



Brazil Insight #1

SPEYSIDE

CORPORATE RELATIONS

**Selling the Family Silver:
The next wave of Brazilian Privatizations &
Concessions in Power and Logistics**

March 2016



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Executive summary

- Phase two of the Logistics Investment program is being launched to grant privatized concessions for toll roads; airports, ports and railways, where the government hopes to raise USD 55 billion.
- Up to 100% foreign ownership is permitted in these ‘concession’ programs, which is usually 30-year in duration, (current leftist government doesn’t like to use the word *Privatization*).
- Eletrobras – Latin America’s biggest power utility – is planning to sell its subsidiaries in several states: Piauí, Alagoas, Acre, Rondônia, Amazonas, Roraima and Goiás.
- CELG – the largest Eletrobras subsidiary covering Goiás – is expected to be privatized in early 2016, and is likely to be considered the first and possibly the main act of privatization of Ms. Rousseff’s government. This sale will act as a litmus test, which if successful, should boost the sale of other state-owned companies.
- Likely to be some union and leftist opposition to the sales but the privatization program comes as the government faces huge financing challenges. Even if the current, troubled, Dilma government should fall (by way of impeachment) the process of privatization is likely to continue.
- Financing for foreign investors is available through special Brazilian infrastructure debentures and credit lines from the National Bank for Economic and Social Development (BNDES).

Logistics

During 2015, as the recession in Brazil deepened even further, Brazil’s government became even less able to finance investment in large infrastructure projects. Taking into account the increasing demand on its infrastructure matrix – which substantially contributes to the so-called ‘Brazil cost’¹ – in June of last year, the Federal Government launched the second phase of a **BRL 198.4 billion² (USD 55.1 billion) program, the Logistics Investment Program** (known in Portuguese by the acronym ‘PIL’). This program grants concessions for the private sector to invest in highways (toll roads), airports, ports and railways.

Since the word ‘privatization’ is ideologically prohibited by the ruling Workers’ Party (PT), the government prefers to refer to the program as ‘a plan of concessions’, with a predetermined period for economic investment by the private sector (which usually varies from 20 to 30 years). According to the government, investments through the Logistics Investment Program (PIL) should reach BRL 69.2 billion (USD 19.2 billion) from 2015 to 2018, and BRL 129.2 billion (USD 35.9 billion) by 2019. Expected investments in the principal four sectors are:

- Railways (BRL 86.4 billion – USD 24 billion)
- Highways (BRL 66.1 billion – USD 18.3 billion)
- Ports (BRL 37.4 billion – USD 10.4 billion)
- Airports (BRL 8.5 billion – USD 2.3 billion)

According to the Ministry of Planning, Budget and Management (MPOG), which leads this project, **foreign investors “are more than welcome to join”**. International companies and groups will not have to use a local partner in order to present their proposals, in other words, **a consortium can be 100% composed of foreign companies**. However, taking into account the economic nationalism of Ms. Rousseff’s government, the final selection of the winning company or consortium may suffer from political pressures in favor of national groups. That said, the government’s ability to favour Brazilian-led groups may be thwarted by the indebtedness or financial weakness of the Brazilian corporate sector. Thus, for potential foreign entrants and concession bidders, the decision to ‘go alone’ (maximizing financial benefits) or in partnership will still be a finely balanced matter of judgement.

¹ The term ‘Brazil Cost’ is related to the high costs of doing business in the country, including high tax burden, insufficient infrastructure, expensive labour and social security costs, low education levels, lack of qualified labour, bureaucracy and complex legal structure etc.

² Exchange rate (USD 1 = BRL 3.6, as of March 13th 2016).

If a foreign company decides to have a local partner, the composed consortium must be led by the Brazilian partner³. This 'leadership' does not mean that the consortium must be financially controlled (50% or more) by the Brazilian company, but rather that the national player must hold the interface between the government and the consortium.

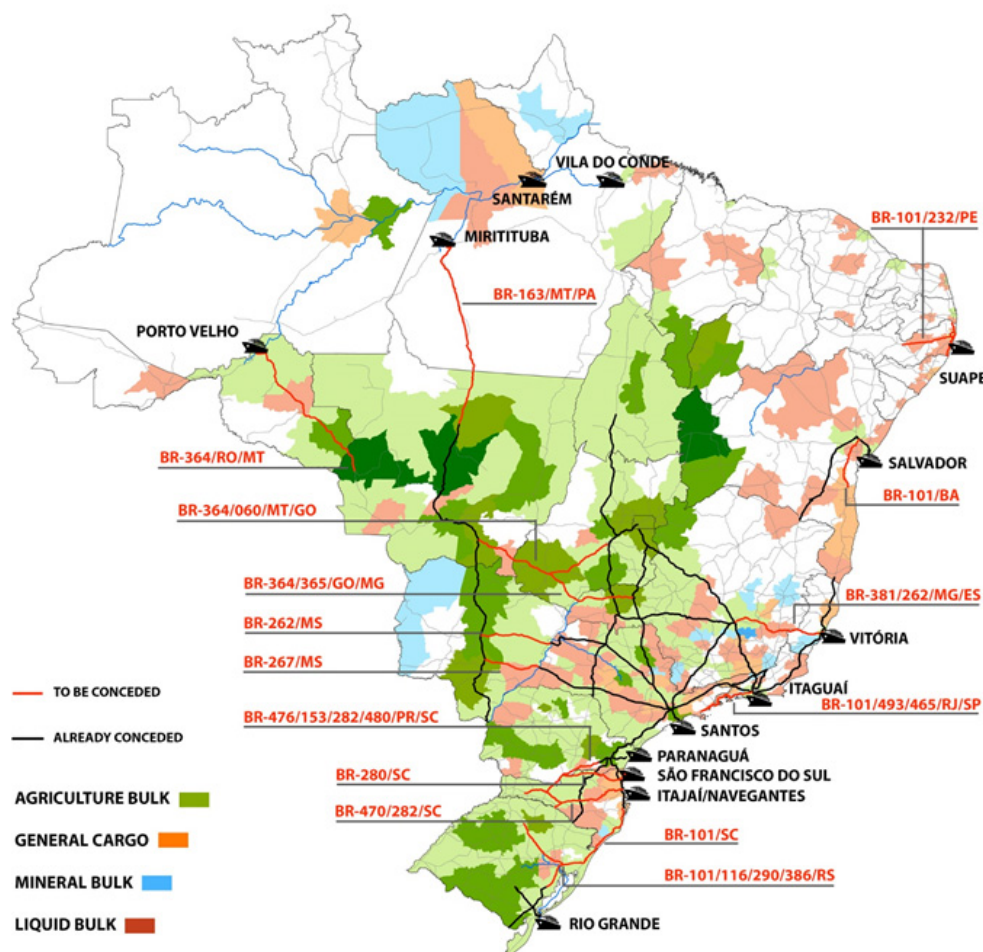
Highways

Road freight is the dominant transport mode in Brazil, with an estimated annual revenue of USD 5.3 billion. Brazil's road network, including both cargo and passenger transportation, amounts to 1.7 million kilometers.

The current round of auctions, which began in July 2015, will grant **concessions for 15 strategic transport corridors**, resulting in approximately 7,000 km of new roads. Investment is expected to reach **BRL 66.1 billion (USD 18.3 billion)**, consisting of BRL 50.8 billion (USD 14.1 billion) of new concessions to take place throughout 2015 and 2016, and BRL 15.3 billion (USD 4.2 billion) to be invested into concessions already in place. The auctions will be evaluated following the lower-tariff criteria.

These auctions can be considered very attractive, as they offer competitive financing conditions (70% potentially leveraged by the Brazilian Development Bank, and 20-year financing terms with a 5-year grace period) and an extended lifespan (30 years)⁴.

Map 1: 'Highways included in the Logistics Investment Program'



Source: Ministry of Planning

³ Public Procurement Law - 8.666/1993, art. 33, § 1st.

⁴ Department of Trade and Investment Promotion (DPR) of the Ministry of Foreign Affairs (MRE).

For the current round of auctions, **the government has received 314 proposals**. The Ministry of Planning has not yet disclosed which companies participated; however, it is common knowledge that **international groups** presented proposals.

In 2016, there will still be auctions for four more highways:

Table 1: 'Forthcoming highway auctions'

Highway	Length in km	Concession (years)	Current stage
BR 476/153/282/480 (States of Paraná and Santa Catarina)	493.3	30	Auction under analysis of the Court of Auditors (has not yet received proposals).
BR 364/365 (States of Goiás and Minas Gerais)	437	30	Auction under analysis of the Court of Auditors (has not yet received proposals).
BR 364/060 (States of Mato Grosso and Goiás)	439.2	30	Public hearing held. Next step will be the analysis of the Court of Auditors.
BR 163 (States of Pará and Mato Grosso)	976	30	Public hearing.

The Ministry of Transport stated last year that it wanted foreign companies to take part in these bids.

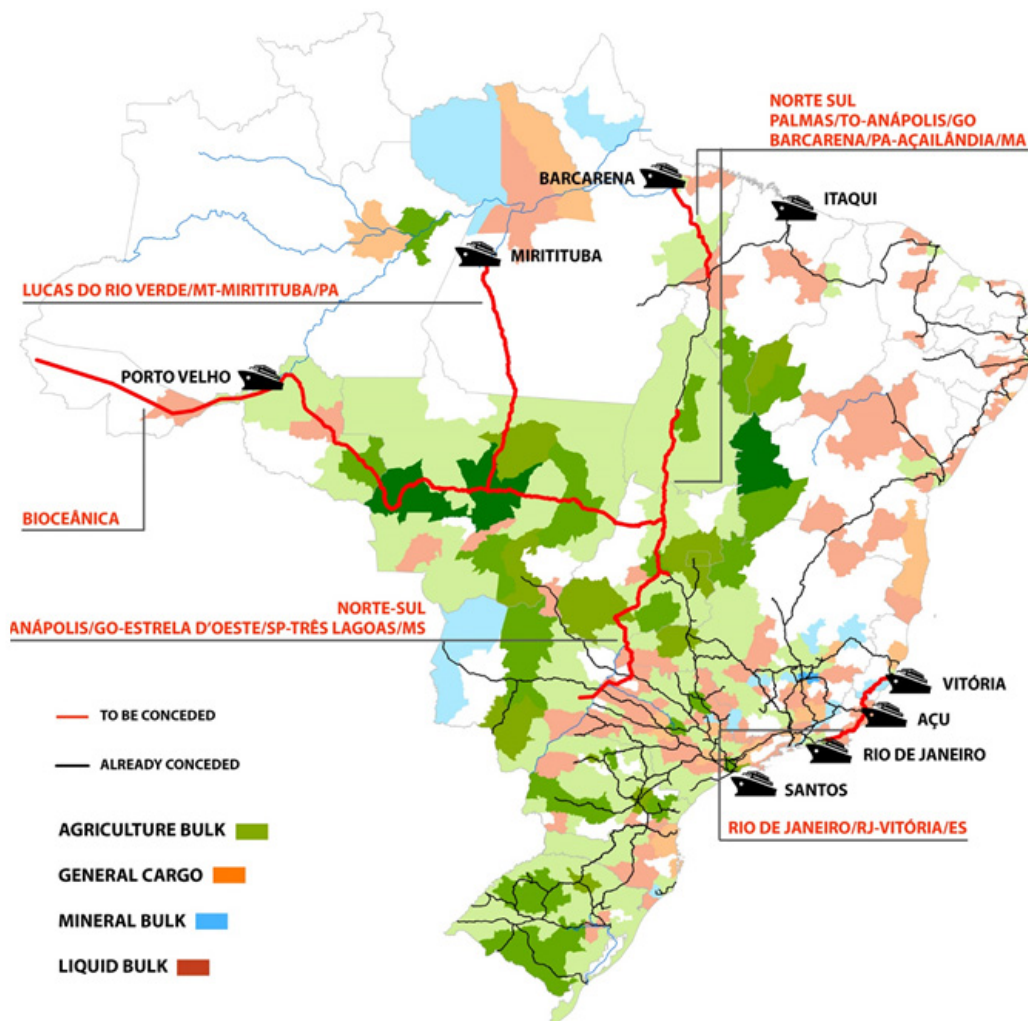
Railways

Having been ignored for decades, the Brazilian rail network may undergo a major transformation. The Infrastructure Public Investment Program is responsible for building **3,000 km of rail**.

Railways account for approximately 25% of Brazil's goods and freight transportation, with soybean especially, iron ore, steel and other minerals being transported. Passenger transport is extremely limited and exists virtually only as a tourist attraction, with low speed trains.

The Logistics Investment Program (PIL) aims at ensuring investment of **BRL 86.4 billion** (USD 24 billion) for the construction, modernization and maintenance of 7,500 km of railways.

Map 2: 'Railways included in the Logistics Investment Program'



Source: Ministry of Planning

Table 2: 'Forthcoming railway auctions'

Railway	Length in km	Current stage
North-South Line (2 stretches - States of Maranhão, Pará, Goiás and Tocantins)	1,430	Preliminary studies delivered. Next step will be the public hearings.
North-South Line 2 (2 stretches - States of São Paulo, Mato Grosso do Sul and Goiás)	895	Public hearing held. Next step will be the consolidation of the contributions obtained in the public hearing.
Rio de Janeiro-Espírito Santo Line	572	Public hearing held. Next step will be the consolidation of the contributions obtained in the public hearing.
Mato Grosso – Pará Line	1,140	Preliminary studies delivered. Next step will be the public hearings.
Bi-oceanic Railway	3,500	Preliminary studies delivered. Next step will be the public hearings.

Airports

Brazil is the largest market for airport traffic in Latin America and has 10 of the 20 busiest airports in the region. Despite the crisis, during the first half of 2015, 107 million passengers passed through Brazilian Airports, 3.36% more than the same period in 2014.

The private sector has already invested into some of the main airports in the country, including São Paulo-Guarulhos, Campinas-Viracopos, Brasília, Belo Horizonte-Confins and Rio de Janeiro-Galeão. Some of the winning consortiums were:

- Inframérica Aeroportos Consortium (composed of the Brazilian Infravix Participações S.A and the Argentinian Corporation América S.A – 50% each)
 - Paid BRL 4.5 billion (USD 1.25 billion) for the 25-year management of the **Brasília** International Airport
- Invepar Consortium (composed of the Brazilian Invepar and the South African ACSA, 90% and 10% respectively)
 - Paid BRL 16.2 billion (USD 4.5 billion) for the 20-year management of the **Guarulhos** International Airport
- Aeroportos Brasil Consortium (composed of the Brazilian groups Triunfo Participações e Investimentos, the UTC Participações, and the French Egis Airport Operation, 45%, 45% and 10%, respectively)
 - Paid BRL 3.8 billion (USD 1.05 billion) for the 30-year management of the **Campinas** International Airport
 - Aeroportos do Futuro Consortium (composed of the Brazilian Odebrecht and the controller of the Singapore-Changi Airport, 60% and 40%, respectively).

On the other hand, São Paulo-Congonhas is still operated by the Brazilian Airport Infrastructure Company (Infraero), a state-owned company.

The country still needs to develop its regional airports and other hubs, currently controlled by Infraero. The second phase of the Logistics Investment Program, will grant private companies the airports of Porto Alegre, Salvador, Florianópolis, Fortaleza, in addition to seven regional airports (six of them in the State of São Paulo – Araras, Jundiaí, Bragança Paulista, Itanhaém, Ubatuba e Campinas-Amarais – and one in the State of Goiás – Caldas Novas).

Map 3: 'Airports included in the Logistics Investment Program'



Source: Ministry of Planning

Scheduled for Q1 of 2016, the auctions of the major airports are expected to provide the government with BRL 7.2 billion (USD 2 billion). This includes:

Table 3: 'Forthcoming airports auctions'

Airport	Expected collection	Passengers in 2014
Salvador – Dep. Luís Eduardo Magalhães	BRL 2.8 billion (USD 777 million)	9,152,159
Porto Alegre – Salgado Filho	BRL 1.7 billion (USD 472 million)	8,447,380
Fortaleza – Pinto Martins	BRL 1.8 billion (USD 500 million)	6,501,822
Florianópolis – Hercílio Luz	BRL 0.9 billion (USD 250 million)	3,629,074

As the *Lava-Jato* ('Car Wash') investigation into multi-billion-dollar kickback schemes and corruption allegations against state-owned oil giant Petrobras advances – foreign companies have encountered difficulties in establishing partnerships with Brazilian companies untouched by corruption allegations. The Ministry of Planning, however, has eased the rules for participation of foreign companies, as mentioned in the ['Logistics' section](#).

Ports

Led by the growth of the agriculture and mining sectors, Brazil's port infrastructure continues to expand. Currently, around 95% of Brazil's total trade in goods passes through its ports. Trade in container cargo has grown at an average annual rate of 10% and shipped cargo is expected to reach over 2 billion tons by 2030 – a **5.7% growth per year**⁵.

⁵ Department of Trade and Investment Promotion (DPR) of the Ministry of Foreign Affairs (MRE).

The Logistics Investment Program forecasts investments of **BRL 37.4 billion (USD 10.4 billion)** in ports, through the concessions of 63 new Private Use Terminals (TUPs) and 24 renewals of existing leases.

For 2016, the next scheduled auctions are:

- State of Pará: 6 grain terminals, 1 container and general cargo terminals, 12 liquid bulk terminals, 1 mineral bulk terminal.
- Santos, State of São Paulo: 2 container and general cargo terminals, 2 liquid bulk terminals, 2 mineral bulk terminals.

Electricity

Mirroring what has occurred in the logistics sector, the electricity sector has undergone ‘concessions’ over the last years, with a predetermined period for private sector investment. Unlike the government of former President Fernando Henrique Cardoso (1995-2002), the PT party also avoids using the term ‘privatization’ in the electricity sector. However, due to the fiscal crisis and the current challenges facing the energy sector, the government is looking at privatizing certain areas.

Eletrobras

Eletrobras (Centrais Elétricas Brasileiras S.A.), Latin America's biggest power utility company and the tenth largest in the world, is a joint capital (public and private) company and generates around 40% and transmits 69% of Brazil's electricity supply. It has operations in several countries in Latin America and Africa, including Angola, Namibia, Argentina, Peru, Uruguay, Morocco and Nigeria.

In late 2015, Eletrobras announced it was planning to sell its subsidiaries in several states: Piauí, Alagoas, Acre, Rondônia, Amazonas, Roraima and Goiás. The company has been planning to do so since 2013 to cut costs and become more competitive.

Eletrobras has posted significant reductions in revenue over the last few years, heavily affecting its value on the São Paulo stock exchange.

5-year graph (Centrais Eletricas Brasileiras SA Preference Shares Series B)



Source: Reuters

Despite opposition from labor unions – who threaten to discontinue their support for President Dilma – Eletrobras confirmed last January that it plans to sell its subsidiaries in the Northern and Center-West regions. The largest subsidiary, Goiás Energy Company (CELG), is valued at BRL 6 billion (USD 1.6 billion) and is majority controlled by Eletrobras with 51% ownership. In June 2015, the State Legislative Assembly of Goiás authorized the sale of an additional 49% of company shares belonging to the State.

The acquisition of CELG by the private sector, which should be completed in early 2016, is likely to be considered the first and possibly the main act of privatization of Ms. Rousseff's government. If successful, it could boost the sale of other state-owned companies. Also in 2016 and 2017, other energy companies, such as the smaller Eletrobras subsidiaries, are expected to be privatized. The state-owned State Grid Corporation of China (SGCC), the world's largest electric utility company, is likely to present an offer to acquire CELG and other energy companies, such as AES Eletropaulo, the main power distributor in the state of São Paulo, and CPFL Energia, the largest private energy generation and distribution group in Brazil. SGCC, as reported by Brazilian media, is considering investing USD 4 billion in the Brazilian energy distribution market⁶.

However, social movements and labor unions would certainly criticize the acquisition of Eletrobras' subsidiaries by foreign groups, as occurred with the demonstrations against mining company Vale do Rio Doce (currently Vale SA) in 1997, and the power distributor of the state of São Paulo Eletropaulo⁷ (currently AES Eletropaulo) in 1999.

Financing

There are two main sources of infrastructure financing for electricity and logistics projects in Brazil: (1) financing on the capital market through infrastructure debentures and (2) credit lines from the Brazilian National Bank for Economic and Social Development (BNDES).

The infrastructure debentures were created in 2010 as a way of providing financing for infrastructure investment projects to foreign investors. As part of the benefits, they are exempt from certain taxes, including corporate income tax and financial transactions tax. Moreover, BNDES is currently the largest financing partner for infrastructure and energy projects in Brazil. It provides corporate finance (company loans) and project finance (for a specific project and not the company).

In addition to companies controlled by Brazilian capital, foreign firms are also eligible to apply for BNDES financing, although partnerships with domestic companies helps to cut through red tape. In other words, the Ministry of Planning has eased the rules for participation of foreign companies in the Logistics Investment Program, eliminating the need for partnerships with local companies; however we believe that the BNDES still remains nationally biased when offering credit.

BNDES announced in March 2016 new rules and benefits for infrastructure debentures – for the second phase of the Logistics Investment Program. The new measures reduces the cost for financing by up to 2%. In addition, the interest rate for most of the financing provided by BNDES is 7.5% per year, almost half the rate of Brazil's government bonds, and still below the official inflation rate in 2015 (10.67%).

⁶ [Chinesa State Grid vai investir R\\$ 15 bi no Brasil em 5 anos](#) (2015). Exame Magazine.

⁷ The sale of both Vale do Rio Doce and Eletropaulo to the private sector in the 1990s took place in a political scenario of economic liberalization in Latin America and privatization of large national companies, which were significantly damaged by corruption, state bureaucracy and political interests. At that time, trade unions, left-wing parties and social movements organized dozens of demonstrations against the new economic and political moment, on the grounds that the government was selling the country's national symbols and its sovereignty to foreign groups. In addition, in the late 1990s, Brazil was also discussing the possible creation of the Free Trade Area of the Americas (FTAA) – which was never implemented – and economic policies to achieve a fiscal surplus, in the international scenario of the Asian financial crisis (1997) and the Russian bond default (1998). Amid this adverse landscape, the demonstrations were frequent and privatization was used as a key argument to expose the government.

On Speyside Corporate Relations

Speyside is a global developing, complex market public policy, and acute issue communications specialist, with a 25-year track record helping leading global companies and organizations with market entry, growth or turmoil management.

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A graduate in law from Cambridge University, who began his career in investment banking with Lazard, Stephen has since had over twenty five years' consulting experience, initially in financial PR and then in public affairs and crisis work. After a sabbatical in Syria in 2000 he got the travel bug and has since lived in emerging markets for over 15 years

Before joining Speyside in Brazil in 2015, Stephen was CEO, Indonesia and Head of Public Affairs, Southeast Asia for Edelman, the world's largest PR firm. While there, he launched a digital team whose products and services were focused on corporate and crisis issues. Prior to Edelman he ran the Eurasia region, and was EMEA head of public affairs, for another PR group, Grayling, living in Russia and then Turkey. Brazil is the seventh country he has lived in.

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Eduardo specializes in government relations and public-private partnerships, having worked in Brazilian government organizations at the local, state and federal levels. He also conducted policy analysis with international organizations such as the United Nations in New York City, the Organization of American States and research organizations in Washington D.C. (U.S. National Academies) and Finland (VTT Technology Center) before joining Speyside in 2014. At Speyside, Eduardo works with government relations, stakeholder engagement strategy and political, regulatory & economic intelligence.

ARTHUR GLUGOSKI, Consultant



Arthur has extensive experience in government affairs, commercial diplomacy and the internationalization of companies in Brazil. As government affairs consultant, he is responsible for analysis of policy and regulatory trends in several sectors (infrastructure, O&G, mining and defense); domestic and regional economic and political change.