
BRAZIL BUSINESS BRIEF

APRIL 2019

NEWS FROM THE BRAZILIAN CHAMBER
OF COMMERCE IN GREAT BRITAIN



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BRAZIL ECONOMIC DATA

EDITORIAL



SÉRGIO GULLO

sergio.gullo@brazilianchamber.org.uk

MESSAGE FROM THE CHAIRMAN

Dear Members,

"If you build a great experience, customers tell each other about that. Word of mouth is very powerful."

Jeff Bezos
Founder-Chairman-CEO, Amazon

That quote connects the Brazilian Chamber of Commerce to our members. As a membership organisation we work diligently to raise the profile of our members and their businesses. We are grateful for your membership and for your partnership. Together we are united around a single purpose – to promote bilateral business between Brazil and the UK.

In this issue we address some topics that are very relevant to the Brazilian Chamber's agenda in 2019 – including fundraising for medium-sized Brazilian companies, with Rogerio Buso

from Majoris offering detailed guidelines about how business owners can access various sources of funding.

With Brazil having a new government and the UK seemingly heading towards some form of new relationship with the EU (although Brexit is still not resolved at the time of writing), new opportunities are bound to arise in the relations between Brazil and UK. In our interview with Simon Wood, the British consul general in Rio de Janeiro, he explains how the Prosperity Fund works and highlights the UK's initiatives in areas where they have been very active, such as sustainable investments in mitigating climate change. In Brazil there are also opportunities for British investors in arbitration and mediation, an area covered in this issue by Lenora de Faria and Luís Peretti.

Ileda Gomes, one of our counsellors, has written an article about issues currently facing the boards of public companies. When it comes to subjects

like CEO succession planning and recruiting new board members, gender diversity and new skills such as digital/cyber are very much on the agenda.

And with the oil and gas sector in Brazil also offering investment opportunities for British companies, our interview with Adriano Pires Rodrigues, founding partner and director of the Centro Brasileiro de Infraestrutura (CBIE), provides an overview of the sector since the late 1990s and the end of Petrobras's monopoly.

We hope you enjoy this edition and look forward to seeing you soon at one of our events.

Yours sincerely,

Sérgio Gullo
Chairman
Brazilian Chamber of Commerce in Great Britain.

ARTICLES

ISSUES FACING THE BOARDS OF PUBLIC COMPANIES

BY IEDA GOMES



A recent survey of board members of American companies listed on the stock exchange, carried out by Corporate Board Member in partnership with Grant Thornton, revealed some interesting developments in perceptions of the main issues needing to be discussed.

In 2013, respondents said that the most pressing issues for the boards

of public companies were long-term strategic planning, acquisitions and mergers, CEO succession, global strategy and digital strategy. In 2019, disruptive technologies and innovation top the list, followed by growth strategy, digital security, CEO succession, and opportunities for acquisitions and mergers.

The latest survey also reveals the view that the main issues that boards

should seek external advice about are digital security, disruptive innovations and succession planning. These topics assume great importance given the fact that the CEOs of most listed companies lack experience in the first two areas, hence the need for boards to recruit younger members who do have experience in digital security and digital innovation, artificial intelligence, and connectivity.

As for CEO succession planning, the issue of diversity is considered very important, as is the role of the chairperson in encouraging effective input from board members, creating an inventory of board members' specific competencies, and deciding which skills should be sought externally.

When it comes to recruiting new board members, the survey found that the factors considered most important are industry experience, expertise in finance, gender diversity, digital/cyber expertise, and experience as a CEO. Although it might be possible to find a candidate possessing all those qualities, the preference for previous experience as a CEO still presents an obstacle for women because most CEO positions in American companies, as in the rest of the world, are occupied by men.

Listed companies have been under considerable pressure from investors, regulators and other stakeholders to improve diversity on their boards. A recent study by the McKinsey consulting firm points out that diversity and inclusion provide competitive advantages, particularly when it comes to a company's expansion into new markets.

A particularly effective form of pressure has been the recommendations from institutional investors and so-called proxy advisers, which guide the voting of institutional shareholders at companies' general meetings. Both ISS (Institutional Shareholder Services) and Glass Lewis have recommended voting against the election of chairs and nominating committee members in companies without female representation on their boards, while institutional investors have expressed the expectation that boards should have at least two female members.

In Brazil, the business landscape is still dominated by companies with state or family control, but the issue of gender diversity is gaining prominence as more women are recruited to boards – particularly women who have expertise in the areas of finance and compliance along with previous experience at executive level. ●

WHEN IT COMES TO RECRUITING NEW BOARD MEMBERS, THE SURVEY FOUND THAT THE FACTORS CONSIDERED MOST IMPORTANT ARE INDUSTRY EXPERIENCE, EXPERTISE IN FINANCE, GENDER DIVERSITY, DIGITAL/ CYBER EXPERTISE, AND EXPERIENCE AS A CEO

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THE FUNDRAISING ISSUE FOR MEDIUM-SIZED BRAZILIAN COMPANIES

BY ROGERIO BUSO



This article will argue that medium-sized Brazilian companies urgently need to adopt a technical approach to support their fundraising actions and efforts.

Successful medium-sized companies experience vigorous growth in their first life cycle. The priority during this phase is expansion: they want to acquire new customers, close sales, deliver goods and services, and

then afterwards they might stop to see how it all looks. That is what happens in practice.

As a side effect, profitability and administration work are often neglected. Business processes, internal controls, corporate governance and finance are often compromised. This situation is of course undesirable, but it is a business reality and there is no reason to blame management.

The company will then need to

prepare itself in order to assure that its future growth will take place in a safe, profitable and sustainable way. Accordingly, it will pursue the internal reorganisation of many business and administration processes and functions.

Now let us focus on the company's financial side and its relationship with its capital providers.

First, let us recognise that as a result of past decisions, the chances

are that the debt structure is unbalanced. In addition to that, the company will need to address its future capital requirements.

Unlike some other reorganisation efforts, financial restructuring and decisions are only possible by taking into consideration external parties, namely creditors and investors.

That is why there is absolutely no room for guesswork. You will need to sit at the table with some well-prepared and financially skilled professionals and you will need to do your homework. In addition to that, medium-sized companies in Brazil are faced with a shortage of credit sources due to the small number of commercial banks, so the more technical you are the better.

But after all, what are the guidelines for a successful fundraising negotiation?

Well, be prepared to answer four questions in advance:

1. How much money does your business need?
2. How much of it will be in the form of capital and how much in the form of debt?
3. What is the required debt repayment schedule?
4. How fast can your company return the investors' capital?

UNLIKE SOME OTHER REORGANISATION EFFORTS, FINANCIAL RESTRUCTURING AND DECISIONS ARE ONLY POSSIBLE BY TAKING INTO CONSIDERATION EXTERNAL PARTIES, NAMELY CREDITORS AND INVESTORS

All the answers have to be grounded in sound financial projections as outlined below.

FIRST STEP

Estimate future sales activity, which means the quantity of your good or service you expect to sell and the price customers will pay.

That does not mean just seeing how your business is doing at the moment and then using a simplistic model based on three possible scenarios – pessimistic, conservative and opti-

mistic. On the contrary, it involves an assessment of the company's strategy and competitive advantage, its business model, and the future trends in the sector in which it operates.

This is the hardest part of the process because it involves the uncertainty of the future; it involves risk assessment. This discussion leads to questions about the most fundamental and conceptual aspects of the company – its very essence. You could see it as an exercise in corporate self-awareness.

All future growth rates and margins should be firmly grounded in an analysis of the company's strategy and competitive position.

In recent decades academia has produced several frameworks to facilitate this analysis, and the methodology that has best withstood the test of time is that of the Harvard Business School, specifically the work developed and led by Michael Porter.

SECOND STEP

In order to support the company's level of activity, estimate the investment amount in fixed and intangible assets and also in working capital. Also estimate the operating costs, i.e. the profit margins over the years.

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THIRD STEP

Define the capital structure. The volume of third-party capital compared to the volume of equity should be considered very carefully and evaluated in the light of the trinomial return to the shareholder, financial risk (liquidity) and tax benefit. The higher the debt, the higher the return to the shareholder and the tax benefit. But this comes at the expense of increased financial risk because debt means fixed costs.

FOURTH STEP

Now that you have sales projections, operating costs, financial expenses (a consequence of the capital structure) and the level of investments in fixed assets and working capital, you can project the free cash flow ('FCF') over the years.

FIFTH STEP

FCF measures the cash available to the capital providers, namely the creditors and investors. Within a certain time frame it dictates how much capital a company can raise and how quickly the company can repay its debt and pay dividends, which are exactly the answers you need to have.

All these steps are taken within the

company's financial model, which must be accomplished by qualitative assessments concerning the business and the management. As part of this work a special section should carry out a detailed analysis of the risks involved.

When all these steps are complete, you can sit at that table.

This article began by stating the urgent need for medium-sized Brazilian companies to change their approach to fundraising. If Brazil really is to experience an economic recovery, companies need to raise money now so that they will be prepared to operate in that growth environment. That is why we argue that companies need to be comfortable in negotiating with their potential capital providers. You have to do your homework, and the sooner the better. ●

THE SUCCESS OF BRAZIL'S ADR MARKET: OPPORTUNITIES FOR BRITISH INVESTORS

BY LENORA HAGE SANTOS BENTO DE FARIA & LUÍS ALBERTO SALTON PERETTI

For centuries, the absence of a reference meridian that would make it possible to ascertain the exact time led navigators to grapple with the calculation of longitudes. In 1714 the British parliament offered "longitude rewards" as an incentive for the invention of a means of telling the right time at sea and therefore precisely determining a ship's position. Several inventors were acknowledged for their contributions. And over the following centuries, telegraph cables extended Greenwich Mean Time to the world.

Like seafaring, international business is also unbound by national borders. The dynamic nature of international transactions requires a safe harbour that allows overseas investors to plot a course and reach their destination. Over the years, so-called alternative dispute resolution (ADR) methods, such as arbitration and mediation, have played this role and became as universal as Greenwich Mean Time in guiding international contracts, as ADRs evolved into indispensable tools for promoting certainty and neutrality in support of investments and trade overseas.

Businesses enter into contracts in



order to organise their ventures and in so doing place their trust in their partners' proper conduct. But if things do not go according to plan, businesses need a reliable tool that will enable such contracts to be enforced. This is what arbitration offers: the availability of a private, neutral and specialised adjudicator whose decision must be enforced as a local judgment in any of the 159 countries that adhered to the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, which is one of the most widely used international treaties worldwide and has been ratified both by Brazil and the United Kingdom. Mediation allows the parties to reach out and resolve their disputes amicably and to attain mutually ben-

eficial results. From this perspective, the use of ADRs facilitates the resolution of potential disputes and bolsters cross-border transactions by promoting the element of trust, minimising transactional costs, and maximising the net benefit of globalised trade in an ever-more-connected world.

ADR's have therefore become vital for international trade and have been incorporated into the public policy of every developing country aspiring to receive foreign investment. The increasing demand for tailor-made ADR procedures gave rise to a global phenomenon: the creation and development of regional institutions dedicated to ADR and ADR-related services. This is precisely the role the Chamber of Conciliation, Mediation

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and Arbitration Ciesp/Fiesp (Chamber Ciesp/Fiesp) has played since its inception. The Chamber was founded exactly one year before the enactment of the Brazilian Arbitration Act (Law 9.307/1996), at a point in the history of Brazil when ADRs were virtually unknown, widely distrusted and underutilised to say the least. While consolidating itself one of the champions of Brazilian ADR, the Chamber contributed decisively to the development of a solid body of rules and practices, upon which what is currently one of the most highly regarded pro-ADR legal cultures has developed.

A combination of several factors has led to the Chamber's success over the years. One of the main features of its work is the focus on intelligent and cost-effective solutions for the industry, a legacy of its founding institutions – the Centre of Industries of São Paulo (Ciesp) and the Federation of Industries of São Paulo (Fiesp), two leading names in the Brazilian economy. Those traditional entities ensure the dependability of the Chamber's work while providing it with support.

In spite of having been founded by those two well-known entities, Chamber Ciesp/Fiesp operates with autonomy. It has its own charter

that guarantees the neutrality of its services and of the arbitrators who serve on its panels. The Chamber is chaired by two former presidents of the Supreme Court, justices Sydney Sanches and Ellen Gracie Northfleet, and benefits from technical guidance from a Superior Council composed of internationally renowned scholars and practitioners. Moreover, the Chamber has a staff of specialised lawyers exclusively dedicated to the institution's affairs regarding the administration of cases and promotional activities.

The Chamber offers a very robust, tried and tested set of rules for arbitration, mediation and dispute-board management. The current Ciesp/Fiesp arbitration rules were enacted in 2013 and have since been optimised and continuously developed by resolutions of the Chamber's presidency. As a result, Chamber Ciesp/Fiesp is acknowledged in the whitelist of Latin American arbitration institutions by the London-based publication *Global Arbitration Review*.¹ The Chamber has managed at least 586 proceedings (543 arbitrations and 43 mediations) involving not only Brazilian parties but also companies organized in 13 other jurisdictions.

Resorting to the Brazilian ADR

market, British investors have the opportunity to benefit from increased local expertise that will allow them to achieve with greater efficiency their desired results within the Brazilian legal system. They may save not only the costs involved in resorting to arbitration in other seats such as London, Paris or Geneva, but also the time required to enforce a foreign arbitral award in Brazil (in a proceeding that would otherwise take months), whilst the awards that are rendered within Brazil may be directly submitted to local courts for enforcement as a final and unappealable judgment.

The Chamber has a growing potential to host and manage international disputes, as its annual caseload statistics make clear, and hence welcomes and provides guidance to all parties interested in resorting to ADR in Brazil. In order to expand the dialogue with international players, Chamber Ciesp/Fiesp has recently promoted major events abroad such as the Chamber's first Arbitration Day in New York and a seminar hosted by the Brazilian embassy in Buenos Aires. ●

1. <https://globalarbitrationreview.com/insight/guide-to-regional-arbitration-volume-7-2019/1178469/whitelist-institutions-worth-a-closer-look-%E2%80%93-latin-america-the-caribbean>

THE BRITISH CHAMBER OF COMMERCE AND INDUSTRY IN BRAZIL

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INTERVIEW



SIMON WOOD BRITISH CONSUL GENERAL, RIO DE JANEIRO

BY IEDA GOMES
BRAZIL BUSINESS BRIEF

Could you tell us a little about the British Consulate's activities in Rio de Janeiro and how you are organised across the country?

The Consulate General in Rio represents all of the UK government's work in, and with, Rio de Janeiro city and state. Naturally we provide consular support to British people living in or visiting Rio: nearly 200,000 Brits visit Brazil annually, and about 12,000 British people live in or around Rio. But our activities go far beyond that. In Rio we help British companies to do business in a range of sectors: notably Energy, but also in Marine, Defence and Creative Industries amongst others. We create partnerships in science and

education (e.g. with institutions such as Jardim Botânico, Fiocruz, and the Museu do Amanhã), and work with local and state authorities on issues such as security and climate action. There are also important UK-Brazil military connections which we work on in Rio. And we promote tourism to the UK; I'm particularly delighted that Norwegian Air is launching a new route from Rio to Gatwick, alongside the existing British Airways route to Heathrow.

In all of this, I'd stress that the British Government in Brazil works as a network across the country. This means I can count on the help of expert colleagues in our other diplomatic posts to develop our work in

Rio. Our embassy in Brasília oversees our political and institutional relationships with the federal government, with Congress and the Senate, and with national institutions. Our consulate in São Paulo acts as a hub for trade and investment work in a wide range of sectors, and provides leadership and support for much of our trade and investment work across Latin America. My colleagues there also nurture partnerships in science research and collaboration. We have smaller consulates in Belo Horizonte and Recife. The British Council (the UK government's organisation for cultural and educational relations) has offices in São Paulo and Rio.

What are the priority areas for trade between Brazil and the United Kingdom?

Both our countries have large and diversified economies so the potential for further trade, and trade liberalisation, is huge. We work across a very wide range of sectors where there are opportunities. Currently we have a particular priority focus on Energy (including Oil & Gas, Renewables and Marine), Life Sciences, Education, and Financial Services.

The International Trade Secretary, Dr Liam Fox, just appointed a new HM Trade Commissioner to champion British trade with Latin America and the Caribbean. How is the new commissioner going to liaise with business and trade organisations?

Joanna Crellin is HM Trade Commissioner for Latin America and the Caribbean, and already has great knowledge of and connections in Brazil having been HM Consul General in Sao Paulo since 2015. Working closely with ambassadors across the region and teams from the Department of International Trade (DIT), Joanna works with business organisations in the United Kingdom and throughout the region to reinforce our business goals. These organisations are key

stakeholders and multipliers and we share a common interest in increasing trade between our countries.

The deadline set for Brexit is 29 March. What arrangements are you putting in place to negotiate future trade deals with countries such as Brazil?

We see Brazil as a strong partner for closer future trade relations. Already, through our bilateral Economic and Financial Dialogues and Joint Economic and Trade Committees, we've made good progress in tackling market access barriers and in regulatory convergence. And we're obviously looking ahead. For example we recently signed a memorandum of understanding (MoU) with the city of São Paulo, which has an economy as big as that of Argentina, to work on projects targeting infrastructure, energy, future cities and more. We have also signed an MoU with ABIQUIFI, an association for pharmaceutical products, to bring Brazilian and British companies in that sector closer together so they can work on products and carry out joint research.

Do you work with Brazilian companies to facilitate investment in the UK and partnerships with British companies?

Yes, that's an important part of our work. Our teams are in close contact with Brazilian businesses interested in learning more about the UK and vice-versa. As an example, last year Aethra, an automotive company from Belo Horizonte that we've been supporting, announced that it is going to open its first office outside of Latin America, in London. They have a five-year plan to invest about £30 million in the UK. In recent years we've helped over 130 Brazilian companies enter the UK market. The UK ranks fourteenth as a destination for Brazilian direct investment, with stocks of £2.7 billion in 2016, and I think we can work together to further increase such investment.

Do you work with British and Brazilian universities to develop people and technology?

Absolutely! Our Science and Innovation teams look for new and innovative partnerships in a number of areas, but particularly in health, life sciences, climate and biodiversity. We've been celebrating our partnerships through the UK-Brazil Year of Science and Innovation, which will culminate soon with a special closing conference in London in April. To give a few examples of our science collabora-

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tion work, we have an ongoing project between the University of Glasgow and Fiocruz Pernambuco which has resulted in the very first DNA sequencing of one type of Zika virus. The São Paulo Research Foundation (FAPESP) and Shell have launched a joint partnership at the University of São Paulo for long-term research into carbon capture and sustainable gas production. And we've helped Rio's Jardim Botânico to expand its Virtual Herbarium by digitally repatriating species of Brazilian plants from Kew Gardens. As a result, over a hundred new species of Brazilian flora have been identified.

Can you tell us about the Prosperity Fund and how it works?

The Prosperity Fund aims to promote social and economic development and stimulate competition and innovation in partner countries. Brazil is a priority partner, with programmes and projects worth up to £80m, focusing on transformative capacity building, reform and pilot projects in a number of areas and locations. In more detail, the Energy Programme incentivises transition to a lower-carbon energy mix through both regulation and new technology. This work is closely linked to our Green Finance Programme which aims to catalyse

and mobilise private finance and support effective allocation of government resources to leverage private investment into sustainable infrastructure. Both of these programmes are based out of Rio. Our Future Cities Programme has four elements: promoting smart mobility in São Paulo, smart water management in Recife, integrated urban planning in Belo Horizonte. The Skills Programme will equip young people with language skills where poor English has previously been a barrier to further education and employment, supporting the implementation of the National Curriculum Reform and aiding social mobility. We have a Better Health Programme designed to increase life expectancy and improve productivity through strengthened primary care, improved data management and translating research and innovation. And last but not least, the Trade Facilitation Programme will support Brazil's further economic development, and its accession to the OECD, whilst increasing the efficiency of operations in key areas of foreign trade such as ports and global value chains.

What are the opportunities for Brazilian companies within the Prosperity Fund?

The Prosperity Fund aims to reduce poverty through inclusive economic growth and development. So our hope and expectation is that many new business opportunities will flow from the programmes, all helping to raise overall prosperity for Brazil. Through the Trade Programme, for example, Brazilian companies will benefit from lower costs in international trade and easier access to international markets. This will be done by introducing mechanisms which will increase the efficiency in the operations of Brazilian ports, reducing the time it takes for goods to be imported and exported; and by facilitating access for micro, small and medium-sized companies to export-promotion programmes through streamlined services, better logistics, and information about overseas markets.

In the past the United Kingdom was instrumental in helping Brazil build up its infrastructure (e.g. railways; electricity and gas distribution; water supply). Do you currently see opportunities for British companies to partner with Brazilian companies in developing infrastructure in Brazil and abroad? And if so, are there any obstacles to the implementation of such partnerships?

We see lots of opportunities! I think we all recognise the infrastructure gap that exists in Brazil, and we want to work together both on commercial opportunities and in creating the financial and regulatory frameworks to incentivise investment. It's already a focus of our Prosperity Fund Future Cities and Green Finance programmes, as well as a complementary programme on sustainable infrastructure funded through the UK's International Climate Fund programme. We have a joint UK-Brazil infrastructure task force that brings together both business and government to tackle barriers to infrastructure trade and investment, as well as ongoing dialogues with state and local authorities in Brazil to share expertise on public-private partnerships. And through UK Export Finance (UKEF) we can support projects financially where there is UK content. Take our work with Contracta Engenharia, for example. They opened their business in the UK in 2017 and from that base they have expanded into Africa with the support of UKEF. I think it's a great example of Brazilian expertise accessing the world by working closely with the UK.

How could the Brazilian Chamber of Commerce in London

WE HAVE A JOINT UK-BRAZIL INFRASTRUCTURE TASK FORCE THAT BRINGS TOGETHER BOTH BUSINESS AND GOVERNMENT TO TACKLE BARRIERS TO INFRASTRUCTURE TRADE AND INVESTMENT

work with the British Consulate in Rio to enhance cooperation and attract investment both to Brazil and the United Kingdom?

We share the same goals of creating long-lasting partnerships for prosperity in both our countries. So there is definitely potential for the chambers of commerce both in the UK and Brazil, and the UK government network, to co-operate even more closely in promoting trade and investment links. In particular we can use the power of networking to increase awareness of opportunities. As one example, this year marks the 35th anniversary of our pioneering Chevening scholarship scheme, through which over a thou-

sand Brazilians have completed post-graduate studies in the UK. I'm sure the members of the Chamber include many Brazilians who have studied in the UK and I'd like to use that alumni network to promote greater collaboration and professional networking in both our countries.

Are there any other points you would like to highlight?

One of my professional as well as personal priorities is our work with Brazil to promote lower-carbon growth, energy transition towards renewable sources, and action to mitigate climate change. In partnership with Brazilian states, businesses and local communities we're supporting projects to tackle deforestation, incentivise commercial partnerships in sustainable forest management, offer capacity building in adopting lower-carbon agricultural techniques, and incentivise sustainable infrastructure. It's a key part of the UK-Brazil relationship. And what we're seeing in this work is that it is a win-win: action to reduce emissions is increasing, rather than holding back, economic growth. So our emphasis on lower-carbon work is a fundamental part of our trade, investment and economic partnership with Brazil. 🌱

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ADRIANO PIRES RODRIGUES FOUNDING PARTNER AND DIRECTOR THE CENTRO BRASILEIRO DE INFRAESTRUTURA (CBIE)

BY IEDA GOMES
BRAZIL BUSINESS BRIEF

How important is the oil and gas sector in Brazil?

According to the Brazilian National Agency of Petroleum, Natural Gas and Biofuels (ANP), using data from the Brazilian Association of Petroleum Services Companies (Abespetro), the domestic oil and gas sector accounts for 13% of Brazil's Gross Domestic Product (GDP). It is responsible for generating thousands of jobs and for investments injecting billions of reals [Brazil's currency] into the country, as over 100 corporate groups operate in the industry. According to the International Energy Agency (IEA), Brazil is the tenth-largest oil producer in

the world and the largest producer in Latin America.

Brazilian oil production reached about 2.7 million barrels per day (b/d) in 2018 and is forecast to rise by a further 10% in 2019, as the country has the geological potential to be among the top five oil producers and suppliers in the world. According to projections from the Energy Research Company (EPE) of the Ministry of Mines and Energy, production could rise to 5 million b/d by 2027, mostly from deepwater pre-salt development. This is currently the focus of Petrobras and other oil companies, but increased production

could also come from the recovery of mature fields and also new, as-yet undiscovered basins, such as unconventional resources.

Oil products account for around one-third of Brazil's total domestic energy supply and the country is one of the largest fuel users in the world. During the last ten years fuel consumption has risen at a faster rate than GDP. Since freight is mainly transported by road in Brazil, the primary demand of the transport sector is for diesel oil.

What key changes have taken place in Brazil's oil and gas sector over the last 20 years or so?

The first and most important change came in 1997 with the end of Petrobras' monopoly, which had begun in 1953, and the approval of Law no. 9,478 that led to the creation of the ANP and, with it, the oil and gas bidding rounds for exploratory blocks. Since those early days of the ANP and the bidding rounds, private companies have gradually increased their market share in the exploratory and production segment, as Petrobras' own share has been reduced from 100% to, currently, 75%.

Another vital development was that of the technology necessary to explore the pre-salt reserves, which came into the foreground in the mid- to late 2000s. The subsequent paralysis of the bidding rounds while Brazilian society was debating how to explore these new reserves led to the Lula and Dilma governments' controversial decision to adopt the production-sharing regime with the obligatory participation of Petrobras in every block (Law no. 12,351) and the complicated transfer-of-rights operation in 2010 (Law no. 12,276), splitting the pre-salt reserves from the previous concession regime. The move by those governments to centralise new oil and gas operations in Petrobras was a

step backwards, and the whole excessive intervention process culminated in 2014 in corruption scandals and financial crisis, from which Petrobras in only now emerging.

Since 2016 Brazil's governments have taken many steps to reform the oil and gas sector. The reforms began in late 2016 with the approval of Law no. 13,365, which removed the obligation of Petrobras as sole operator with 30% participation in any pre-salt consortium under the production-sharing regime. This was followed in 2017 by a number of resolutions from the Brazilian National Energy Policy Council (CNPE) that implemented a multiyear schedule of bidding rounds for the pre-salt, conventional exploratory blocks, and a new local content policy that loosened the strict rules that had been introduced in the 2000s and had increased costs and delayed project schedules. The reforms continued with Law no. 13,586, which extended through to 2040 the REPETRO preferential customs regime for imports of equipment for the oil and gas industry, and an ANP resolution which established clear rules for the process of individualisation (unitisation) of production in reservoirs that extend beyond their previously delimit-

ited exploratory blocks. These reforms resulted in the successful resumption of ANP bidding rounds in 2017 after a decade of scarce offerings, attracting a record number of private companies, both Brazilian and foreign, and huge signing bonuses totalling R\$ 28 billion for 72 blocks (which represented about three-quarters of the world total of about US\$ 9 billion spent on 3,000 blocks in 100 auctions in 82 countries in the same period).

Development in the downstream segment has been much less profound than in the upstream, as the end of Petrobras' monopoly in 1997 did not translate into a de facto increase in private participation. Petrobras still dominates Brazilian refining with over 95% of processed oil volumes. The proposed practice of fuel prices in parity with international prices did not last long. The period from 2003 to 2016 was marked by government interference in fuel prices with the aim of fighting inflation, which eventually led to Petrobras' financial ruin as the company was subsidising fuel prices to an extent far beyond what its cash generation allowed. The new government in 2016 allowed Petrobras to adopt a new pricing policy, further upgraded to daily adjustments in 2017.

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However, external factors beyond Petrobras' control, such as the fall in the value of the real and increasing oil prices, led to higher fuel prices and a truckers' strike with a huge impact in the Brazilian economy, solved by the introduction of short-term government subsidies.

What changes still need to take place to ensure more investment and competition?

Brazil has an unprecedented opportunity to attract investment in its high-quality pre-salt assets. The country needs to ensure that its legislation and regulatory environment are appropriate in the face of the transition to renewable energy sources and the possibility of fossil fuels becoming obsolete given environmental restrictions. To overcome this challenge there is still a long list of reforms that will enable the domestic oil and gas industry to realise its impressive potential, attract investment and generate jobs, create opportunities for the goods and services supply chain, and produce income for Brazil's federal, state and municipal governments.

For the upstream segment the government must respect and amplify the multiyear schedule of bidding rounds for exploratory blocks, focus-

THE COUNTRY NEEDS TO ENSURE THAT ITS LEGISLATION AND REGULATORY ENVIRONMENT ARE APPROPRIATE IN THE FACE OF THE TRANSITION TO RENEWABLE ENERGY SOURCES AND THE POSSIBILITY OF FOSSIL FUELS BECOMING OBSOLETE GIVEN ENVIRONMENTAL RESTRICTIONS

ing on holding the bidding round for the Transfer of Rights Surplus. Going forwards, the local content policy needs to avoid strict market quotas of the type that hinder innovation and productivity for equipment or services, potentially delaying projects and increasing their costs. The goal of local content should be to foster domestic industry growth and competitiveness, not to reward distorted market capture. One other thing the authorities need to focus on is the development of further incentives for mature fields, either onshore or in shallow waters, as

a way of maximising recovery from an otherwise spent energy source. Some short-term difficulties that need to be overcome are the approval of the reform of the transfer-of-rights law in Congress and the absence of preliminary environmental assessment of blocks offered in bidding rounds.

For the downstream segment the authorities should focus on ending Petrobras' de facto monopoly by privatising refining, transportation and distribution in both the oil and gas chains.

For the natural gas segment, domestic consumption per capita is very low when compared to countries such as Colombia and Mexico, and it is necessary to expand the market through investment in the construction of pipeline infrastructure outside southeast Brazil, building gas-fired thermal power plants, fuelling the transportation sector and stimulating the industrial use of natural gas so as to reach an economically feasible level of demand. Despite the increasing importance of natural gas as an energy source that will help Brazil transition to a cleaner economy, the domestic market is still underdeveloped and low demand is hindering further oil development as there is nowhere to pump pre-salt gas to.

There are currently large multinational players investing in exploration and production in Brazil, as the country possesses very attractive deepwater/pre-salt oil provinces. But why don't we see independent companies operating and investing in smaller oil fields?

The areas where pre-salt is being produced have been contested by major international players for years, due to the high productivity and good quality of the oil. Despite the extremely large front investment and longer-term return there have been excellent results so far in terms of profits. The other areas of Brazil are not as attractive, either due to lower productivity or because of their oil of lesser quality, and in most cases these are being developed by small Brazilian private companies. Nevertheless, there are the following examples of exploration or production by medium-sized independent international companies: Murphy Oil – exploration in the Sergipe-Alagoas Basin; Karoon – exploration in the Santos Basin; Imetame – onshore blocks, mature fields; Wintershall – the Potiguar Basin, a new frontier; Maha Energy – specialised in the recovery of mature fields, Sergipe-Alagoas and Recôncavo

basins. The number of small and medium-sized companies attracted to the next ANP bidding rounds, starting later this year, is expected to be greater as the price of a barrel of oil remains at a high enough level (between US\$ 50 and US\$ 70). It should be stressed that investment in the E&P sector is by its very nature long term, due to the maturation time of 5-7 years for a given project and the following decades of operations with positive cash flow.

Oil prices have been very volatile in 2018. Is deepwater exploration competitive in Brazil at crude prices of US\$ 40-60 per barrel?

Yes. Recent data show that the break-even price is around US\$ 40 per barrel for the pre-salt area, with Petrobras aiming to reduce production costs to US\$ 30 per barrel level in the next few years. This is one of the main upsides of the investment in deepwater-specific technology and pre-salt formations studies: the projects have a high success rate. There are virtually no dry wells and no need for large investments in exploration since there are many reservoirs in the region to develop.

President Bolsonaro has appointed an economic liberal as

economy minister and an admiral as mines and energy minister. What are their priorities for the energy sector? Do you foresee the acceleration of the Petrobras divestment programme and new upstream bid rounds?

In late January the new mines and energy minister, Admiral Bento Albuquerque, presented his ministry's priorities for 2019. Most of the priority actions concern the electricity sector but two deal specifically with oil and gas, both exploration and production (upstream) and refining and distribution (downstream).

In the E&P segment the ministry intends to focus on guaranteeing the continuity of the multiyear schedule of bidding rounds, increasing the competency of the CNPE to establish exploratory regimes in pre-salt areas, and holding the bidding round for the Transfer of Rights Surplus – the latter is also a priority for the economy minister, Paulo Guedes, and President Bolsonaro's chief of staff, Onyx Lorenzoni.

For the downstream segment the priority will be to attract investment in refining and distribution logistics, evaluating alternatives for the pricing of liquid petroleum gas (LPG), and fighting tax evasion and product adulteration in fuel distribution.

INTERVIEW

INTERVIEW

INTERVIEW

The CNPE and ANP have advanced with the preparations for holding the 16th bidding round under the concession regime and the 6th pre-salt auction later this year. Under both fiscal regimes the ANP has scheduled twice-yearly bidding rounds all the way through to 2021, as well as a 'permanent offer of areas' for blocks never previously offered or returned fields, which may be developed by specialist oil companies.

Last December Petrobras released a business plan for 2019-2023, increasing to US\$ 26.9 billion the amount of cash it intends to generate with asset sales in the divestment programme. The new CEO, Roberto Castello Branco, has upheld the company's business plan and other initiatives with a focus on investments in the core business, deepwater E&P, while taking new measures to ensure the selling of non-core assets such as the Pasadena refinery in Texas. In the short term the company will be focused in selling: Transportadora Associada de Gás S.A (TAG), the 4.5-thousand-km gas pipeline in the north/northeast of Brazil; its participation in the petrochemical company Braskem; and Liquigás, its liquid petroleum gas (LPG) distributor sub-

sidiary. Some of the company's fields in Brazil are also for sale, such as the Topázio (onshore fields) and Ártico (shallow-water fields) projects.

What lessons can be learned from the United Kingdom's liberalisation of its energy sector in the 1980s and 90s?

The UK's experience of opening its energy markets to privatisation was an inspiration for the Brazilian liberalisation and privatisation phase in the mid-1990s. There is still much to be done, mainly in terms of establishing a market environment that assures competition. The de-integration of Petrobras from its downstream market domination is part of that process, while concluding the privatisation of power distributors is another. One important lesson from the UK's liberalisation is the importance of implementing horizontal market segmentation, thus sustaining the newly established competition. Another lesson is the importance of planning and of introducing the reforms gradually to avoid abrupt shocks to the industry and minimise social costs.

What are the investment opportunities for British companies in Brazil, and do you also see possibilities for partnerships and joint

ventures?

Currently Shell has a 12% share of Brazilian oil production due to its participation in the Lula Field, which is Brazil's largest (almost 900 thousand b/d), along with partnerships in nine other pre-salt blocks, three as operator. BP is participating in five pre-salt blocks, one as operator. These partnerships and joint ventures should be carried on and expanded through opportunities in the next bidding rounds coming out in the next few years. As for smaller and medium-sized British companies, there are interesting opportunities in less expensive offshore projects in either new frontiers or mature basins. Indeed, there are certain companies that could potentially be active in the Brazilian offshore, based on the similarities between operating off the Brazilian coast and their existing developments in the North Sea region or other offshore regions around the world: EnQuest (operates in British North Sea), Dana Petroleum (North Sea, the Middle East and West Africa), Premier Oil (already operating in Brazil), Ophir Energy (Africa, Asia and Mexico), Tullow Oil (Africa and South America), SOCO International (Africa and Asia), and KCA Deutag (Europe, Asia, Africa).

We see lots of growth in renewable energy in Brazil, in particular solar, wind and biofuels. If Brazil leaves the Paris Agreement will this threaten the development of renewable energy sources?

The position of the Bolsonaro government with regard the Paris Agreement is still uncertain, but the latest official position from Brazil's environment minister, Ricardo Salles, is that the consensus inside the government is to stay in the agreement, at least for now. The government appears to be interested in potential financial resources that could come from developed countries committed to the climate issue. Regardless of the ideological/political position, the growth of renewable energy and the reduction in the use of fossil sources is another opportunity for the development of the domestic energy sector, given the diversity of Brazilian sources.

As for long-term plans, the Ministry of Mines and Energy (MME), through the Energy Research Company (EPE), prepares two forward-looking plans: the Ten-Year Brazilian Energy Expansion Plan (the current one is the PDE 2027) and the Long-Term Energy Plan (the current one is the PNE 2050). In the PDE 2027, for the next decade,

THE GOVERNMENT APPEARS TO BE INTERESTED IN POTENTIAL FINANCIAL RESOURCES THAT COULD COME FROM DEVELOPED COUNTRIES COMMITTED TO THE CLIMATE ISSUE

the target share of renewables in the energy supply is 48% while the target share of renewables in power generation is 86%. According to MME reports, in order to meet the growing demand for energy and at the same time maintain the share of renewable sources, investments of R\$ 1.8 trillion are expected in the period 2018-2027. Despite the encouraging projections, more energy policies and reforms will be necessary to keep Brazil at the forefront of sustainable development.

Climate change targets for 2050 will drastically reduce the role of fossil fuels. Is there a risk

for Brazil if those targets delay the development of oil provinces? Should Brazil use part of its oil revenues to build up sovereign funds before it is too late?

There is a significant risk if Brazil fails to seize the current opportunity to develop the deepwater pre-salt area while demand for oil and gas is at an extremely high level, given that those fuels are cost-effective and economically viable. In fact the country should develop its hydrocarbon reserves as quickly as possible to capitalise on a profitable natural resource and invest in adapting the economy for future generations. Otherwise environmental and technical restrictions will make the exploration of big reserves obsolete in a future society based on renewable energy sources. With the production-sharing regime law (Law no. 12,351/2010) Brazil has approved the creation of a public wealth fund for social and regional development, investing in education, healthcare, science and technology, and in adapting the country to climate and environmental changes. Despite the already existing version of the social fund, Brazil could benefit from an expanded regulation on the subject of a long-term sovereign fund for public investment. ●

INTERVIEW

BRAZIL ECONOMIC DATA



QUICK FACTS

GEOGRAPHY	5th Largest Country in the World
POPULATION	209 Million Inhabitants
ECONOMY WEIGHT	World's 9th Largest Economy
OVERALL GDP	2,055,506 million US\$
FOREIGN INVESTMENT INFLOW	88.3 billion US\$
TOTAL EXPORTS	218 billion US\$
TOTAL IMPORTS	151 billion US\$

(BID)

SOURCES: IBGE, World Bank and WTEs

BRAZILIAN ECONOMIC DATA

GDP GROWTH RATE



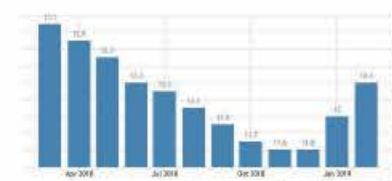
The Brazilian economy advanced 0.1 percent on quarter in the fourth quarter of 2018, slowing from a downwardly revised 0.5 percent expansion in the previous period and below market expectations of 0.2 percent. Considering full 2018, the economy grew 1.1 percent over the previous year.

GDP GROWTH PER CAPITA PPP



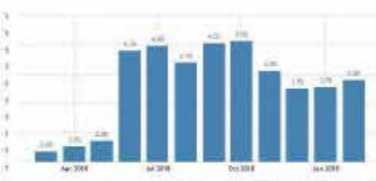
The Gross Domestic Product per capita in Brazil was last recorded at 14,103.45 US dollars in 2017. The GDP per Capita in Brazil, when adjusted by PPP is equivalent to 79% of the world's average.

UNEMPLOYMENT RATE



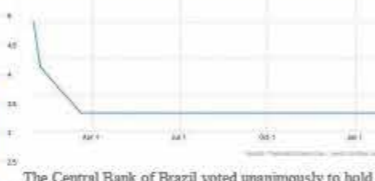
The unemployment rate in Brazil rose to 12.4 percent in the three months to February 2019 from 11.6 percent in the September-November period but dropped from a 12.6 percent a year earlier. It was the highest jobless rate since the three months to June 2018 period.

INFLATION RATE



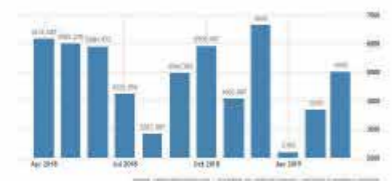
The annual inflation rate in Brazil rose to 3.89 percent in February of 2019 from 3.78 percent in the previous month. It is the highest inflation rate in three months, mostly due to higher cost of food and non-alcoholic beverages.

INTEREST RATE



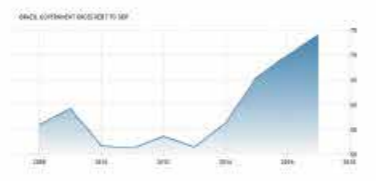
The Central Bank of Brazil voted unanimously to hold its key Selic rate at a record low of 6.50 percent on 20 March 2019, as widely expected. Policymakers noted that recent data on economic activity came in below expectations, still the domestic economy continues on a gradual recovery path and added that the global outlook remains challenging.

BALANCE OF TRADE



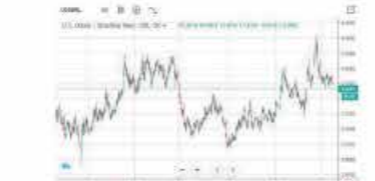
Brazil's trade surplus narrowed to USD 4.99 billion in March 2019 from USD 6.28 billion in the same month a year earlier and missing market expectations of a USD 5.548 billion. Imports rose 5.1 percent year-on-year while exports fell 1.0 percent. Imports tend to be volatile during Carnival season.

GOVERNMENT DEBT TO GDP



Brazil recorded a government debt equivalent to 74.04% of the country's Gross Domestic Product in 2017. Government Debt to GDP in Brazil averaged 58.45% from 2006 until 2017.

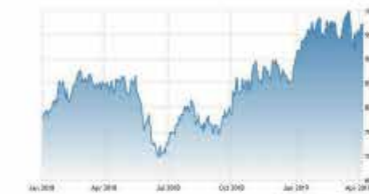
CURRENCY



The USDBRL decreased 0.0002 or 0.01% to 3.8488 on Tuesday April 9 from 3.8490 in the previous trading session. Historically, the Brazilian Real reached an all time high of 4.21 in September of 2018 and a record low of 0.01 in January of 1993.

BRAZILIAN MARKET DATA

STOCK MARKET



The Ibovespa increased 6357 points or 6.98% since the beginning of 2019, according to trading on a contract for difference (CFD) that tracks this benchmark index from Brsfil. Historically, the Brazil Stock Market (BOVESPA) reached an all time high of 99993.92 in March of 2019.

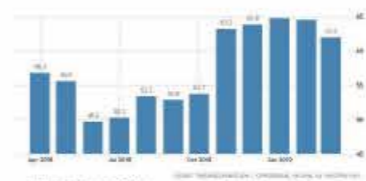
BRAZIL GOVERNMENT BOND 10Y



Brazil 10Y decreased 0.26 percent or 0.26% since the beginning of 2019. Historically, the Brazil Government Bond 10Y reached an all time high of 17.91 in October of 2008 and a record low of 8.71 in February of 2019.

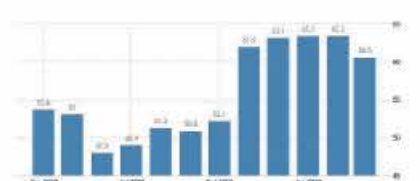
BRAZILIAN BUSINESS DATA

BUSINESS CONFIDENCE



The Industrial Entrepreneur Confidence Index in Brazil fell to 61.9 in March 2019 from 64.5 in the previous month. It was the weakest reading since October, as the assessment for current conditions deteriorated (53.6 from 55.6 in January), namely regarding the country's economic situation (54.3 from 57.1) and the company's situation (53.3 from 55).

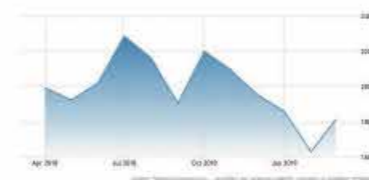
SMALL BUSINESS SENTIMENT



Small Business Sentiment in Brazil decreased to 60.50 in March from 63.30 in February of 2019. Small Business Sentiment in Brazil averaged 51.63 from 2010 until 2019, reaching an all time high of 65.40 in January of 2010 and a record low of 34.50 in October of 2015.

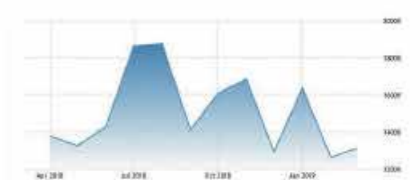
BRAZILIAN TRADE DATA

EXPORTS



Exports from Brazil dropped 1.0 percent year-on-year to USD 18.12 billion in March 2019. Sales declined for manufactured products (-68.2%), namely cargo vehicles, fuels, and autos. Meanwhile, sales of basic products went up 123%, mostly corn, soybeans, coffee beans and crude oil.

IMPORTS



Imports to Brazil increased 5.1% from a year ago to USD 13.13 billion in March 2019, mainly driven by purchases of capital (13 %); intermediate (5.8 %) and consumption goods (1.6 %). On the other hand, purchases of fuels and lubricants decreased 0.5 percent.

EDITORIAL

BRAZIL BUSINESS BRIEF, APRIL 2019

NEWS FROM THE
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IN GREAT BRITAIN

EDITOR

LENA BERALDO

EDITORIAL COUNCIL

IEDA GOMES & ANTHONY PEREIRA

GRAPHIC DESIGN

NENI ALMEIDA · NENIALMEIDA.COM

PROOFREADING

MICHAEL MARSDEN · MICHAELMARSDEN.CO.UK

OUR GUEST WRITERS AND COLLABORATORS IN THIS EDITION



IEDA GOMES

Ieda Gomes is a councillor at the Brazilian Chamber. She is the managing director of Energix Strategy Ltd, an energy and gas consultancy company. Ieda is also a senior advisor at FGV Energia and visiting fellow at the Oxford Institute for Energy Studies.

ieda.gomes2@gmail.com



ROGERIO BUSO

Rogerio Buso, 55, has 30 years' experience in commercial and investment banking, having worked in all the main Brazilian and international banks in Brazil. His main skills are credit appraisal, firm valuation, client coverage, financial products and team management.

rogerio@majorisbrasil.com.br



LENORA HAGE SANTOS BENTO DE FARIA

Lenora is the deputy secretary-general of Chamber Ciesp/Fiesp. She has a postgraduate degree in civil procedure from the Pontifical Catholic University of Rio de Janeiro and a master's (LL.M.) in international dispute settlement from the joint programme of the Graduate Institute of International and Development Studies and the Geneva University Law School, Switzerland.

lenora.hage@ciesp.com.br



LUÍS ALBERTO SALTON PERETTI

Luís is the secretary-general of Chamber Ciesp/Fiesp. He has a diploma from the Paris Institute of Political Studies (SciencesPo), a master's in global business law from the University of Paris I Panthéon-Sorbonne, and a master's in comparative law from the University of Paris II Panthéon-Assas.

luisperetti@ciesp.com.br



CATHY BREMNER

Cathy works in the London office of B3, the Brazilian Stock Exchange, where she is responsible for EMEA clients and business development, as well as advising major financial institutions about the Brazilian markets. She has a BA in Spanish, Portuguese and Brazilian Studies from King's College London and an MSc from UCL.

cathy.bremner@b3.com.br

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PERSONALITY OF THE YEAR AWARDS 2019



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