

IMPACT STORIES

SNTA Supports a Water Utility in Brazil's Frontier Region



PPIAF's Sub-National Technical Assistance (SNTA) support to the Brazilian water utility DESO has helped to secure a BRL 18.9 million financing by substantially improving the company's ability to interact with financiers. SNTA provided technical assistance in 2010 to help DESO prepare financial projections and a credit memorandum on the company. By delivering this forward-looking analysis to the company and going through the process of discussing the impact of the key turnaround initiatives in future financials, the company has attracted more interest from commercial banks to refinance the company's BRL 40 million short- and medium-term debt.

As a result of SNTA support, a Brazilian water utility in a frontier region became ready to borrow on commercial terms and, through the financing obtained, gained efficiencies by reducing water losses and energy consumption.

The water company owned by the Brazilian state government of Sergipe ("DESO") had gone through several years of mismanagement when, in early 2007, the state government decided to hire professional managers to run the company. Although the results of the management change were starting to show, the company still did not have access to commercial sources or to local development finance institutions. DESO could not adequately demonstrate the impact of the financial and operational turnaround being implemented to the potential financiers. Furthermore, they did not have sufficient capacity or experience to prepare a forward-looking view that investors and financiers would normally request.

PPIAF SUPPORT

The state government of Sergipe thus sought assistance from the Public-Private Infrastructure Advisory Facility (PPIAF)'s SNTA program in 2010 to improve the company's ability to interact with potential financiers. PPIAF-SNTA quickly brought in a financial consultant to assist DESO in preparing financial projections and a credit memorandum on the company.

Only a handful of top tier public water utilities in Brazil have access to both commercial banking and capital markets. They have the capacity and experience to prepare information and conduct forward looking analysis to show their creditworthiness. The rest of the water utilities have much more limited capacity and experience in dealing with commercial banking and capital markets. Water utilities in the north and northeast of Brazil lag particularly behind, given the lower income client base and precarious financial situation, exacerbated by generally weak corporate governance and lack of well trained and skilled staff on financial assessments. Not all utilities are suited for private management, given the operating environment, including political sensitivity. In such a case, private financing of infrastructure may be a more effective way to introduce commercial orientation, better disclosure of financial operational information, medium-term planning, and even better corporate governance. To this effect, SNTA helped the Brazilian water utility DESO achieve the following objectives:

- Prepare the key financial and operational information, including historical and projected financial statements
- Assess and quantify the financial and operational impact of the proposed institutional development programs
- Compile other key information normally requested by commercial banks, including environmental and social practices, corporate governance, insurance policy, etc.
- Provide training to the companies' finance and planning teams on the use of financial assessments and projections

OUTCOMES

As a result of the PPIAF-SNTA support, the company was able to borrow on commercial terms. While the SNTA-funded activity primarily helped DESO access a BRL 18.9 million loan from the International Finance Corporation (IFC), it is expected that, as a result of this assistance, the utility will also have access to capital market instruments such as CCB (Brazilian medium-term bond), FIDC (securitization of receivables), and debentures, which require further disclosure and better corporate governance.

The appraisal revealed a company with qualified financial statements and a low operating cash flow, but improving at a fast pace. In addition, the team identified high quality collateral available to be pledged, which substantially reduced the credit risk for potential investors. The team mitigated credit risk with a pledge of receivables from water supply to one of the largest oil companies in the world (Petrobras) and receivables from sales to a diversified pool of customers. Each of these components was expected to exceed debt service by multiple times. The company also committed to

Since 1999 PPIAF, a multidonor technical assistance facility, has helped developing countries use public-private partnerships to improve their infrastructure. A key focus has been upstream technical assistance to support the development of an enabling environment for such partnerships.

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not increase indebtedness and undertook to implement a plan to eliminate all auditors' qualifications on the financial statements. To further improve the credit profile, IFC agreed to jointly approach local banks to form a syndicate to refinance DESO's short-term debt.

DONOR COORDINATION

This activity complements World Bank projects in the states of Sergipe, currently under preparation, and in Rio Grande do Norte, under execution, which address the states-wide water resources management issues as well as sector regulatory issues. Furthermore, the two projects mentioned above include components for expanding water supply and wastewater services.

IMPACTS

The BRL 18.9 million project—now financed—will reduce water losses that were approaching 50% and make customers more accountable for their water use, which are critical in a water scarce state, where water for the metropolitan area is brought from 100 kilometers away. In addition to saving part of the costs associated with pumping the water over long distances by reducing water losses, the volume saved will increase availability of water to the population, which has recently faced rationing periods.

A subsequent World Bank loan that will be complementary to the loan financed by the IFC is designed to finance complex and broad water sector institutional reforms at the state level and investments in water supply, sewerage expansion, irrigation improvements, and other initiatives with over 25 years of tenor and at a spread over LIBOR of less than one tenth of IFC's spread.

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