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Power Company Stresses Its Commitment to Brazil

By TONY SMITH

SÃO PAULO, Brazil, April 10 — "Nobody invests $4 billion to change their mind later," read the advertisements in leading Brazilian newspapers. The ads are meant to deliver a clear message from the AES Corporation to its customers, the markets and the government.

Steven Clancy, center, president of Eletropaulo, Latin America's biggest power distributor and the AES Corporation's main Brazilian unit, says, "We're absolutely here to stay."

"We're absolutely here to stay," said Steven Clancy, president of Eletropaulo, Latin America's biggest power distributor and AES's main Brazilian unit.

That there should be any doubt about AES's commitment to Brazil may seem strange. The $4 billion that AES, based in Arlington, Va., has sunk into Brazil since 1996 makes it the largest private investor in the country's electric power industry. And AES gets a quarter of its worldwide revenue from Brazil, more than it gets from North America.

But since January, when AES defaulted on part of the $1.2 billion it borrowed in 1998 from Brazil's national development bank to buy Eletropaulo, there has been mounting speculation that the company is preparing to leave the country.

AES says that is not so — hence the ad campaign.

But if the company were to depart, analysts say, it could lead to an exodus by other foreign utilities, especially now that the new left-leaning government appears to be favoring the public sector over private investors in the industry.

Mr. Clancy said that for the moment he was concentrating on renegotiating AES's Brazilian debt with commercial banks, holders of the company's debentures, and BNDES, the state development bank.

He must also strive to cut costs and improve a sagging cash flow, while keeping customers happy and persuading shareholders around the globe that the Brazilian operation is worth keeping.

None of these tasks will be easy. AES lost $2.77 billion in the fourth quarter of 2002, mainly because of failed investments overseas, and it has sold off units scattered from California to the Middle East to raise cash and reduce the likelihood of any more defaults in Brazil.

Talks with BNDES over the company's obligations were already difficult last year; since the Workers' Party government was sworn in Jan. 1, they have all but stalled completely. The new administration named left-leaning executives with a nationalist penchant to run BNDES, and the bank has hardened its negotiating line, saying AES must repay all its creditors or hand Eletropaulo back to the state.

"The only deal we'll do with AES is one in which they pay their debt," Darc Costa, the bank's No. 2 executive, said in a recent interview. "Either they pay cash or they pay in assets. But they have to pay."

On a recent trip to Brasília, the United States assistant secretary of commerce, William Lash, fired back, saying that AES could not pay because it was itself owed more than $300 million by local governments.

But analysts said that hard words and brinkmanship on both sides could damage the negotiating atmosphere beyond repair.

"I have a feeling it could be tough for AES to keep hold of Eletropaulo," said Armando Franco, energy analyst at Tendências, a consulting firm based in São Paulo. "These negotiations are not going on in heaven. There are no angels on either side."

According to one Eletropaulo executive, Mr. Clancy is adopting a more diplomatic approach in Brazil than AES representatives have in the past. Mr. Clancy arrived in São Paulo last September and formally took over as president in February.

"Previously, there was sometimes a `Me Tarzan, you Cheetah' approach," said the executive, who spoke on condition of anonymity. "But up a tree in Brazil, very often Cheetah turns out to be more agile than Tarzan."

Mr. Clancy, striking a conciliatory tone, seemed confident that he could reach a deal with BNDES. "Whenever you're in negotiations with someone with whom you have a $1 billion debt and you're not paying, it's bound to be strained," he said. "There's no easy solution for either side. But I'm optimistic we could have something by the end of May."

Mr. Clancy laid the blame for AES's default — two missed payments totaling more than $400 million — on "a perfect storm" of negative factors that have plunged nearly all of Brazil's privatized utilities into crises, and have transformed AES into "a poster child for the energy sector's woes."

There is no doubt that the whole sector is hurting. Electricité de France had to inject $1 billion of fresh capital last year into Light, the debt-ridden power distributor in Rio de Janeiro. The PPL Corporation wrote off its entire $317 million investment in a controlling stake in Cemar, a Brazilian utility that filed for bankruptcy protection early this year. Enersis, the Latin American investment arm of Spain's Endesa, recently refinanced $2.3 billion of its debt because of the economic crises in Brazil and Argentina.

"Nobody is in great shape," said Claudio Sales, head of the Brazilian Chamber of Investors in Electricity.

Mr. Sales said that all of Brazil's privatized utilities were suffering from three main problems.

First, years of drought and a lack of investment culminated in a nationwide energy crisis in 2001. Facing blackouts and rationing, Brazilians slashed consumption by 20 percent or more, and demand has not rebounded.

Second is the fall in the value of the Brazilian currency, the real, which has fallen by almost 60 percent against the dollar since 1998, eroding the value of the utilities' assets while making their dollar-denominated debts harder to repay.

Third, regulation of the industry appears to be in flux under the new government, which has publicly wondered whether Brazil may have become too dependent on foreign companies for its energy.

Elected on promises to improve the lot of millions of poor Brazilians, the government so far has frowned on utilities' requests to raise prices, one way of replacing lost revenue.

This week, the mines and energy minister, Dilma Rousseff, said she was effectively altering the distributors' contracts, putting off for a year the reimbursements that they get for costs like exchange rate fluctuations. The decree could cost the sector $480 million to $650 million this year, analysts said.

For Eletropaulo, these factors have added up to disaster. The 2001 power crisis cut its revenue by $450 million, and consumers used less power last year than in 2001 even though rationing had ended, leaving the company with a $260 million loss for the year. Ms. Rousseff's decree this week could cost it another $145 million, analysts said.

With AES's $4 billion investment so far having returned only $310 million in profit, and Brazil's regulatory environment still unclear, AES's chief executive, Paul Hanrahan, said last fall that he would sink no more fresh money into the country.

The departure of PPL, and of Reliant Energy before it, "make you wonder if there won't be others leaving soon," Mr. Clancy said then.

That is why all eyes here are on AES.

"AES is definitely a barometer for the sector," Mr. Franco of Tendências said this week. "If they have to hand the keys to Eletropaulo back to the government, there will be a line of other investors waiting to do the same, and the Brazilian state will end up with a herd of white elephants."

That is basically what Brazil had before its privatization program began. Electricity rates were low, but only because the monolithic federal utility, Eletrobras, was subsidized with tax money.

Privatization was supposed to solve that problem, but the market-friendly former president, Fernando Henrique Cardoso, managed to sell only part of the system in his eight-year tenure, mainly distribution companies; 80 percent of the country's generating capacity stayed in state hands, effectively stifling competition among the distributors.

Now, instead of selling off more of the power industry to promote competition, the new government says it wants to take back more control of the market.

Analysts said that Ms. Rousseff's decree this week was meant to divert cash from the private sector to strengthen the state-owned generating companies so that they can finance new capacity.

But the Brazilian state is too short of cash to be able to afford renationalizing the energy industry, and analysts expect the government to eventually settle for a mix of state and private utilities.

"They're there looking in the top hat for a rabbit," Mr. Franco said. "But I still hope they'll end up opting for the private way out."