Hard Knocks Keep Coming for Brazil's Ethanol Plants

Stratas Advisors

This is condensed from a recent report from our Global Biofuels Assessment service. Members have access to the complete report, which includes a detailed analysis of the current market landscape for Brazilian ethanol plants, including our forecast for ethanol production and fuel consumption.

As the 2015-2016 sugarcane harvest begins in Brazil, the outlook for the country's ethanol producers remains uncertain. Ethanol plants are still feeling the weight of heavy debt amid the sector's ongoing recovery from the 2008 financial crisis and the effects of recent droughts, reduced investment capital and plummeting sugar prices. Since 2011, 47 plants have closed, and about 18% of the remaining facilities are under judicial review, according to UNICA, Brazil's sugar-ethanol producer association.

Stratas Advisors does expect ethanol production to rise in 2015, but at a very modest level because of the financial pressures.

Although total government investment into the sector has expanded, loans for plant modernization have decreased, affecting the industry's ability to increase operational efficiency. BNDES, Brazil's development bank, disbursed 21% less for modernization in 2014 than in 2013, whereas financing for ethanol storage saw a 208% increase during the same period. This shift was in line with the recent requirement that ethanol producers store ethanol to meet the country's E25 mandate.

With government financing waning for modernization projects, ethanol plants have turned to private banks for loans. But
ethanol plants are a high-risk investment and, given their large debt, private banks are either discouraged from investing or they offer loans with high interest rates. In a recent study by Standard and Poor’s of the Brazilian plants in its portfolio, the vast majority received a dire outlook, with the financial risks for many labeled moderate or high, which could lead to lower cash flows and limited access to credit.

A steep decline in international sugar prices has also affected ethanol producers because 66% of Brazil’s plants are both sugar and ethanol producers. International sugar prices decreased 22% from April 30, 2014, to April 30, 2015, while sugar prices for the Port of Santos, the main port for Brazil’s Center South producing region, dropped 26% during the same period. The drop in prices has meant less revenue for ethanol producers, leading to more borrowing to sustain their plants, or to plant closings.

Recent government decisions could ease some of the sting for ethanol producers. An increase in the ethanol blend from 25 vol% to 27 vol% should expand demand and, therefore, production of anhydrous ethanol as blending firms, especially Petrobras, buy more to meet the new mandate. Similarly, an increase in fuel taxes on gasoline C should incentivize the consumption of E100 (hydrous ethanol) over gasoline C, further expanding the revenue inflow for ethanol producers.

But the relief provided by these changes will be tempered because of persistently low international prices for sugar and crude oil, which affect ethanol supply and demand. Furthermore, the slowdown of the Brazilian economy will continue to restrain growth in overall fuel consumption.

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