

# Ita: extending Brazilian debentures

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In March Brazilian hydroelectric project Ita Energetica became the first entity to successfully close an offering of domestic bonds featuring a put to development bank BNDES, in a groundbreaking deal that has extended tenors beyond the five year term typical in the Brazilian debenture market.

The offering was led by Unibanco, which underwrote the sale of Real168 million (\$81 million) worth of debentures, which are backed by revenues from the Ita hydro plant located in the south of the country. The offering was oversubscribed, and is likely to be the first in a series of put-bonds in support of Brazilian power projects.

A year ago BNDES invited a number of banks to structure a solution to take out a R\$700 million bridge loan which they had disbursed to the Ita project, explains Adhemar Kajita, director of project finance and privatisation at Unibanco in Sao Paulo. We worked together closely with BNDES, and the solution we came up with was to access the local capital markets.

The decision to tap the local capital markets came after a series of frustrating delays in trying to attract dollar financing. The original idea had been to split the Ita debt financing between BNDES and the Interamerican Development Bank (IDB), but the planned A and B loan proved difficult to close. This left BNDES with a bridge loan, and a need to look for alternative long term financing solutions.

Unibanco sounded out potential investors and, having established that the appetite was there, last November stepped up and fully underwrote the offering, making a firm commitment to Ita Energetica to raise the R\$168 million required, and capping the interest rate that they would have to pay.

Standard & Poor's gave the bonds a local rating of brBBB, while they were also rated by local agency Atlantic Rating.

Interest rates gradually were falling, and in March the deal was launched at a final price of IGPM plus 11.2% (approx 12.3%), having attracted heavy demand, and total bids of R\$380 million for a R\$168 million issue, mainly from asset managers and pension funds.

The interest rate compares favourably with borrowing in dollars, taking into account the high spreads that investors demand on Brazilian notes, as well as the cost of PRI cover.

The book building process was a public auction process, because BNDES wanted as many investors as possible to have access to the deal, explains Kajita. Unibanco was sole bookrunner on the deal.

The structure addressed the perennial problem that in emerging markets investors are rarely willing to buy long term assets, which makes their domestic capital markets unsuitable for project bonds. But by giving investors the right to put the bonds to BNDES during the third year the term is effectively broken into two parts. In addition the bonds start to amortise after the put date, so their average life is shorter than the 12 year overall term.

The put is European style, exercisable on a single date. This means that at the time of the put date investors will be looking at a bond with an average life of less than five years, which is the kind of maturity that institutional investors feel comfortable with.

Clearly the intention of BNDES is to keep the bonds in the market, rather than actually have to buy them back, but the put makes investors feel comfortable. However the credit risk is that of the project, not BNDES.

Projeto Ita is owned by Gerasul (acquired by Tractebel as the deal was being structured) together with steel maker CSN and cement maker Itambe. These three are also the power offtakers. Thus although the debentures are project bonds, in that they are backed by the PPA rather than having recourse to the sponsors, the sponsor group are also acting as the offtakers. These types of inter-connections between sponsors and offtakers are typically needed to get projects closed in Brazil at present.

The hydro plant is located in the south of Brazil in the state of Rio Grande do Sul. It has a total potential capacity of 1450MW. Work began on the project back in 1996, and the first unit came onstream in summer 2000. Thus the financing effort benefited from the fact that the project has already gone through its construction period, with the first turbines already producing power.

Kajita is optimistic about the development of the domestic capital markets as a funding solution for projects, and even sees the possibility of some deals getting done without a BNDES put. "It will be viable to structure some thermo plant financings with BNDES bridge financings, and after completion get funding from the capital markets on a seven year term with one year grace period," he says. Real denominated funding from the local capital markets would be highly attractive for thermo projects, which already face the challenge of the mismatch between dollar denominated gas prices and Real denominated revenues, a problem made more severe if project debt is in dollars too.

Brazilian institutional investors such as pension funds are increasingly looking for long term assets, and project bonds should be able to tap into a deepening market. Five year unsecured debenture deals are regularly oversubscribed, bought by pension funds, investment managers and banks, and there is market talk about Petrobras coming with a seven year unsecured domestic bond, which would represent another milestone in the development of the market.

In March a second offering of bonds featuring a BNDES put was also being launched, this time featuring another hydroelectric plant known as Machadinho. However on this occasion there was full recourse to the sponsors, with the bonds being issued at consortium level rather than by the project company itself. The Machadinho sponsors include top names such as Grupo Votorantim and Alcoa. This hydro plant located in the same region as Ita.

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### Ita Hydro

Status: Closed

Financing amount: \$81m debentures

Sole bookrunner: Unibarco

Sponsors: Gerasul, CSN, Itambe

Offtakers: The sponsors

Description: 1450MW Hydro Plant

Pricing: IGPM+11.2%

Term: > 12 years

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