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**ALL and Rumo seal merger and end billion Real litigation**

By Graziella Valenti and Ivo Ribeiro

The future of the largest railroad in the country, ALL, was decided in a typical Brazilian shareholders' meetings. A routine event in the company's headquarter in Curitiba, which lasted only seven minutes, approved the incorporation by Rumo for the merger of the businesses with the presence of 75% of the capital and the agreement of 67%. As such, since yesterday, although without the absolute majority of shares, the main rail tracks of the country are in the hands of businessman Rubens Ometto, owner of Cosan, who will hold the majority of seats on the board of directors of the company.

The result of this combination is that ALL resumes its capacity for investment and expansion. While the approval of the merger depends on the agreement of the Conselho Administrativo de Defesa Econômica (Cade), a plan is already being drawn with a R$5 billion investment expected to expand transport capacity within the next five to eight years. The figure can reach R$8 billion depending on a potential extension of the concession terms of the railroad. The exact details are not yet finalized.

Without giving details, Ometto told Valor that Rumo is concluding a railroad expansion project that will "change the logistical paradigm for agribusiness in the country" and that the success of the merger is a result of "arduous labor."

Currently, the railroad's capacity is 17 million tons per year (in the so called broad gauge). With the conclusion of the duplication of the Campinas-Santos segment, it should reach 35 million and, with the new investments, the desire is to reach 70 million in the long term.

Ahead of this new ALL remains Alexandre Santoro, who occupies the role since June 2013.

The combination of the businesses was supported by Beto Sicupira, from the trio who created AmBev (with Marcel Telles and Jorge Paulo Lemann), and one of the founders and former partners of GP Investimentos – main shareholder of ALL until 2009, when it sold its stake to asset manager BRZ.

It was Sicupira who triangulated the re-initiation of the dialogue between Ometto and Wilson De Lara, from ALL's controlling block. The idea was that they find a negotiable solution to the billion Real dispute regarding a sugar transport contract signed in 2009. Ricardo Arduini, also a controller of the railroad, helped in reestablishing conversations.

The fight began in October of last year, just after a tiring eighteen-month negotiation for Ometto to enter the controlling block of ALL by buying shares ended in frustration. The conversations did not have a happy ending, but the three businessmen remained with a wish to join each other. Even in that first conversation a merger was already imagined.

Quickly the dispute regarding the contract turned bellicose and ended in the judicial system and entered arbitration. The fight had the potential to destroy value for both companies. In November, Pércio de Souza, owner of investment boutique Estáter, was hired by ALL to seek a solution.

Shortly after one month of Estáter's hiring, both sides realized that the even a peaceful solution, negotiated around the contract, could damage the valuation of both Rumo as well as ALL. In addition to being very difficult, given the complexity of the agreement. The way forward was to seek consensus for a merger, despite the prior climate of mistrust between shareholders given the unfruitful past negotiation.

So began what was called "Projeto Atlas". The name – given inside Estáter – was inspired by the book "Atlas Shrugged," from philosopher and writer Ayn Rand, an American of Russian descent, whose plot develops around the Taggart Transcontinental rail company.

A few days before Christmas, the controlling block of shareholders of ALL – led by De Lara and Ricardo Arduini, but that includes also BNDES, Previ, Funcef and BRZ – agreed that a merger be sought with Rumo.

The primary structure was defined close to the end of year festivities, when everyone was on holiday, in an endless number of transcontinental phone calls and emails. Ometto was in New York (US). De Lara in Agra dos Reis (Rio), and Souza in Australia. Marcos Lutz, president of Cosan was in Miami (US) and Santoro split between Curitiba and an attempt for holidays in the Caribbean.

In the beginning there was a mismatch in the wishes of each side. The shareholders of ALL accepted that Rumo represent 36% of the new combined entity, but it would come with R$1 billion in new cash to be capitalized by investment funds.

Cosan and the minority shareholders of Rumo, the asset manager Gávea and the fund Texas Pacific Group (TPG), believed that the logistics company should have 45% to 50% of the sum of the businesses.

Between the start of January and the 24$^{th}$ of February when the offer was officially launched by Cosan (approved yesterday at the ALL shareholders' meeting), everything happened. The new money from Rumo and a full due diligence left the conversations. And so the percentages started to converge.

The final model was established in a binding (which one cannot walk away) and closed door (without future adjustments in the case of contingencies, even without the due diligence) offer where the shareholders of Rumo remain with 36.5% of the business and those of ALL, controllers and minority shareholders, with 63.5%.

This was the way identified to end the skepticism of ALL's shareholders that Ometto could leave the table – as happened in the prior negotiation – and still accelerate the acceptance of the heterogeneous controlling group of the railroad company. Also, the execution of the shareholders' meeting before Cade was the exit used to avoid the risk that occurred in the merger of education companies Kroton and Anhanguera.

The solution to the contract from 2009 was the essential fuel for the merger. It was this partnership, signed by the former management of ALL, that took the company to its final destination underneath Cosan Group.

Ometto's company will have less than 27.5% of the final company, but nine of the 17 board members. There will be a new shareholders' agreement, where it will be joined by BNDES (despite having less influence is the investor with the largest stake in ALL), Gávea and TPG. Together they will own 44% of the new ALL.

The value of the contract negotiated is kept in secret by those involved. But Valor found that it represented at least half of the valuation of Rumo of R$4 billion inside the transaction – that is, at least R$2 billion. ALL was valued around R$7 billion.

In 2009 the contract seemed good for both parties. But today, five years later, what is said – also by both sides – is that the partnership was great for Rumo because it was what made the company viable and was the main reason for the R$400 million investment by Gávea and TPG in 2010. For ALL, if everything had happened as planned it was only "good".

At the time, however, it was the best way that the company found to obtain R$1 billion to invest in increasing capacity – tracks, coaches and locomotives. This was the counterpart by Rumo to commit to ALL to transport, in growing volumes, what today would be 9 million tons. The reality is that, as it could not duplicate the entire segment to Santos Port in the foreseen timeframe, today only two million tons of sugar pass through the tracks.

The problem is that this contract contains, in addition to an attractive remuneration for Rumo in the shape of a rate per ton transported, heavy penalties in case of non-delivery by ALL. And these penalties started to be charged to the dot after the end of the first negotiations between Ometto and ALL in 2013. There was not in the contract the simple prediction that the capacity demanded by Rumo would only be delivered after the conclusion of the necessary works.

With the merger, between efficiency gains with the substitution of sugar for commodities with larger loads and the end of the losses caused by contract expenses, the new ALL will have the potential to generate ten times more cash than at the moment – potentially going to R$500 million per year of operating cash flow.

This new reality is what should allow the company to finance itself by seeking new debts, including from BNDES. At the end of March, ALL's net debt stood at R$4.6 billion, equivalent to 2.3 times the earnings before interests, taxes, depreciation and amortization (Ebitda) of the last 12 months. With the incorporation, the indicator should drop to 1.6 times.

In the case that a capitalization is necessary, besides the business conditions being more attractive for an eventual access to markets, the Canadian fund Canada Pension Plan (CPP) still has interest in the business. The foundation has maintained negotiations since around two years to invest in Rumo and would be interested to buy Gávea's stake. Conversations were stopped, awaiting the merger.

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http://www.estater.com.br/sites/default/files/valor-all.pdf