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FOREWORD

BRAZIL ROUNDTABLE

The importance of Brazil to South America and the wider world is undeniable. It is home to around half the continent's population, covers half its geography and contributes about half its GDP. It wields huge political and economic power in the region, while the proportion of the Amazon rain forest in its territory means it plays a global role in realising the world's climate change ambitions.

Its political history has been volatile, with frequent allegations of corruption against its leaders. And, over the last 20 years, leadership has swung between both ends of the political spectrum. The extent of political polarisation is, perhaps, exemplified by the recent elections, which pitched left-wing former president Lula da Silva against the right-wing incumbent, Jair Bolsonaro.

It was against this backdrop that IFR, in partnership with Scotiabank, Global Banking and Markets, held its latest LatAm investor webinars. Moderated by Keith Mullin of KM Capital Markets, the webinar brought together a panel from across Brazil's financial and commercial spectrum to discuss the economy, capital markets and sustainability.

ROUNDTABLE PARTICIPANTS

Bianca Nasser

CFO and head of IR, Votorantim Cimentos

Bianca Nasser has been global CFO and investor relations officer for Votorantim Cimentos since March. She was previously CFO and investor relations officer at development bank BNDES responsible for finance, accounting, tax, investor relations and the office of the controller, and worked for Petrobras from 2002 to 2019, latterly as executive manager of corporate finance and treasury. She has a bachelor's degree in economics from UFRJ, the Federal University of Rio de Janeiro, and a master's degree in business administration and finance from PUC-Rio.

Marcos Assumpcao

Director of corporate finance, Suzano

Marcos Assumpcao is corporate finance director of Suzano responsible for the treasury, M&A, credit and insurance departments. He has worked as head of equity research at Itau BBA, specialising in steel and mining and paper and pulp industries and worked for four years at Merrill Lynch. He graduated from Federal University of Brasilia (UnB) and holds an MBA of COPPEAD from UFRJ.

Otavio Ladeira de Medeiros

National Treasury undersecretary, Public Debt Office, Ministry of Finance

Otavio Ladeira de Medeiros is undersecretary at Brazil's National Treasury responsible for the Public Debt Office, a position he took on in May 2021. From June 2016, he was deputy treasury secretary, national treasury secretary between December 2015 and May 2016, and undersecretary of planning and fiscal statistics from April to November 2015.

He has also represented the government on the boards and fiscal councils of public and private companies and was a consultant to the World Bank and the IMF between 2007 and 2014.

Paulo A C Bernardo

CEO and country head, Scotiabank Brazil

Paulo Bernardo leads Scotiabank's corporate banking operation in Brazil with clients in the energy, power, infrastructure and mining. He joined Scotiabank in 2011 as a managing director responsible for developing the corporate banking business in Brazil and worked at another multinational financial services group overseeing client coverage, business planning, strategy and marketing in corporate banking. He has a business degree from the Catholic University in Sao Paulo and an MBA from University of Sao Paulo.

Keith Mullin

Director and founder, KM Capital Markets (moderator)

Keith Mullin is founder and director of KM Capital Markets, a media and thought-leadership consultancy and adviser for banking, capital markets, sustainable finance, financial regulation and related topics. Before setting up KM Capital Markets in 2018, Mullin spent more than 30 years in specialist banking media and related fields, latterly in the thought-leadership group of the capital markets insights group of Thomson Reuters, now Refinitiv. He was previously editor-in-chief of the company's capital markets publishing group, which includes IFR.

PANDEMIC PERFORMANCE

Like the rest of the world, Brazil was severely impacted by Covid-19. A questionable governmental response to the pandemic resulted in the country recording some of the world's highest death tolls, while the economy experienced a severe contraction in gross domestic product due to the combination of falling external and internal demand and a precipitous drop in commodity prices.

Along with its global peers, the Brazilian government moved to mitigate the consequences of Covid with fiscal and monetary policy.

"The Brazilian government spent US$120bn, more than 80% of its GDP, to face the social and economic impact of the pandemic," said Otavio Ladeira de Medeiros, undersecretary at the National Treasury, with responsibility for Brazil's public debt.

Taking those measures when the economy was moving into recession resulted in the country's debt-to-GDP ratio "increasing from 75% to almost 89%, the highest annual rise in our country's history", according to de Medeiros.

That trend had reversed by 2021, with government expenditure and borrowing returning to pre-pandemic levels. "Last year we delivered the first surplus since 2014, and our debt to GDP fell to almost 80%," said de Medeiros. "We will probably deliver a positive result again this year, reducing debt to GDP to maybe 75%."

Inflation, on the other hand, began to escalate as the country emerged from the first wave of the pandemic. The cost of living, which had been increasing by less than 4% per year between 2017 to 2020, began to pick up sharply from 2021, reaching more than 12% in April this year and forcing the central bank into one of the world's most aggressive rate-hiking exercises.

In September, the Banco Central do Brasil signalled an end its aggressive interest rate stance, keeping the Selic rate – the country's primary instrument of monetary policy – steady at 13.75%. Brazil's inflation rate eased below 8.75% in August, the first time it had fallen to single figures for a year.

"We are reaping the benefits [of our interest rate policy] and it looks like inflation is moving back towards 6.5% in 2022 – according to market expectation – and 5% in 2023," said de Medeiros. "Our target is 3% for 2024."

With international reserves of around US$360bn, de Medeiros said the country's external position was "very comfortable", which is how he also described the levels of foreign direct investment.

"For the last decade FDI has been sufficient to finance our deficit," he said. "In 2022, for example, FDI is projected at US$60bn while the deficit is expected at US$20bn." He expects similarly strong flows of FDI in future.

There was also a notable rebound in the strength of the economy. From a pandemic-induced 4% contraction during 2020, GDP grew by 4.6% in 2021, moving back to pre-pandemic levels of expansion. The economy is forecast to grow at 2%–2.5% in 2022.

CORPORATE FOCUS

Throughout the pandemic-related volatility in domestic and international markets, large Brazilian corporates continued to target growth. They continue to do so, according to Paulo Bernardo, CEO and country head of Scotiabank, Brazil, but the central bank's aggressive monetary stance has left them more cautious when allocating capital.

Despite the challenges, some sectors of the economy continue to post good results and remain well placed to take advantage of any rebound.

"Even during the pandemic and the international crisis, the cement industry actually increased sales," said Bianca Nasser, CFO and head of IR at Votorantim Cimentos. Increased sales contributed to Votorantim's cash position and the company's conservative balance sheet management helped it through a period of uncertain economic and financial conditions. Votorantim favoured liquidity.

“Keeping liquid enabled us to deal with the challenges of recent years and that policy is helping us maintain a positive outlook for the next few years”

Bianca Nasser,
CFO and head of IR, Votorantim Cimentos

“Now we are facing a different kind of challenge,” said Nasser. “Higher inflation and a potential economic slowdown will really affect the cement industry. The challenge is how to maintain our current level of sales, and even increase them.”

Margins are under pressure, but the company still managed to pass on some of the higher input costs to customers. And, although the company remains cautious, it is in a good position to maintain capex levels and start enough projects to keep growing.

“Keeping liquid enabled us to deal with the challenges of recent years and that policy is helping us maintain a positive outlook for the next few years,” she said.

Higher cost inflation is also an issue for Suzano Papel e Celulose – but maybe not as significant an issue for Suzano than for its competition in the global pulp and paper industry. Suzano is the lowest cost pulp and paper producer in the world, according to Marcos Assumpcao, director of corporate finance. “At the end of the day our cost advantage has actually increased through this difficult period,” he said.

As with Votorantim, Suzano has benefitted from maintaining strong liquidity. That financial discipline has resulted in the company registering its lowest level of leverage since its merger with Fibria.

“The cash position of the company is at the highest level since the merger,” said Assumpcao. “And our Ebitda last year was the strongest ever.”

A comfortable cash position has this year enabled the company to pay dividends, instigate a buyback programme and support capex deployment at the highest levels in Suzano’s history.

It is an impressive performance in such volatile conditions. But, as Bernardo explained, corporate Brazil’s vitality in the face of a difficult economic and monetary environment is not such a surprise given the country’s track record.

“Brazilian corporations, and the Treasury, have been living with inflation for around 50 years,” he said. “We have a culture of managing this dynamic. Brazilian corporations and their executives have become very flexible and very effective in tackling the very challenging scenarios around inflation.”

CAPITAL MARKETS DISCIPLINE

A similar level of corporate discipline is also apparent in the capital markets. Suzano, which approaches the market in a discerning manner, has no urgent need to raise fresh debt.

“The company has done well in terms of bringing on liquidity over the last year when rates were benign,” said Assumpcao. “Our selective methodology enabled us to fix our interest exposure at attractive levels and manage our average debt maturity.”

It is a similar situation at Votorantim. The company has been financing its needs based on cashflow generation and the liquidity accumulated in recent years. Nevertheless, lower operational results over the past year have temporarily affected leverage.

“Our leverage levels used to be around 1.5,” said Nasser. “We’ve seen a slight increase to 1.9 but, based on expectations for the second half of the year, we expect to get it back to 1.5 by the end of the year.”

Throughout the recent volatility, Votorantim’s investment-grade rating has been important in keeping the firm’s funding options open when raising debt, in either the bond or bank markets. Indeed, access to the local currency bond market provided an opportunity to conduct a buyback operation of one of its long-dated bonds with a maturity to 2041 as part of its overall liability management strategy.

“We used the local market to finance this buyback rather than as a means of raising new funds,” said Nasser.

Liquidity in the domestic market has also been important at a sovereign level during a time when sovereign bond yields in international markets have been rising. Borrowing levels for sovereign issuers have come under pressure as central banks around the world tighten monetary policy. And cautious investors are demanding wider spreads across the credit spectrum from anyone looking to borrow in US dollars – particularly from emerging markets.

“We are in a very particular situation where 95% of our debt is held by Brazilians in our own currency,” said de Medeiros. “What we observe in the international markets does not really constrain our financing strategy – at least for 2022 and 2023. In fact, as the central bank comes to the end of its tightening cycle, we’re seeing the return of foreign investors into local markets.”

Hopes of interest rates peaking soon is not only attracting foreign investors to the Brazilian debt markets but is also encouraging domestic investors to move out the yield curve into long-dated, fixed-interest securities.

An increasingly benign local currency market does not mean we won’t see Brazil in the international markets again, however. Hard currency bond markets are still open for a country like Brazil that follows a strategic approach to its visits to the international debt arena and thereby offers investors some rarity value.

“We are not a regular issuer,” said de Medeiros. “We just issue in very specific windows to create benchmarks at points of our yield curve, usually 10 and 30 years. Those points of reference help Brazil’s big companies issue bonds.”

Well-rated Brazilian borrowers have access to different pots of investor liquidity, not only international markets but at home.

“The local market has been quite active at the current high levels of interest rates,” said Assumpcao. “Investors are moving from the equity capital markets to debt capital markets, and there is a lot of local currency liquidity for the best names."

Borrowing domestically also avoids exposure to the foreign currency risk from tapping international markets, which is particularly important in such volatile times. But when the scenario improves, "Brazilian companies will go back to the international market where they can find very large pools of liquidity and investors willing to lend at longer terms than are available in the local markets", said Bernardo.

Volatility in international debt markets is keenly monitored by Suzano which, as a pure exporter, looks to fund itself almost entirely in dollars. But in a situation where US interest rates are moving higher and credit spreads wider, the borrower has looked to diversify its funding sources.

"We've looked at a variety of possibilities, including the local market," said Assumpcao. "We have just closed a small transaction on a financial leasing at a very, very competitive cost. But we also looked at ECAs, agency debt, and other sources because when the bond market has become more expensive, we look for alternatives. The local market is an alternative, but investment pools are not as large as internationally."

SUSTAINABILITY IMPACT

The topic of sustainability and of financing the transition to a carbon-free world are constant themes of conversation for policymakers, investors, borrowers, bankers and the public. Brazil plays a hugely important role in that transition.

Neighbouring countries have been quick to take advantage of developments in sustainable finance, with Chile already issuing in a variety of structures including sustainability-linked bonds. Brazil has not yet joined the ranks of sovereign borrowers issuing bonds targeting environmental, social and governance concerns although some of the country's corporates and financial institutions have launched such deals in the domestic and international currencies.

BRAZIL IS CONSIDERING ITS OPTIONS.

"We haven't issued ESG bonds yet," said de Medeiros. "We are working with the World Bank and the Inter-American Development Bank to build a robust sustainable framework for Brazil. We think we can make a start with a 'use-of-proceeds' bond as that structure fits our requirements better at the moment."

A sustainability framework needs to allow for continuity, and continuity is something very important for Brazil because it plans to make sustainable finance mainstream to its funding opportunities, not just a collateral consideration.

"Germany's experience in this market is very interesting because it created twin bond structures," said de Medeiros. Germany issues two lines of government debt, green and conventional, that are fungible in coupon and maturity. It has led to the development of two yield curves that reflect the premium for issuing green bonds, or greenium.

"This is something very interesting for us," said de Medeiros. "We are planning for the medium term, not the short term, and we need to start with the perception of continuity, not something lateral to the main strategy. We need to be very cautious and very effective when we start this exercise.

"For strategic reasons, 2023 may be the best moment to start issuing this kind of bond," he said.

Suzano's Assumpcao said that ESG and green instruments will be increasingly important "for companies like us that believe that sustainability is integral to the business". Suzano, which has issued various ESG-labelled products, already benefits from the greenium in the current market – by as much as 15bp–20bp in some cases. He sees the benefit in cost of funds as compensating for the additional effort companies need to hit the targets they commit to.

"We have nearly 40% of our debt coming from sustainable instruments," said Assumpcao. "In the future I expect us to have even more."

For Votorantim, the climate agenda and the company's commitment to it is obligatory. It defines the company's strategic plan to reduce CO2 emissions and aligns progress to the commitments of its peers in the concrete sector in reaching net-zero emissions by 2050.

Although Votorantim has yet to issue ESG bonds, it includes different KPIs in financial contracts to show its level of commitment to the agenda.

POLITICAL FUTURE

Throughout the webinar, the country's political situation and elections were never far away from the discussion. The election result could have major implications on Brazil's growth trajectory and corporate Brazil's balance sheet.

"The ideal scenario would be for a government that would dedicate its efforts to conduct important reforms. Reforms that enable the country to grow, to modernise its economy, and to incentivise companies to continue investing and grow; reforms that are also attractive to foreign investors," said Bernardo, who highlighted tax reform as being one of the important drivers for growth.

De Medeiros agreed that reforming a complicated tax system is important but acknowledged that, despite a consensus that reform is needed, the conversation becomes complex when it involves federal government, states and municipalities.

"Maybe we can address small parts of the tax structure rather than reformulate the whole process," he said.

He also warned against structural changes to the fiscal framework.

"The fiscal framework has been responsible for keeping our expenditure at under 20% of GDP for a long period of time," he said. "We don't want to see the size of the state increase or government expenditure expanding."

Assumpcao also said fiscal discipline was crucial in generating investor confidence in the economy, maintaining lower interest rates and enabling higher GDP growth.

"What is important is a stable scenario that promotes investment," said Bernardo. "Depending on the new government and new measures, we expect clients to continue investing and we are here to support them." ■