Electricity Distribution Privatisation in an Uncertain Market

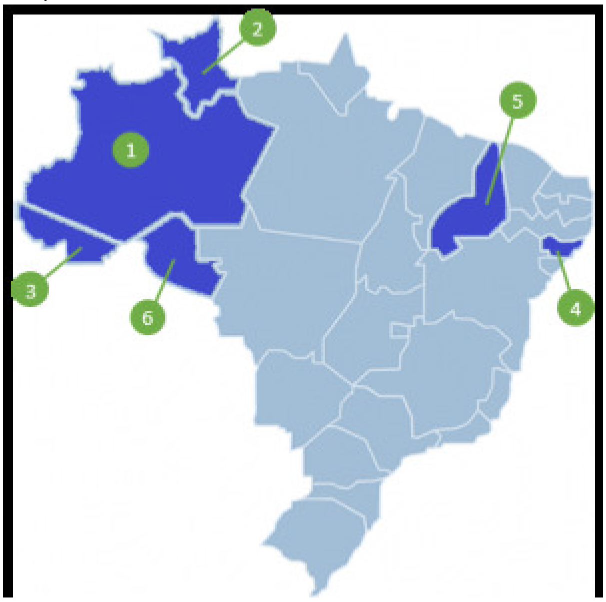
The current Government in Brazil has been making its way through privatization plans in the energy and other infrastructure sectors (water & sanitation, roads, ports, airports, oil and gas) since launching its investment partnership program (PPI) in September 2016.

Divestment of the government-owned electricity company – Electrobras – has been a main target of the PPI from the start, and as a part of this plan, several of its hydropower and distribution assets have been prioritized for sale.

An early success was the sale of distribution company Celg (Companhia Energética de Goiás) in central Brazil to the Italian energy company Enel in February 2017. Media reports indicate that Enel paid R $ 2,187 billion[1] for the company, split between the State government of Goiás and government-owned Electrobras.

Earlier this year the Government approved the privatization plan for six (6) Electrobras distribution companies in the North and North East of the country that serve over 4 million consumers (state and number of consumers as of 2017 shown in parentheses):

1. Amazonas Distribuidora de Energia (AmE) (Amazonas State) (966,5k)
2. Boa Vista Energia (Boa Vista) (Roraima State) (117,2k)
3. Companhia de Eletricidade do Acre (EletroAcre) (Acre State) (258,5k)
4. Companhia Energética de Alagoas (CEAL) (Alagoas State) (1.139k)
5. Companhia de Energia do Piauí (CEPISA) (Piaui State) (1.247k)
6. Centrais Elétricas de Rondônia CERON (Rondonia State) (558,5k)



This effort is being led by the Brazilian Development Bank (BDNES) which plans to launch the auction in early May 2018. A number of firms active in the market have already expressed interest and are following the process with BDNES and Eletrobras.

Opposition to the PPI has used the March 21 blackout that affected a large part of the company as evidence against further private participation in the sector. This blackout was caused by a major fault in a transmission line near the large Belo Monte hydropower station in the central state of Para, managed by Electrobras and China State Grid Corporation. The incident cut 22-25% of the total load, affecting 14 states and millions of people across the country. The hardest hit regions were in North and Northeast, where some municipalities were restored after only several hours (whereas full service was restored to Southern regions within 20 minutes). The causes of this fault are still under investigation, but it comes as a reminder of the unreliability of power supply in the North and Northeast. A few months earlier, 120,000 customers in Acre and Amazonas were subject to 10 days of rolling brownouts due to a fire in the engine room at a Electrobras-AC plant, managed by Guascor, on January 3 which knocked out over half of its generators.

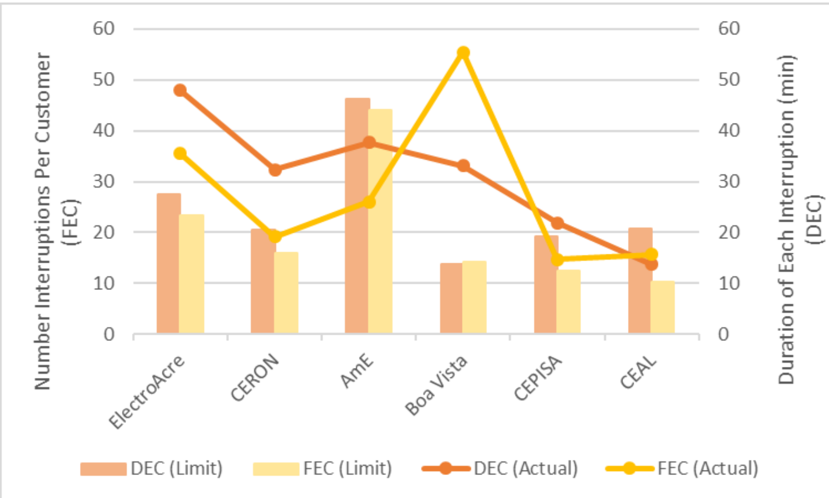
While neither of these incidents are the result of Eletrobras distribution company operations, both business performance and public perception are negatively affected by the inability to provide regular supply consumers due to upstream events.

Often in the lead-up to an imminent sale, firms release optimistic results to the market to raise investor interest. Eletrobras, however, has openly reported the declining performance of its distribution line slated for privatization. According to the results released 27 March 2018, 2017 performance shows a loss of R $ 4.179 billion[2] in the distribution segment, of which 55% is attributed to Amazonas Distribuição alone.

The Eletrobras holding company itself is scheduled for divestment at the end of the year. Consistent with the trend shown in distribution, the company thus reported a net loss of R $ 1.726 billion for 2017, which is a reversal from the net income of R $ 3.513 billion[3] shown for 2016. The sale of Celg and loss of related revenue is blamed for part of the 62% fall in EBTIDA from 2016. In addition, the parent company has assumed R $ 11.2 billion in debt from its distribution companies in order to facilitate their privatization. In contrast, Eletrobras reported an increase in revenue from both generation (+13.4%) and supply (+14%) activities in 2017.

The uncertainty generated by these divergent year-on-year results invariably narrows the pool of prospective investors to those who best know the market and are positioned to manage the risks inherent to a business highly affected by exogenous factors. Aside from capital injection and debt management that new investors bring, the Eletrobras distribution companies need turn-around management to reduce operational costs and losses, which are a further cause of poor financial performance. In most cases, service quality indicators exceed regulatory limits, as shown in Figure 2 for the frequency (FEC) and duration (DEC) of interruptions per year (for each customer in the respective distribution zones).

Figure 1 – Eletrobras Distribution Service Quality Indicators (2017)



The BNDES plan for the sale of Eletrobras distributors foresees a symbolic price for each company (around R $ 50 thousand ($12,5k USD)), plus an equity and investment plan for the concession. These investment plans are expected to range from R $ 240 million ($60 million USD) in the smallest companies (Boa Vista, ElectroAcre) up to R $ 720 million ($180 million USD) in the larger ones (CEPISA, CEAL). The Government estimates that among the six (6) the distribution companies, an immediate capital contribution of R $ 2,4 billion ($600 million USD) is needed to be achieved through the privatization. For the full first five (5) years of concession operations, BNDES expects the new owners will need to finance around R $7,8 billion ($1,95 billion USD) of investments and improvements to reach performance targets.

On-going opposition within the government has slowed the BNDES-led process and generated enough uncertainty about its potential for success that the sector regulator (ANEEL) has begun drafting a back-up plan to the BNDES transaction in which ANEEL would hold auctions to liquidate the companies. Both initiatives have the support of the Ministry of Mines and Energy, with the aim of ensuring that divestment takes place by the third quarter of 2018, if not before.

For further information please contact Joanne Dixon (jdixon@mrc-consultants.com).