

Fitch Sees Bright Future for Water and Sewage Companies in Brazil

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According to Fitch Ratings, which has just released a special report entitled "Brazilian Water Utilities: Companies Ready to Invest," fundamentals for the Brazilian water utility sector are positive and are poised to remain so over the next few years.

Substantial improvements in credit quality, says Fitch, have put the country's largest water utilities in a better position to expand capacity and enhance their services.

In addition, the introduction of a regulatory framework for the industry has reduced sector risk by establishing important rules for sanitation services and requiring the signing of concession contracts between operators and municipalities served.

"Economies of scale are fundamental to improving the profitability of this business," said Mauro Storino, a Fitch analyst and the lead author of the report. "Over the past five years, the number of customers supplied with water and sewage collection has clearly increased, leading to strong net revenue and EBITDA growth."

In addition, the eight basic sanitation operators featured in the report benefited from the appreciation of the Brazilian currency, the real, from 2003 to 2007, as the latter resulted in a significant decline in the companies' debt in US dollars.

Investment in the sector has thus far been limited. However, low risk combined with a lack of universal access to water supply and sewage collection services make business expansion in this sector attractive and necessary.

With water supply and sewage collection services currently reaching only 75% and 47%, respectively, of all residences, and with only 20% of the sewage currently being treated, companies are seeking to expand their coverage, requiring large-scale investments.

According to Ricardo Carvalho, Senior Director at Fitch, "strong financial profiles with low to moderate financial leverage at the water utilities should allow for higher debt levels to fund a portion of these capital investments without significantly jeopardizing the companies' payment capacity."

With the sector often unable to recover its high levels of investment with the rate charged or requiring a very long time period to earn a return, the existence of long-term funding sources at low cost is essential to prevent a weakening in these companies' credit profiles. Thus, sector investment within the Government's Accelerated Growth Program (PAC), partly financed by the Brazilian national development bank, appears to meet these criteria.

