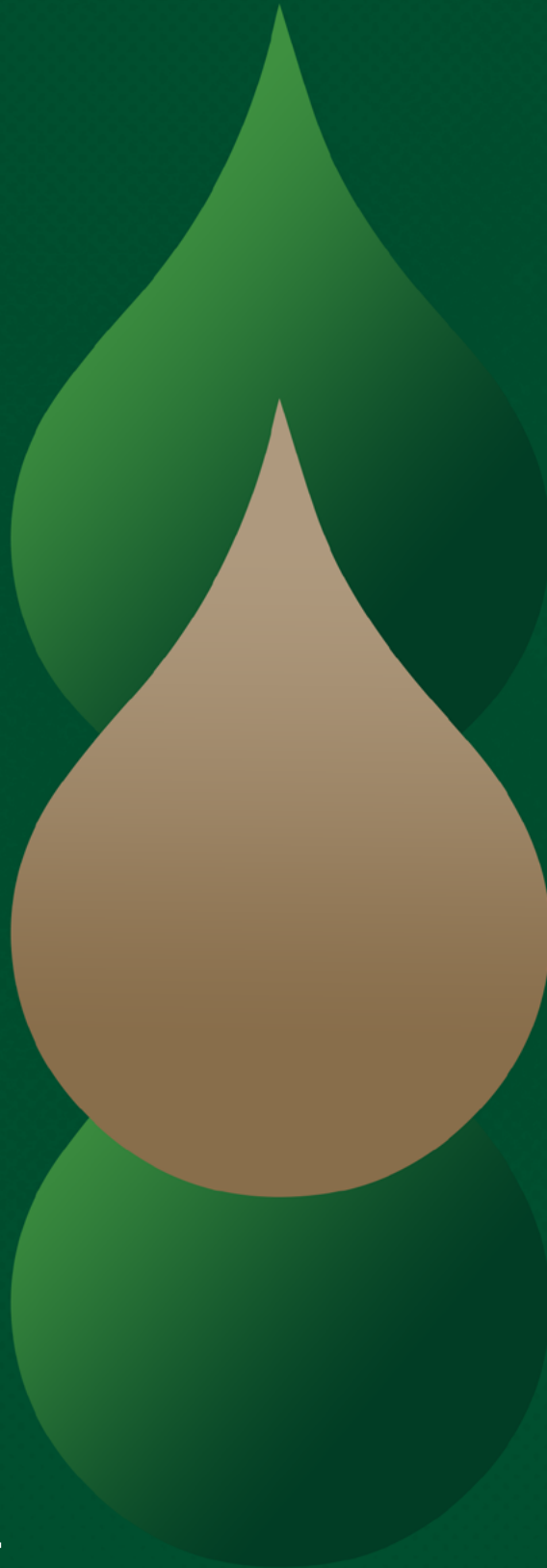


LETTER TO INVESTORS

Sanitation Bill approved by the House of Representatives in Brazil



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São Paulo, December 18th, 2019

Sanitation Bill Approved by the House of Representatives

After several weeks of negotiations, on December 11th, 2019, the House of Representatives approved, by 276 votes to 124, an updated version of draft bill #4,162, also known as the “Sanitation Bill”, incorporating some of the deputies’ main requests while maintaining the core purpose of the bill.

Given the uncertainty regarding the approval of the rapporteur’s version – from Senator Tasso Jereissati – the House of Representatives (“lower house”) preferred to vote on the bill presented by the government in August 2019. By doing so, the Lower House will have final say on the text, which will now go to Senate and, if the Senate suggests any change, will be resubmitted to the Lower House for final revision.

The amendments included in the bill were: (i) reinstating ANA (the federal water regulator) as the sector watchdog that will establish investment, efficiency, quality, and service coverage targets; (ii) concessions without a formal contract and contracts between state-owned enterprises (“SOEs”), so-called “contratos de programa”, will have until March 2022 to be potentially renewed for up to 30-years, only if the SOEs comply with certain investment targets as well as quality and efficiency indicators, a requirement which may be challenging without the help of private players; (iii) if there are no changes to existing contracts between SOEs, privatization may occur without approval by city halls; and (iv) SOEs breaching ANA quality indicators will not be allowed to pay dividends to their shareholders.

The bill establishes the goal that, by 2033, coverage of treated water should reach 99% of the population and sewage collection and treatment should reach 90% of the population. These targets cannot be reached exclusively by SOE-focused investment, and as such, this will significantly increase the

need for private players to participate in more Public-Private Partnerships (PPPs) and concessions.

The bill also prohibits new contracts between SOEs from being signed without competition from other public and private players (except for the “one-time renewal” allowed under strict conditions that could only be met with difficulty). Regarding environmental licenses, the bill states that (i) any project license requested by a company in the water and sanitation sector will have a prioritized analysis (versus requests from other sectors) and (ii) the issuance of environmental licenses must be the responsibility of the municipality or of a state-owned institution, if there is no local municipal entity to provide it.

The governors of the states of São Paulo, Rio de Janeiro and Minas Gerais have been vocal about privatization and have publicly stated that approval of this bill would be a necessary step in that direction.

The approval of the bill is an important step taken towards the much-needed universalization of water and sanitation in Brazil. The bill opens space for private players to become large platforms that will perform a key role to meet the challenging targets established by the new regulation and bring important environmental, social and health benefits to over 100 million Brazilians that currently lack access to sewage collection in addition to over 35 million Brazilians that lack access to treated water (according to the Trata Brasil Institute).

The opportunity ahead of us

According to Federal Government data, Brazil must invest around R\$500 billion in capex until 2033 to achieve the investment targets and quality and efficiency indicators established in the new Sanitation Bill.

The SOEs that now have until 2022 to adapt their existing contracts to the new rules and compulsorily agree with the new obligations do not have the financial capacity required to bare all of the projected investment necessary in order to comply with the Sanitation Bill's requirements. In terms of public expenditures and fiscal responsibility, municipal governments also do not have enough funding to support this level of legally mandated investment.

As consequence, we see a wave of opportunities for private investors to partner up with the public sector in new investments required in the water and sanitation sector in Brazil. More specifically, privatizations, new concessions and PPPs will be the three forms of engagement for the private sector in the market.

PPPs that are purely concessions of civil works tend to be less interesting in our view, considering that they will have less room for improvement and efficiency gains .

Full concessions of water and sewage systems and the acquisition of entire sanitation SOEs through privatizations will be in our opinion the most interesting opportunities, given not only the need for capital allocation in the expansion and modernization of the existing infrastructure, but also the need for improvements in operational and commercial efficiency.

In a nutshell, we might see higher IRRs in investments in full

concessions and privatizations of SOEs than we would in PPPs. We might also see more competition coming from construction companies in PPPs more focused in civil works than in full concessions and privatizations.

Finally, existing private platforms that are very much oriented to turnarounds with a buy and improve strategy might have an additional benefit of efficiency gains in synergies and financial engineering in refinancing existing assets considering the economies of scale and scope within the platform.

In conclusion, we do believe that the sanitation sector in Brazil will be one of the most attractive infrastructure subsectors for capital allocation in the coming years. We might see a very bullish market until 2022, with SOEs preparing to be privatized and municipalities entering into new concession agreements following municipal elections in October 2020.

From 2023 until 2033, we forecast that we will have the most concentrated period of capex disbursement in Brazilian sanitation sector, with potential IPOs of existing private platforms in the public equity markets and more private equity investments and M&As coming from large international institutional investors as well as global strategic players.

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IG4 CAPITAL



IG4 Capital Investimentos Ltda.

R. Leopoldo Couto de Magalhães Jr. 1098

6º andar Itaim Bibi 04542 001

São Paulo SP Brasil

T +55 11 2844 8036

IG4 Capital Advisors LLP

1 Ropemaker Street

11th floor EC2Y 9HT

London UK

T +44 20 8885 8472

IG4 Capital Inversiones SpA

Isidora Goyenechea 3000 Piso 29

Las Condes 7550653

Santiago Chile

T +56 2 2592 6795



contact@ig4capital.com

www.ig4capital.com