EMPEA
Emerging Markets Private Equity Association

Case Study: **Equatorial Energia (Brazil)**

Equatorial Energia's Story

Equatorial Energia S.A. is the holding company for Companhia Energética do Maranhão (CEMAR), a power distributor serving the Brazilian state of Maranhão in the country's tropical northeast. As the state's sole electric power distributor, CEMAR's concession area covers 333,000 square kilometres, or nearly 4% of Brazil's national territory. CEMAR is the second-largest electricity provider in the northeast of Brazil and serves 1.5 million households and businesses representing a population of approximately 6.2 million.

CEMAR's history dates back to 1958, when the company was founded as a fully state-owned and operated electric utility. CEMAR was privatized in mid-2000 and purchased by the American energy company, PPL (formerly Pennsylvania Power & Light).

In the years that followed CEMAR's privatization, Brazil was confronted with a severe drought that resulted in one of the most serious energy crises in the country's history. The government responded by implementing a strict rationing program that, while preventing rolling blackouts, reduced revenues to power generators and distributors by over 20 percent.

This energy crisis strained Equatorial's financial resources and the company encountered serious financial problems as a result. In August 2002, Brazil's National Electric Power Agency (ANEEL) concluded that the company's financial distress threatened its ability to provide adequate electricity distribution and ordered an administrative intervention.

Between October 2002 and early 2004, GP Investments—a private equity firm focused on buyout and growth capital investments in Latin America—negotiated a restructuring plan with CEMAR's main creditors and took control of the company. Following its acquisition of CEMAR, GP created Equatorial Energia—a holding company for CEMAR—and went to work restructuring the company's balance sheet, installing a new management team and initiating an aggressive program of business improvements. Having stabilized Equatorial's financial position and strengthened its operations, GP led the company through its initial public offering on the São Paulo Stock Exchange (BM + FBOVESPA) in 2007. Since Equatorial's IPO, the company has diversified beyond electricity distribution to generation.

The Role Played by Private Equity

When GP Investments encountered Equatorial Energia in mid-2002, the company was being administered by ANEEL, and its owner, PPL, had essentially abandoned the company's equity as valueless.

Meanwhile, Equatorial's creditors—including Eletrobrás, Brazil's largest electricity utility, and several large local financial institutions—sought to avoid a costly bankruptcy by selling the assets. However, other large players in the sector saw Equatorial's operations as too small and its finances as too distressed to justify becoming involved. Moreover, PPL had undertaken few reforms since Equatorial's privatization and the company's operations performed well below it peers.

After more than 18 months of negotiation, GP reached an agreement with ANEEL and Equatorial's creditors on a restructuring plan. Through its negotiation, GP achieved a haircut on some of Equatorial's debt and convinced the lenders to capitalize or lengthen the terms on portions of what remained. Agreeing to commit US$3.2 million in equity from its private equity funds and with an additional US$8.5 million from co-investors, GP took control of the company in May 2004. ▶

The Company

equatorial ENERGIA

Essentials

Company: Equatorial Energia (www.equatorialenergia.com.br)

Country: Brazil

Sector: Energy

Business focus: Electricity distribution

Size: BRL879 million (US$497 million) revenue, BRL379 million (US$214 million) EBITDA and 1,215 employees at exit

GP: GP Investments, a private equity firm focused on buyout and growth capital investments in Latin America

Date of investment: April 2004

Investment: US$11.7 million, including co-investors

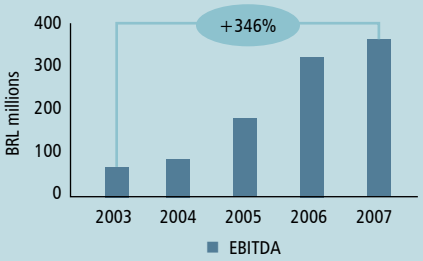
Impact Highlights

GP Investments structured a transaction that kept Equatorial Energia—the electricity distributor for one of Brazil's poorest states—out of bankruptcy and oversaw the company's transformation into an industry leader

GP Investments installed a new management team, including one of its own partners as CEO, and implemented a far-reaching turnaround plan that improved corporate governance, cut costs and enhanced service quality

Between 2005 and 2006, Equatorial Energia's "Light for All Program" expanded electricity coverage to over 100,000 new households and businesses—benefiting over 500,000 residents

Financial Performance

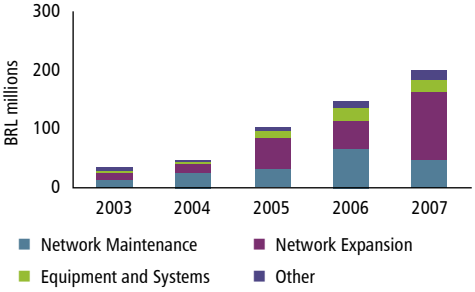


The Company View

"GP Investments brought a very broad array of management methodologies and business tools to Equatorial Energia. Its budgeting, goal setting and cost control programs aligned management and shareholders and helped to generate real value."

"For many years, Equatorial Energia was the largest investor in Maranhão, and this was a tremendous source of employment and development for the state."
Octavio Lopes;
Managing Director,
GP Investments
and Chief Executive Officer,
Equatorial Energia
(2004–2007)

Capital Expenditure



GP's first priority was to install a professional management team. GP named one of its own Partners, Octavio Lopes, to serve as the company's CEO. Under Lopes's leadership, GP's turnaround plan for Equatorial consisted of several elements. First, GP focused on the company's corporate governance by identifying and tracking key performance metrics; on implementing formal processes for budgeting, goal setting and cost controls; and on structuring the flow of information between the company and the board. Early on, GP also redefined how the company hired and incentivized its employees and introduced the Variable Remuneration Program, which instituted bonuses at all levels of the organization based on the achievement of pre-defined goals.

Second, with both its price of energy acquisition and its sales price tightly regulated, Equatorial's profitability was largely a function of its operating performance. Reducing the company's manageable cost per consumer therefore became an important part of GP's turnaround plan. Lopes and his team implemented a system of zero-base budgeting, renegotiated all the company's service contracts and installed new systems to reduce energy loss. At the same time, he initiated a series of campaigns directed at billing and payment collection which had the effect of cutting the company's bad-debt provision from 37% in 2004 to 15% in 2006.

Finally, GP focused on improving service quality by standardizing procedures and encouraging continuous improvements. As a result, CEMAR's frequency and duration of customer interruption were both cut in half between 2004 and 2007.

When GP Investments exited its position in Equatorial Energia in 2007, the company was radically different from the company the firm first encountered three years earlier in 2004. Octavio Lopes and his team's focus on cost cutting, budgeting and operational excellence brought CEMAR from the brink of bankruptcy to being one of the industry's leaders. During GP's ownership of the company, its customer base grew by 24%, its EBITDA grew by 346% and its EBITDA margin grew to an industry-leading 43%.

Beyond the Bottom Line

With an income per capita comparable to that of Vietnam, Maranhão is one of Brazil's poorest states. Through its participation in Equatorial Energia, GP Investments contributed to the state in terms of investment, infrastructure and employment.

Under GP Investments' ownership, Equatorial Energia dramatically expanded its investment program in Maranhão, and between 2004 and 2007, the company's capital expenditures grew more than four times from BRL49 million to BRL199 million. In 2007 alone, Equatorial invested nearly BRL114 million in network expansions, which primarily benefited the state's poorest regions with augmented electricity coverage and much-needed investment funds. In addition to its investments in expanded coverage, by 2007 the company had brought power to nearly 150,000 new consumers under Brazil's "Light for All" program, which helped to improve the lives of approximately 515,000 of the state's residents.

In addition, Equatorial launched its "Community Electrician" program in 2007 to provide jobs for experienced but under-qualified electricians from underprivileged communities. The company also formed a partnership with the São Luís (Maranhão's capital and largest city) Mayor's Office to donate telecenters to municipal schools as a means of using information technology to create jobs and encourage economic development. Since 2004, over 12,000 people have benefited from this initiative.

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