRs as American securities allows one to be part of various American bank and retirement fund portfolios that cannot acquire foreign securities;

Denominated in U.S. dollars, dividend payments on the underlying shares are converted into American dollars by the depository bank. This minimizes exchange rate problems for international and American investors.

Besides the advantages to the American investor and the domestic Market, there are advantages for non-American companies that issue ADRs.

The ADR Reference Guide (2005) cites, among others, at least four advantages of ADRs. They:

- provide a simple way to diversify the company's shareholder base and access to the important American market;
- make it possible to increase liquidity;
- help increase the presence and recognition of the foreign company's name in the market and among American investors;
- allow the company to raise capital in the American market through an ADR program.

The listing of shares in foreign markets helps reduce the cost of capital of the enterprise since it reaches the following objectives according to the ADR Reference Guide (2005):

- Increases the liquidity of its shares in that it facilitates its trading in domestic markets of foreign shareholders;
- Increases share price by overcoming typical imperfections of pricing of a segmented domestic market without liquidity;
- Provides a secondary liquidity market, which supports a new issue of shares in the foreign market;
- Establishes a secondary market for shares used in the acquisition of local companies;
- Increases the company's visibility and builds credibility among clients, suppliers, creditors and governments;
- Creates a secondary market for shares used for employee bonuses in subsidiaries.

On the disadvantages of dual listing through ADRs, Bruni (2002) mentions the high costs involved in the process, such as those related to the disclosure of accounting and financial reports.

Other motives are given to justify low demand in the ADR market. According to Rodrigues (1999a), most emerging markets have higher direct and indirect barriers to integration than do developed markets. However, launching a ADR is seen as a way of lowering these barriers since trading shares of domestic companies occurs in another market.

Eiteman, Stonehill and Moffett (1999) point out the biggest two arguments for a company to turn to the global capital market:

- to increase liquidity; and
- to enjoy advantages arising from segmented capital markets.

Increasing liquidity is desirable when the domestic capital market is no longer able to offer funds to a company in a timely manner and without incurring an increase in costs. The availability of capital beyond the borders of the domestic market, in the form of shares, fixed income securities and cash, expands the limit by which a company can raise capital before it experiences increasing costs that make projects unviable.

A company that obtains its resources exclusively from a segmented market will, most likely, have a higher cost of capital than a company that has access to other markets. A market is segmented when the rates of return required on traded securities differ from those required on securities having the same return and risk of other markets. When the markets are integrated, these rates are the same after being adjusted for political and exchange rate risks characteristic of each market. Market segmentation is the result of restrictions put in place by the government and of investor perception.

The most common flaws of a segmented market are: information barriers, transaction costs, exchange rate risk, anti-takeover strategies, small scale markets, political risk and regulatory barriers. A company that manages to escape from its dependence on a segmented market to an integrated one can reduce its cost of capital.

Spers (1997) analyzed the issuing of Level III ADRs of Aracruz Celulose, the first made by a Brazilian company. Spers (1997) argued that the company's main objectives were to increase the possibility of raising capital, reduce the cost of capital

and to increase company visibility. According to the company, this would make obtaining future resources easier through placing Eurobonds and securitization in the international market.

Errunza & Miller (2000) studied 126 companies from 32 different countries, based on the returns within 36 to 7 months before the double listing, compared with the returns within 7 in the 36 months after the double listing. The results indicated significant declines in the cost of capital of the companies studied. Introducing ADRs resulted in a reduction of 42.2% in the cost of capital. This is consistent with the hypothesis of segmented markets, in that these present higher rewards of risk and, consequently, higher costs of capital.

According to Bekaert & Harvey (1997) volatility is one of the main items in calculating the cost of capital of segmented markets. The evidence shows that volatility declines significantly after market liberalization. Regression analyses suggest that reducing volatility in the markets can have an important effect on the cost of capital of an emerging market.

Bekaert & Harvey (1998) analyzed the effects of market liberalization on the costs of capital by studying changes in returns and profitability of the dividends in prior periods (36 to 7 months before) and posterior (4 to 34 months later). An interval of nine months (six before and three after) was used to analyze the effect of reevaluation. The sample of emerging markets did not allow a confirmation of significant alterations in returns or in reevaluations of the assets analyzed. However, the authors argue that alterations in the profitability of dividends (dividend yield) could be used as a proxy of changes in cost of capital. Based on this estimate, the results show significant declines of 5 to 90 basis points in the profitability of dividends compared with the prior and posterior periods.

Even for the double listing, Henry (2000) found evidence that financial market liberalization in certain countries improves the evaluation of domestic shares and causes a drop in the cost of capital. A positive association between integrating financial markets and the increase in allocation efficiency would exist. Lower costs of

capital would be healthy for economic growth and would encourage new investments.

Clearly, permission for foreign participation increases market integration, which raises allocation efficiency. Mittoo (1992) mentions some benefits to the company upon embarking on an ADR program:

- Reduced cost of capital;
- Access to foreign capital markets;
- Increase in investor base;
- Increased share liquidity;
- Increased visibility, exposure and prestige.

Rosenthal (1983) presented one of the first foreign studies on the hypothesis of ADR market efficiency. This study examined the low efficiency of these markets, employing the calculation of serial autocorrelations and race signal tests for 54 ADRs traded between 1974 and 1978. Significant serial correlations were found for the weekly and fortnightly returns, but no significant evidence was found for monthly returns.

Officer & Hoffmeister (1988) found that adding ADRs to a domestic portfolio presented many benefits to the investor, substantially expressed in reducing risks. Including only four ADRs in a portfolio representative of the North-American stock market reduced risk by 20 to 25% without sacrificing returns. Another interesting finding of the authors refers to the degree of low correlation in ADR prices compared with those in the domestic market.

Wahab & Khandwala (1993) questioned whether adding ADRs to a purely domestic North-American portfolio – represented by the S&P 500 index – would be more worthwhile with risk vs. return than the foreign share itself, for which the ADRs were created. The results obtained by Wahab & Khandwala (1993) proved that ADRs can provide expected returns similar to those of the shares issued in the domestic market and, potentially, offer better benefits for lessening risk as well – these benefits can be reached by including only seven ADRs to the domestic portfolio.

Johnson & Walther (1992) studied three types of foreign traded assets in the North-American capital markets: ADRs, direct foreign shares (DFS) and international mutual funds. After employing active portfolio management strategies from 1983 to 1986, Johnson & Walther (1992) showed that ADRs and direct foreign shares contributed substantially to improving profitability and, less so, to reducing risk – compared with domestic diversification strategies.

According to Craig Doidge, G. Andrew Karolyi & René M. Stulz (2003) the benefits to a foreign company of double listing are:

- Reducing risk premium: if North-American investors find it difficult to invest in a foreign (non-American) company and if its listing in the U.S. reduces such difficulties, the risk becomes smaller and shared, thereby reducing the risk premium for investors;
- access to a more developed capital market;
- disclosure: access to the North-American market requires more disclosure of financial information;
- auditing: with more regulation of the North-American market, investors are protected more, this includes reduced agency costs.

Jayaraman et al. (1993) studied the effect of issuing ADRs on risk and return on domestic shares. After analyzing daily returns before and after the listing, as well as average adjusted returns, with the objective of filtering those that were abnormal, they found slightly positive returns just before and for a short time after the date of the listing, as well as a permanent increase in share volatility. This leads to the hypothesis that agents with privileged information acted in the market.

Foester & Karoly (1996) carried out a broad study of the effect on foreign share prices listed in three North-American stock markets (NASDAQ, NYSE & Amex). Results showed abnormally positive weekly returns for the listed shares in the previous year and the week of the listing, and negative returns in the year after it.

The results support the hypothesis of segmentation - which establishes that returns, on average, should compensate for the risk associated with the barriers imposed on

capital flows. The authors present other possible effects for the changes in returns as resulting from the hypotheses of investor recognition and increased liquidity.

Jiang (1998) analyzed 113 ADRs from Australia, France, Japan, Holland, South Africa, Spain, Sweden and the United Kingdom that were traded between 1980 and 1994. After comparing the performance of the portfolios, made up of S&P 500 and foreign market indices, with that of the portfolios composed of S&P 500 and ADRs, Jiang found improved performance of the portfolios with ADRs.

Cointegration analyses suggests that only three of the eight pairs of portfolios analyzed were found to be cointegrated – indicating that investors with long-term investments could not assume the ADRs equaled their domestic portfolios. According to the results, the ADRs would be “above average” – demonstrating superior performance compared with domestic market indices.

Analyzing the relationship between ADRs and domestic portfolios, the author found evidence of mutual influence, after applying VECM and VAR econometrics. In general, the ADRs were affected by their respective domestic market, whereas the impact of the ADRs in the domestic market is stronger in countries with higher cointegration between ADRs and market indices.

A third point the author analyzed were the causes influencing the returns on the portfolios made up of the ADRs. Eight portfolios with national ADRs were weighted according to the market values of the ADRs. The returns were modeled using Garch1 techniques to analyze the impact of three factors: the North-American market return, the local market orthogonal return and the orthogonal return of the currency analyzed. The results show the three factors are significant in explaining the variation of the returns of the ADRs.

In addition, the benefits of diversification through ADRs have two main sources: country diversification – resulting from the industrial structure differences resulting from the comparative and competitive advantages – and the diversification of currencies – resulting from the distinct monetary policies in place in each country. Contreras & Cartes (1999) analyzed the evolution of informational efficiency of the ADR market using portfolios made up of Chilean ADRs issued up to the end of 1997.

According to the authors, a decline in the abnormal returns near the issue date of the ADRs for three portfolios representative of issuances in 1990 through 1992, 1994 and 1995 through 1997 would be expected. This would be consistent with the market efficiency hypothesis and would represent a learning process among investors. However, the results did not show evidence of learning: the dispersion of the abnormal returns near the date of the event either increased or remained constant.

In one of the first studies on Brazilian ADRs, Matsumoto (1995) analyzed the question of the double listing of South-American shares up to 1993. The study involved ten Argentinian shares, seven Chilean, four Venezuelan, two Colombian and one Brazilian. After applying an analysis based on the study of events, in which the CAPM was applied as a price setting model, results showed the existence of positive abnormal returns in the period before listing, with increases in the risk premiums for systematic risk. The author concluded the hypothesis of informational efficiency of the South-American market was valid – no significant evidence was found of alteration of the values of the companies after a new fact occurred.

Hargis (1997) analyzed a sample of 100 Latin-American ADR programs, of which 21 were Brazilian, to identify the effect of the issuing on the liquidity and trading volume

of the domestic markets. Hargis (1997) also sought to infer the eventual effects on domestic market segmentation of issuing ADRs. The sample was subdivided in relation to:

- expanding the shareholder base after listing;
- the types of restrictions on foreign investment in the domestic market;
- the domestic market liquidity before the listing;
- the transparency in the flow of orders among the different markets observed.

The impact, both on liquidity and volume, was analyzed after the listing, having identified situations in which issuing ADRs exerted positive or negative impacts.

Spers (1997) analyzed, specifically, the process of ADR issuance by Aracruz Celulose S.A., a pioneer in issuing Level III ADRs. According to the author's description, the process of ADR issuance resulted in "excellence of administration of financial resources," creating the conditions for the company to turn to the stock market for capital (SPERS, 1997). Another objective of issuing ADRs would be company recognition, which would facilitate raising resources through Eurobonds and securitization in the international market.

Costa Jr. et al. (1998) studied the effect of issuing ADRs on the returns and volatility of seven shares: Acesita ON, Acesita PN, Aracruz PNB, Cemig PN, Lojas Americanas PN, Telebrás PN, and Vale do Rio Doce PN. The results showed no relation between the beginning of ADR trading and the presence of abnormal returns— which would be consistent with the hypothesis of informational efficiency of the Brazilian market. The conclusions also showed reduced volatility of the shares with ADR after trading began.

In a broad study on questions related to the segmentation and fragmentation of Brazilian capital markets, Rodrigues (1999) analyzed 40 shares of companies that launched ADRs and/or GDRs beginning in 1992. The results show that double listing contributed to the increased recognition among investors and to the liquidity of the domestic market of these shares. It was also possible to verify that issuing ADRs, in fact, contributed to increased liquidity and trading volume and to reduced risk of nearly all the shares analyzed.

Several authors highlight the appeal of ADRs as an option of international diversification of investors' portfolios citing the increase in value of the shares after the issuance and consequent reduced cost of capital of the issuing companies. Bekaert & Harvey (1997) for example, point out the relatively low correlations between the assets of emerging countries and those of more developed countries, as well as the high average returns provided by the former. Empirical evidence compatible with these ideas is presented by Kang & Stulz (1997) and Ratner & Leal (2002) and, in Brazil, by Bruni, Fuentes & Famá (1998) and Bruni (2002). Their studies show, in general, that internationally diversified portfolios can have substantial advantages in the form of higher expected returns and lower volatility of returns.

Bruni (1998) cites other arguments brought up by those who defend the idea that with the internationalization of finance, the liquidity of investments (papeis) increases in companies that issue the ADR. If investors desire a secondary market with higher liquidity and efficiency and if the absence of liquidity involves some compensation in the form of a higher required return, it is not difficult to imagine the expected return of the security decreasing after the ADRs are issued. Additionally, one might expect that higher trading volume would make the values of the share less sensitive to individual buy or sell orders.

These are some of the potential consequences associated with higher efficiency in the U.S. stock market.

### **3.2 ADR Programs**

Various types of ADR programs exist in which a company may participate. We analyze the main characteristics of each.

#### **3.2.1 Level 1**

The most basic ADR program, Level I, is used when issuers are not initially looking to increase capital in American markets, list their ADRs on an exchange, or even quote them on NASDAQ; or do not want to adjust their accounting to USGAAP. The Level I

ADR Program offers an easy and inexpensive way for an issuer to measure the interest in their securities and start to build a presence in American securities markets.

Level I ADRs are traded on the Over-the-Counter Market (OTC) with prices of supply and demand updated automatically at the end of the trading day by the Information Service of the LLC Pink Sheets.

Level I ADR Programs today require, at minimum, registering with the SEC. Issuers seek exemption from the traditional SEC reporting and accounting requirements under the rule 12g3-2(b). With this exemption, issuers agree to send an English language version of copies or summaries of any report of public documents launched in their domestic markets and, under certain circumstances, adequately summarized in English (including documents to regulatory agencies, stock exchange or directly communicated to shareholders). The depositary, working with the issuer, also files the registration forms of declaration F-6 with the SEC, to set up the program and register the ADRs under the Securities Act.

### **3.2.2 Level 2**

In the Level II ADR Program, ADRs are listed on American stock exchanges or quoted on NASDAQ. This offers the company more visibility in the U.S., more active trading and higher potential for liquidity.

Issuers must meet the requirements of the American stock exchanges or of the markets in which they want to appear.

### **3.2.3 Level 3**

In the largest ADR profile, the Level III ADR Program, issuers publicly offer participation in American depositaries representing their securities in the U.S. and list them in one of the American stock markets or on NASDAQ. The benefits are substantial: increases in capital, which provides significant visibility in the American

market. Issuers must meet a series of requirements of the American stock exchange or of the market in which they want their ADRs to be listed or quoted.

Level III ADR Programs must meet various SEC rules, including the complete registration under the Securities Act and the continuity of the reporting requirements of the Exchange Act. These links are the following:

- Statement of registration on form F-6, to register the ADRs;
- Form F-1, to register the underlying equity securities of the ADRs publicly offered in the U.S., including a prospectus to inform potential investors of the issuer and the inherent risks of the trade, the offer price of the securities, the plan to distribute the ADRs, etc. For temporary issuers, the Statement of registration, summarized on form F-3, can be made available.
- Statement of registration on Form 20-F and the Annual Report 20-F, in an annual filing that discloses the financial details of the issuer, including balance sheets and complete conversion of these balance sheets to USGAAP or IFRS. Alternatively, an issuer can file Form 8-A with the SEC to cover the initial registration under the Exchange Act.
- Intermediary financial reports or monetary development (Form 6-K) submitted to the SEC regularly.

### **3.2.4 Rule 144 A**

Many foreign companies seek to increase capital in private American markets by issuing restricted securities known as ADRs Rule 144 A.

These ADRs do not require the review of the SEC, registration or USGAAP/IFRS.

A facilitates the resale of privately placed securities to qualified institutional investors.

Two years after the last participation deposit set out in Rule 144 A, the ADRs become eligible for inclusion in an unrestricted ADR program.

Rule 144 A ADRs are dealt with electronically among QIBs only through the site. They are not listed nor evaluated publicly.

Disclosure is typically the financial information available elaborated according to the corporate market law of the issuing company's country and its accounting conventions.

### **3.3 Establishing an ADR Program**

Companies must seek to maximize their opportunities to raise resources. Generally this maximization takes place first in the domestic market. When the company seeks internationalization, this process should take place gradually. The most appropriate path is for the company to reduce its lack of information by disclosing analysis and financial statements providing more transparency in the markets in which it is interested. Next comes issuing, the most common being to begin issuing bonds in the less prestigious markets. The next step can be issuing bonds in a more prestigious market or even in various markets (Eurobond Issue). A group of important financial institutions make up the network of worldwide financial markets, through which the issuing of Eurobonds and Euroequities occur. Afterwards, the company seeks to penetrate equity markets, starting with listing its shares in international markets (secondary market) and the subsequent issuing of new shares. Listing shares allows them to be quoted and traded in other markets through Depositary Receipts (DR).

When one creates an ADR program, non-American issuers must first establish a proportion for the number of original shares that represent an ADR (or the number of ADRs that represent an original share). Depending on the issuing company's objective, the number of original shares that represent an ADR can be increased or decreased to raise or lower the trading price of the ADR.

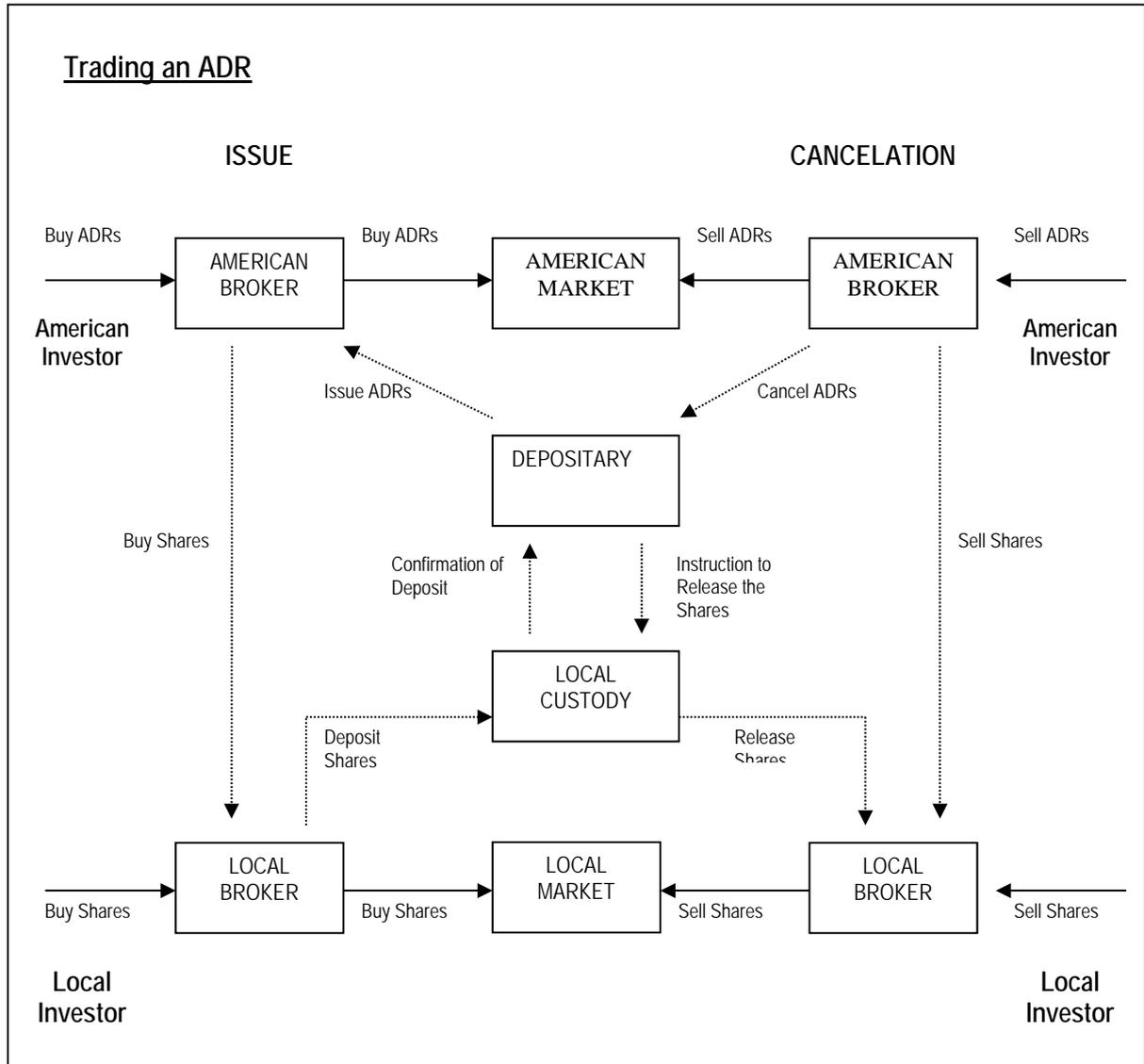
This proportion between shares and ADRs, at present, is US\$ 30 to US\$ 40.

However, this range serves only as an initial parameter, still requiring analysis of the range of trading price of the business activity of the company issuing the ADR.

### **3.4 ADR Trading Process**

The ADR buying process begins when a North-American investor decides to invest in shares of companies that are not North-American. This investor must then ask a local

broker to acquire the purchase of shares through ADR programs. The North-American broker must acquire the shares in his or her market of origin, through his or her branch or another local broker. This local broker must go to the local stock market, buy the shares and solicit their delivery to the custodial bank located in the country and that is a participant of ADR mechanisms. The custodial bank informs the depositary bank holding the ADRs in the U.S. of the number of shares received for safekeeping. The depositary bank then emits a proportionate number of shares and delivers them to the North-American broker, who begins the process. Finally, the ADRs are delivered to the North-American investor.



## 4 The Company – ELETROBRAS S/A

### 4.1 Brief summary of the Company's history

The incorporation of Brazilian Electric Power Company (Centrais Elétricas Brasileiras – Eletrobras) was proposed in 1954 by President Getúlio Vargas. The bill faced great opposition and was only passed after seven years in the Brazilian Congress. On April 25th 1961, Jânio Quadros, the president of Brazil at the time, promulgated Law n. 3.890-A that authorized the incorporation of Eletrobras by the Brazilian Government. The official incorporation of the company occurred on June 11, 1962, when President João Goulart, in a solemn session of the National Council of Water and Electric Power (CNAEE) at the Laranjeiras Palace in Rio de Janeiro. At first, formed as a

mixed-capital company, Eletrobras aimed at fostering studies, construction projects and the operation of generating plants, transmission lines and substations for electric power distribution, in addition to the celebration of commercial acts related to such activities. Accordingly, it started to decisively contribute to the expansion of electric power offer and the development of Brazil.

Since the beginning, Eletrobras assumed the features of a holding company – core of a concessionaires with great administrative autonomy – with the task of managing the resources from the Federal Electrification Fund (Fundo Federal de Eletrificação), what quickly transformed Eletrobras in the main financial agency in the sector. As a result, at first Eletrobras added as subsidiaries the existing companies, Companhia Hidrelétrica do São Francisco (Chesf), Furnas Centrais Elétricas S.A. (Furnas), Companhia Hidrelétrica do Vale do Paraíba (Chevap) and Termelétrica de Charqueadas S.A. (Termochar), which together held a generating capacity of 5,800 MW.

In 1964, Eletrobras participated intensely at the Commission for the Nationalization of Public Utility Concessionaires (Comissão de Nacionalização das Empresas Concessionárias de Serviços Públicos - Conesp), which studied the purchase, by the Brazilian Government, of concessionaires belonging to American & Foreign Power Company (Amforp) operating in Brazil. The deal was closed in November of the same year, transferring to Eletrobras ten additional subsidiaries.

Effective 1967, several laws were enacted aiming at the growth of Brazil's energy sector. It was assigned to Eletrobras the execution of the federal electricity policy and to Brazilian National Department of Water and Electrical Energy (Departamento Nacional de Águas e Energia Elétrica - Dnaee), created in 1965, regulatory and supervisory duties.

In 1968 and 1973, respectively, the subsidiaries Centrais Elétricas do Sul do Brasil S.A. (Eletrosul) and Centrais Elétricas do Norte do Brasil S.A. (Eletronorte) were established. In 1973, Eletrobras and Administración Nacional de Electricidad, a Paraguay-owned company, incorporated Itaipu Binacional, which purpose is to build

and operate the Itaipu Hydroelectric Power Plant, located at the Paraná River in the border between the two countries.

Then, Law n. 5,899, of July 5, 1973, assigned to Eletrobras the power to promote, through its regional companies, the construction and operation of high and extra-high voltage transmission systems, aiming at the inter-state integration of systems and the transportation of electricity from the Itaipu Hydroelectric Power Plant. For this purpose, Coordinating Groups for Interconnected Operation (Grupos Coordenadores para a Operação Interligada - GCOI) were created.

With the first oil crisis in 1974, the government of President Ernesto Geisel formulated a new policy to expand the energy sector in the country. This expansion included the construction of hydroelectric dams, nuclear plants, and a research center dedicated to the sector's technological development (Cepel), established during the 1980s.

In May 1995, Eletrobras and its four regional companies - Chesf, Furnas, Eletronorte and Eletrosul - were included in the National Privatization Program (Programa Nacional de Desestatização - PND). At the time, Eletrobras Group accounted for 48% of generating capacity installed in the country, totaling 55,512 MW. During this period, the company also started to operate, by legal and transitory order, in distribution of electric power through the companies Companhia Energética de Alagoas, or Ceal (current Distribuição Alagoas), Companhia Energética do Amazonas, or Ceam (current Amazonas Energia), Companhia Energética do Piauí, or Cepisa (current Distribuição Piauí), Centrais Elétricas de Rondônia S.A., or Ceron (current Distribuição Rondônia), and Eletrobras de Eletricidade do Acre (current Distribuição Acre), all directly controlled by the holding company, and also through Boa Vista Energia S.A. (current Distribuição Roraima), and Manaus Energia S.A. (current Amazonas Energia), by the time controlled by the subsidiary Eletronorte. In 2004, new regulation of the electric sector excluded Eletrobras and its subsidiaries from the National Privatization Program.

Today, Eletrobras is a publicly-held, mixed-capital company, with shares traded at the São Paulo (Brazil), Madrid (Spain) and New York (U.S.) Stock Exchanges.

Eletrobras directly controls 12 subsidiaries - Chesf, Furnas, Eletrosul, Eletronorte, CGTEE, Eletronuclear, Distribuição Acre, Amazonas Energia (a result of the merger of Ceam and Manaus Energia), Distribuição Roraima, Distribuição Rondônia, Distribuição Piauí e Distribuição Alagoas – Eletrobras also controls Eletrobras Participações S.A. (Eletropar), a holding company, and the largest research center in the Southern Hemisphere, the Research Center for Electricity (Centro de Pesquisa de Energia Elétrica, or Cepel), also holding half of the capital of Itaipu Binacional on behalf of the Brazilian Government.

Present throughout Brazil, Eletrobras group had on December 31, 2011, installed capacity to produce 41,621 MW, including half of the power of Itaipu which belongs to Brazil, and approximately 60,000 kilometers of transmission lines.

## **4.2 Organizational Structure**

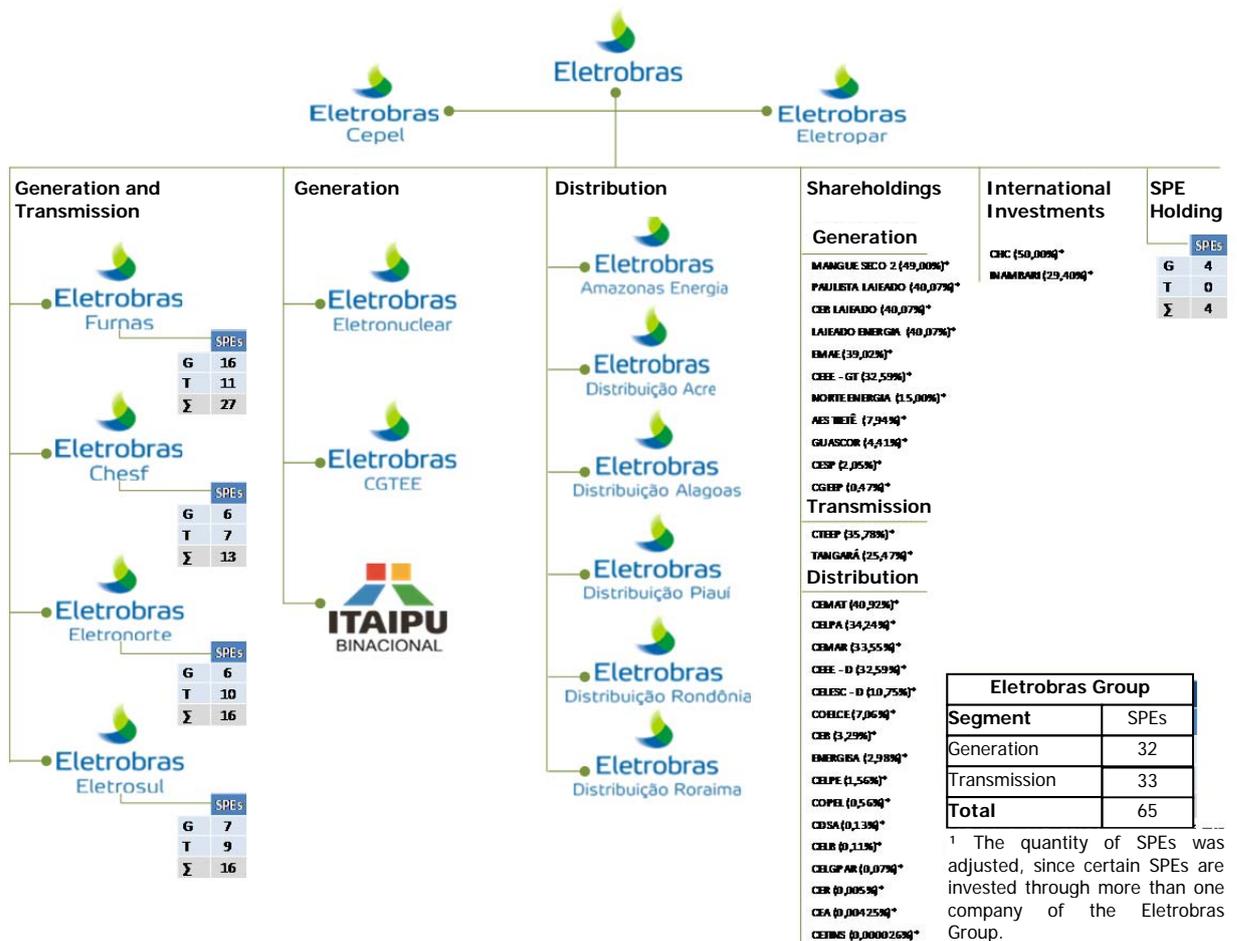
Eletrobras operates generation, transmission and distribution activities in Brazil through the following regional subsidiaries:

- *Itaipu*, a plant in which Eletrobras and a Paraguayan governmental entity (ANDE) each hold a 50.0% interest and which is one of the world's largest hydroelectric plants by volume of energy generated;
- *Eletrobras Furnas*, which engages in generation and transmission activities in the southeast and part of the center-west regions of Brazil;
- *Eletrobras Chesf*, which engages in generation and transmission in the northeast region of Brazil;
- *Eletrobras Eletronorte*, which engages in generation, transmission and limited distribution activities in the north and part of the center-west regions of Brazil and is the holding company of Eletrobras Distribuição Roraima;
- *Eletrobras Eletronuclear*, which owns and operates two nuclear plants, Angra I and Angra II, and is planning to construct a third, Angra III;
- *Eletrobras Amazonas Energia*, which engages in generation and distribution in the State of Amazonas;
- *Eletrobras Eletrosul*, which engages in transmission activities in the State of Santa Catarina, Rio Grande do Sul, Mato Grosso do Sul and Paraná;
- *Eletrobras Distribuição Piauí*, which engages in distribution activities in the State of Piauí;
- *Eletrobras Distribuição Alagoas*, which engages in distribution activities in the State of Alagoas;
- *Eletrobras Distribuição Rondônia*, which engages in distribution activities in the State of Rondônia;
- *Eletrobras CGTEE*, which owns and operates thermal plants in the south region of Brazil; and
- *Eletrobras Distribuição Acre*, which engages in distribution activities in the state of Acre.

Eletrobras is also the main sponsor of Cepel, the largest technological research and development center in the electricity industry in Latin America, and also holds a majority interest in Eletrobras Eletropar, a holding company that holds minority interests in the following Brazilian distribution companies: (i) AES Eletropaulo Metropolitana de Eletricidade de São Paulo S.A – AES Eletropaulo; (ii) Energias do

Brasil S.A. – Energias do Brasil; (iii) Companhia de Transmissão de Energia Elétrica Paulista – CTEEP; (iv) Empresa Metropolitana de Águas e Energia S.A. – EMAE; and (v) Companhia Piratininga de Força e Luz – CPFL

The following organizational chart shows the Company's summarized shareholder structure and subsidiaries as of December 31, 2011 (Eletrobras also has minority shareholdings in 30 state utility companies throughout Brazil, not indicated in this chart):



Eletrobras Group	
Segment	SPEs
Generation	32
Transmission	33
<b>Total</b>	<b>65</b>

<sup>1</sup> The quantity of SPEs was adjusted, since certain SPEs are invested through more than one company of the Eletrobras Group.

## 4.3 Lending and Financing Activities

### 4.3.1 Loans Made by Eletrobras

Brazilian law allows Eletrobras to only lend to its subsidiaries. Historically, Brazilian law allowed Eletrobras to act as lender to its subsidiaries and to public energy utilities under the Company's control. While certain of those subsidiaries are no longer in the

Eletrobras Group, the majority of the loans are to related parties. Prior to the privatization of the Brazilian electricity industry that began in 1996, this was a particularly widespread part of the Company's operations because most companies in the industry were state-owned, allowing Eletrobras to engage in lending activities to them. However, as the result of privatization, the number of companies to whom we may lend has diminished and lending is no longer a significant aspect of our business. The total amounts recorded on the consolidated balance sheet of Eletrobras were R\$9.7 billion as of December 31, 2011, R\$9.7 billion as of December 31, 2010 and R\$11.8 billion as of December 31, 2009. Of this total amount, loans to Itaipu accounted for R\$5.8 billion as of December 31, 2011, R\$5.7 billion as of December 31, 2010 and R\$6.5 billion as of December 31, 2009. The loans related to the Company's distribution companies are as follows: R\$3.8 billion as of December 31, 2011, R\$4.0 billion as of December 31, 2010 and R\$5.3 billion as of December 31, 2009.

#### **4.3.2 Sources of Funds**

Eletrobras obtains funding for its lending activities from loans from financial institutions and offerings in the international capital markets. As of December 31, 2011, the Company's consolidated long-term debt was R\$38,408 million, compared to R\$31,270 million as of December 31, 2010 and R\$28,393 million as of December 31, 2009, with the majority of our foreign currency debt (approximately 40% over the three-year period) denominated in U.S. dollars. Further details of our borrowings are set out in item 10.1(f) of this Reference Form.

In addition, Eletrobras utilizes borrowings from the RGR Fund, which the Company administers, to on-lend to its subsidiaries and other electricity companies. As of December 31, 2011, December 31, 2010 and December 31, 2009, Eletrobras incurred interest at 5.0% in respect of borrowings from the RGR Fund and charge an average administrative fee of up to 2.0% on funds which it on-lends to subsidiaries and other entities.

### 4.3.3 Equity Participation

Eletrobras acts as a minority participant in private sector generation and transmission companies and joint ventures. The Company is also authorized to issue guarantees for those companies in which it participates as an equity investor. Eletrobras is constantly considering investments in a number of such companies, focusing primarily on those in line with its strategy of building on its core businesses of generation and transmission.

The current participations that Eletrobras has are in private sector generation and transmission companies and joint ventures. Participation is determined primarily on merit and profitability criteria based on the Company's managerial controls.

The table below shows an estimate of the total percentage of the Company's participation in transmission and generation companies as of December 31, 2011:

<b>Special Purpose</b>		
<b>Company/Consortium</b>	<b>Object of investment</b>	<b>Eletrobras Participation</b>
<b>Transmission</b>		
Interligação Elétrica do Madeira S.A.	600 kV transmission line of 2,375 km plus Rectifier and Inverter Station	Eletrobras Chesf (24.5%) Eletrobras Furnas (24.5%)
Norte Brasil Transmissora de Energia S.A.	600kV Transmission Line of 2,375 km:  SE Coletora – Araraquara	Eletrobras Eletronorte (24.5%) Eletrobras Eletrosul (24.5%)

Special Purpose	Company/Consortium	Object of investment	Eletrobras Participation
		2, Porto Velho	
	Estação Transmissora de Energia S.A.	500/±600 kV Conversion and Inversion Station 01	Eletrobras Eletronorte (100.0%)
	Manaus Transmissora de Energia S.A.	500 kV Transmission Line of 587 km:	Eletrobras Chesf (19.5%) Eletrobras Eletronorte (30.0%)
		Oriximiná – Silves; 500 kV Transmission Line of 224 km and Substations Itacoatiara e Cariri: Silves –Lechuga	
	STN – Sistema de Transmissão Nordeste S.A. (2)	500 kV Transmission Line of 546 km:	Eletrobras Chesf (49.0%)
		Teresina-Sobral-Fortaleza	
	Intesa – Integração de Energia S.A. (2)	500 kV Transmission Line of 695 km: Colinas-Miracema-Gurupí-Peixe Nova-Serra da Mesa 2	Eletrobras Chesf (12.0%), Eletrobras Eletronorte (37.0%)
	Porto Velho Transmissora de Energia S.A.	230 kV transmission lines of 17 km: 500/230 kV SE Coletora	Eletrobras Eletrosul (100.0%)

Special Purpose	Company/Consortium	Object of investment	Eletrobras Participation
Ártemis – Transmissora de Energia S.A.(2)	Porto Velho	525 kV Transmission Line of 476 km: S. Santiago-Ivaporã-Cascavel	Eletrobras Eletrosul (100.0%)
Transenergia Renovável	230/138 kV Transmission Line of 635 km: Connects biomass plants and small hydroelectric plants to the National Interconnected System ( <i>Sistema Interligado Nacional - SIN</i> )	Eletrobras Furnas (49.0%)	
Brasnorte Transmissora de Energia S.A.(2)	230kV Transmission Lines of 402 km: Jauru-Juba-C2; LT Maggi-Nova Mutum	Eletrobras Eletronorte (49.7%)	
RS Energia – Empresa de Transmissão de Energia do Rio Grande do Sul S.A.(2)	525 kV Transmission Line of 260 km: Campos Novos-Nova Santa Rita and 230 kV transmission line of 33 km SE Monte Claro – SE Garibaldi	Eletrobras Eletrosul (100.0%)	
Companhia Transleste de Transmissão S.A.(2)	345 kV Transmission Line of 139 km: Montes Claros-Irapé	Eletrobras Furnas (24.0%)	

**Special Purpose**

<b>Company/Consortium</b>	<b>Object of investment</b>	<b>Eletrobras Participation</b>
Amazônia Eletronorte Transmissora de Energia S.A. – Aete(2)	230 kV Transmission Line of 193 km: Coxipó-Cuiabá-Rondonópolis and SE Seccionadora Cuiabá	Eletrobras Eletronorte (49.0%)
Etau – Empresa de Transmissão do Alto Uruguai S.A. (2)	240 kV Transmission Line of 187 km: Campos Novos-Barra Grande-Lagoa Vermelha-Santa Marta	Eletrobras Eletrosul (27.4%)
Uirapuru Transmissora de Energia S.A.(2)	525 kV Transmission Line of 122 km: Ivaiporã-Londrina	Eletrobras Eletrosul (100.0%)
Companhia Transudeste de Transmissão S.A.(2)	345 kV Transmission Line of 144 km: Itutinga-Juiz de Fora	Eletrobras Furnas (25.0%)
Companhia Transirapé de Transmissão S.A.(2)	345 kV Transmission Line of 61 km: Irapé-Araçuaí	Eletrobras Furnas (25.0%)
Companhia Centroeste de Minas S.A.	345 kV Transmission Line of 63 km: Eletrobras Furnas-Pimenta II	Eletrobras Furnas (49.0%)
Linha Verde Transmissora de Energia S.A.	230 kV Transmission Line of 987 km: Porto Velho - Jauru	Eletrobras Eletronorte (49.0%)

<b>Special Purpose Company/Consortium</b>	<b>Object of investment</b>	<b>Eletrobras Participation</b>
Rio Branco Transmissora de Energia S.A.	230 kV Transmission Line of 487 km: Porto Velho-Abunã-Rio Branco	Eletrobras Eletronorte (100.0%)
Transmissora Matogrossens de Energia S.A.	500 kV Transmission Line of 348 km: Jauru – Cuiabá and SE Jauru	Eletrobras Eletronorte (49.0%)
Transenergia São Paulo S.A.	Itatiba Substation, 500 kV	Eletrobras Furnas (49.0%)
Transenergia Goiás S.A	230 kV Transmission Line of 188 km: Serra da Mesa-Niquelândia-Barro Alto	Eletrobras Furnas (49.0%)
Consórcio Goiás Transmissão	500 kV Transmission Line of 193 km: Rio Verde Norte –Trindade. and 230 kV Transmission Line of 66 km: Xavantes-Trindade-Carajás and SE Trindade	Eletrobras Furnas (49.0%)
Consórcio MGE Transmissão	500 kV Transmission Line of 248 km: Mesquita-Viana 2. and 345 kV transmission line of 10 km: Viana – Viana 2 and SE Viana 2	Eletrobras Furnas (49.0%)

**Special Purpose**

<b>Company/Consortium</b>	<b>Object of investment</b>	<b>Eletrobras Participation</b>
TDG Transmissora Delmiro Gouveia SA	230 kV Transmission Line of 96 km: São Luiz II – São Luiz III and SE Pecém and SE Aquiraz II	Eletrobras Chesf (49.0%)
Interligação Elétrica Garanhus SA	500 kV Transmission Line of 653 km: Luiz Gonzaga – Garanhus, Garanhus – Campina Grande III and Garanhus – Pau Ferro and 230 kV transmission line of 13 km: Garanhus – Angelim I	Eletrobras Chesf (49.0%)
Transnorte Energia SA	500 kV Transmission Line of 715 km: Engenheiro Lechuga – Equador (RR) – Boa Vista e SEs	Eletrobras Eletronorte (49.0%)
Costa Oeste Transmissora de Energia SA	230 kV Transmission Line of 143 km Cascavel Oeste –Umuarama	Eletrobras Eletrosul (49.0%)
Marumbi Transmissora de Energia SA	525 kV Transmission Line of 28 km: Curitiba – Curitiba Leste	Eletrobras Eletrosul (20.0%)
Transmissora Sul Brasileira de Energia SA	525 kV Transmission Line of 495 km: Salto Santiago	Eletrobras Eletrosul (80.0%)

Special Purpose	Company/Consortium	Object of investment	Eletrobras Participation
		–Itá –Nova Santa Rita and 230 kV transmission line of 303 km: Nova Santa Rita –Camaquã –Quinta	
	Consórcio Caldas Novas	SE Corumbá 345/138 kV – 2 x 75 MVA	Eletrobras Furnas (49.9%)
	Generation		
	Madeira Energia SA	HPU Santo Antonio with 3,150 MW	Eletrobras Furnas (39.0%)
	Energia Sustentável do Brasil	HPU Jirau with 3300 MW	Eletrobras Chesf (20.0%) Eletrobras Eletrosul (20.0%)
	Foz do Chapecó Energia S.A.	HPU Foz do Chapecó with 855 MW	Eletrobras Furnas (40.0%)
	Enerpeixe S.A.(2)	HPU Peixe Angical with 452 MW	Eletrobras Furnas (40.0%)
	Consórcio Energético Cruzeiro do Sul S.A.	HPU Mauá with 361 MW	Eletrobras Eletrosul (49.0%)
	Serra de Facão S.A.	HPU Serra do Facão with 213 MW	Eletrobras Furnas (49.5%)

**Special Purpose**

<b>Company/Consortium</b>	<b>Object of investment</b>	<b>Eletrobras Participation</b>
Energetica Águas da Pedra S.A.–EAPSA (Aripuanã; Água Das Pedras)	HPU Dardanelos with 261 MW	Eletrobras Chesf (24.5%), Eletrobras Eletronorte (24.5%)
Baguari I Geração de Energia Elétrica S.A.(2)	HPU Baguari with 140 MW	Eletrobras Furnas (15.0%)
Retiro Baixo Energética S.A.	HPU Retiro Baixo with 82 MW	Eletrobras Furnas (49.0%)
AMAPARI Energia S.A.(2)	TPU Serra do Navio and Small HPU Capivara with 53 MW	Eletrobras Eletronorte (49.0%)
Norte Energia S.A.	HPU Belo Monte with 11,233 MW	Eletrobras Eletronorte (19.9%) Eletrobras Chesf (15.0%) Eletrobras Holding (15.0%)
Brasventos Eolo Geradora de Energia S.A.	Parque Eólico Rei doVentos I with 49 MW	Eletrobras Furnas (24.5%) Eletrobras Eletronorte (24.5%)
Rei dos Ventos 3 Geradora de Energia S.A.	Parque Eólico Rei dos Ventos 3 with 49 MW	Eletrobras Furnas (24.5%) Eletrobras Eletronorte (24.5%)
Brasventos Miassaba 3 Geradora de Energia S.A.	Parque Eólico Miassaba 3 with 50 MW	Eletrobras Furnas (24.5%) Eletrobras Eletronorte (24.5%)

**Special Purpose**

<b>Company/Consortium</b>	<b>Object of investment</b>	<b>Eletrobras Participation</b>
Companhia Hidrelétrica Teles Pires	HPU Teles Pires with 1,820 MW	Eletrobras Eletrosul (24.5%) Eletrobras Furnas (24.5%)
Cerro Chato I S.A.	Parque Eólico Coxilha Negra V with 30 MW	Eletrobras Eletrosul (90.0%)
Cerro Chato II S.A.	Parque Eólico Coxilha Negra VI with 30 MW	Eletrobras Eletrosul (90.0%)
Cerro Chato III S.A.	Parque Eólico Coxilha Negra VII with 30 MW	Eletrobras Eletrosul (90.0%)
Eólica Mangue Seco 2 Geradora e Comercializadora de Energia Elétrica	Eólica Mangue Seco 2 with 26 MW	Eletrobras Holding (49.0%)
Inambari Geração de Energia S.A.	UHE Inambari with 2,000 MW	Eletrobras Furnas (19.6%) Eletrobras Holding (29.4%)
Chuí Holding S.A.	Eólicas Chuí I a V with 98 MW and Eólicas Minuano I and II with 46 MW	Eletrobras Eletrosul (49.0%)
Livramento Holding S.A.	Eólicas Cerro Chato IV, V and VI, Ibirapuitã e Trindade with 78 MW	Eletrobras Eletrosul (49.0%)
Santa Vitória do Palmar	Eólicas Verace I to X with	Eletrobras Eletrosul

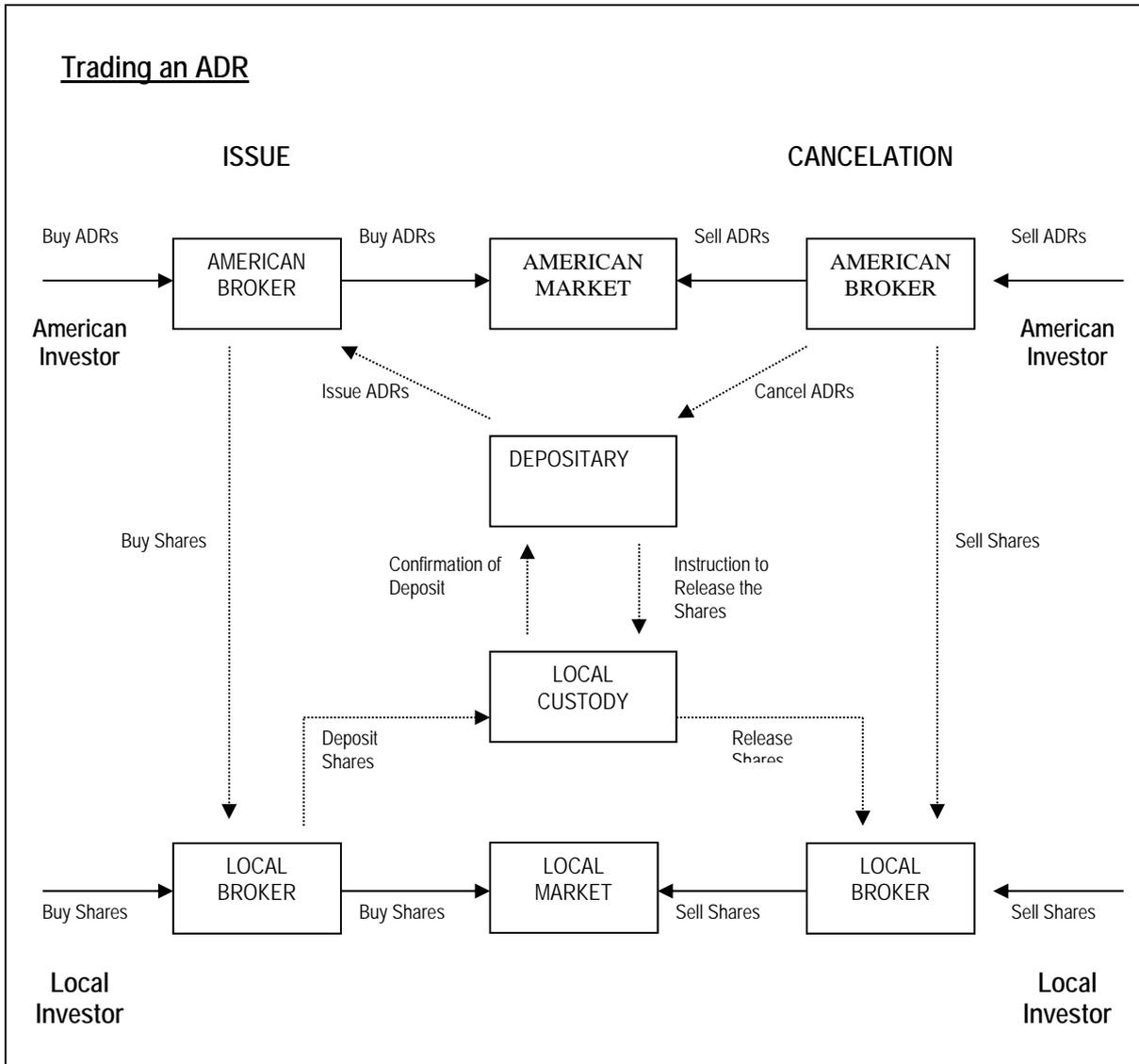
**Special Purpose**

<b>Company/Consortium</b>	<b>Object of investment</b>	<b>Eletrobras Participation</b>
Holding S.A.	258 MW	(49.0%)
São Pedro do Lago S.A.	Eólica São Pedro do Lago with 30 MW	Eletrobras Chesf (49.0%)
Pedra Branca S.A.	Eólica Pedra Branca with 30 MW	Eletrobras Chesf (49.0%)
Sete Gameleiras S.A.	Eólica Sete Gameleiras with 30 MW	Eletrobras Chesf (49.0%)
Central Geradora Eólica Famosa I S.A.	Eólica Famosa I with 23 MW	Eletrobras Furnas (49.0%)
Central Geradora Eólica Pau – Brasil S.A.	Eólica Pau – Brasil with 15 MW	Eletrobras Furnas (49.0%)
Central Geradora Eólica Rosada S.A.	Eólica Rosada with 30 MW	Eletrobras Furnas (49.0%)
Central Geradora Eólica São Paulo	Eólica São Paulo with 18 MW	Eletrobras Furnas (49.0%)
Energia dos Ventos I	Eólica Goiabeira with 19 MW	Eletrobras Furnas (49.0%)
Energia dos Ventos II	Eólica Ubatuba with 13 MW	Eletrobras Furnas (49.0%)

**Special Purpose**

<b>Company/Consortium</b>	<b>Object of investment</b>	<b>Eletrobras Participation</b>
Energia dos Ventos III	Eólica Santa Catarina with 16 MW	Eletrobras Furnas (49.0%)
Energia dos Ventos IV	Eólica Pitombeira with 27 MW	Eletrobras Furnas (49.0%)
Energia dos Ventos V	Eólica São Januário with 19 MW	Eletrobras Furnas (49.0%)
Energia dos Ventos VI	Eólica Nossa Senhora de Fátima with 29 MW	Eletrobras Furnas (49.0%)
Energia dos Ventos VII	Eólica Jandaia with 29 MW	Eletrobras Furnas (49.0%)
Energia dos Ventos VIII	Eólica São Clemente with 19 MW	Eletrobras Furnas (49.0%)
Energia dos Ventos IX	Eólica Jandaia I with 19 MW	Eletrobras Furnas (49.0%)
Energia dos Ventos X	Eólica Horizonte with 14 MW	Eletrobras Furnas (49.0%)





#### 4.4 The Corporate Strategy

As can be seen, ELETROBRAS engages in the international capital markets, trading its shares in the stock markets of New York and Madrid (over-the-counter) and raises huge funds in foreign banks. Given this setting, in 2003, its executives decided to implement an ADR Level II program (trading stocks on the NYSE). According to these executives, the expected benefits will be the consolidation of a control environment that meets the most rigorous rules of corporate governance (SOX and new market – Bovespa), an increase in its shareholder base and a significant reduction in Eletrobrás' spread of risk, thereby making it possible to raise larger quantities of resources at more satisfactory interest rates. However, to reach these

objectives, the company has been undergoing deep changes, which cause great expectations and pressure within the company to meet these demands. Adapting to the rules required by SEC is complex, costly and sometimes time-consuming, since it does not involve merely adapting to US GAAP accounting rules; the company must also have higher levels of disclosure and transparency because to trade shares on the SEC implies meeting the rules of corporate governance (SOX).

At the end of September, 2008, the company delivered its request for registration to the SEC. On October 31, 2008, Eletrobrás received its registration with the SEC and has been trading its ADRs on the NYSE since.

## **5 FINAL CONSIDERATIONS**

This study analyzed the positive and negative arguments of a company that participates in an ADR program to raise capital in the North-American market.

According to the literature and interviews carried out at Eletrobrás, the most important benefits are: reduced cost of capital, increased share liquidity, increased visibility and an increased shareholder base.

Studies by Enruzza & Miller (2000) and Foester & Karolyi (1999) show that listing shares in foreign markets reduces a companies' cost of capital.

Further, according to Alanko (2004) the expected benefits of a double listing are: increased share liquidity, increased visibility, an increased shareholder base and reduced cost of capital.

These arguments are the same as those presented by Eletrobrás as objectives to be reached after listing its Level II ADR. Therefore, the arguments presented by Eletrobrás agree with this research and could possibly be applied to companies of similar size seeking the same goals.

We understand the decision of a company to engage in an ADR program should be based on a deep analysis of its intent and its own corporate characteristics.

Many Brazilian companies have already decided to participate. In the case of Brazilian companies, 45 opted to join a Level I ADR program. Twenty seven Brazilian companies have joined Level II and III.

This data shows most companies join Level I, in which we can identify only the advantage of increased shareholder base.

In Level II and III programs, companies are obliged to create synergy with the North-American capital markets, since they are subject to the rules of this market. With this, according to Carlin & Lima (1999) they are subject to high costs and to the complexity of American legislation, which makes the ADR mechanism accessible to large companies only.

Despite these difficulties, we observed many advantages to engaging in these programs. The listed companies are those that need voluminous financing and whose demands often cannot be met by the internal market.

In joining these programs, companies want, among other things, to increase their capital through external markets that offer lower rates than those practiced in the local market.

Various studies support the hypothesis that Brazilian companies listed in the North-American stock market can decrease their cost of capital. Petrobrás and Aracruz Celulose reduced their cost of capital considerably in the international market after implementing an ADR program listed on the stock market.

We conclude the choice of the ADR program is directly linked to company intent, since each program has its expected benefits. But, for those companies that need external financing, an ADR program listed on the stock market is best because the expected benefit is the reduced cost of capital.

The matter does not end with the arguments put forth here. For future research, we suggest analyzing the cost of capital of Eletrobrás after it launched its Level II ADRs.

Of equal interest would be to determine which characteristics a company that wishes to join the North-American capital market must have to reap the expected benefits.

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