

Middle Market / Private Company Services

*A market that represents
Brazil's strength*



The Middle Market in Brazil

The middle market is Brazil's main driving force, as the largest source of income and new jobs. Of the more than 6 million companies of all sizes operating in Brazil, almost 500,000 are small and medium enterprises (SMEs). Another 100,000 are large or transnational companies of non-Brazilian origin, and the others are micro businesses of small scale and revenue.

The power of the Middle Market is evident in its 30% share (R\$ 1.3 trillion) of Brazil's R\$ 4.4 trillion Gross Domestic Product (GDP). The middle market segment employs more people than any other segment, with 10.1 million employed by small enterprises and another 5.5 million by medium ones.

In the last decade, the Brazilian middle class has made great advances, the result of the record low unemployment rate, combined with the increase of average household income and lower interest rates for consumer loans. Over 40 million new consumers stepped up into the middle class during recent years. The middle class now includes 96 million people, which catalyze local market demand, which in turn promotes the start-up of new enterprises and the growth of existing ones.

But it is not just the middle class advances that are boosting the middle market. Other factors have contributed and will continue to do so over the next several years:

- The benchmark annual interest rate (Selic) was reduced from 12.5% in 2011 to 7.25% in 2012, the lowest rate in history. Despite a possible increase in the short term, the rate is expected to remain relatively low by Brazilian standards;
- The consumer default rate is low;
- The federal government has reduced excise taxes on durable goods (household appliances, automobiles, construction material) to stimulate consumption;
- Government-controlled banks are competing with the private sector by offering lower interest rates and increasing available credit; and
- The Brazilian development bank (BNDES) has expanded its financing lines at very low interest rates directed to investments and exports by middle-market companies.

And the Government is not focusing its attention only on the interest rates. Given the middle market's size and importance, President Dilma Rousseff's administration created a Small Enterprise Department to promote the sector and to consider issues such as reducing taxes and bureaucracy. Additionally, the government procurement system is undergoing a transition to new regulations that will benefit small businesses.

Brazil will host the 2014 FIFA Soccer World Cup and the 2016 Olympics and Paralympics, which offer a unique opportunity for improving our infrastructure and creating millions of new jobs and numerous new businesses to meet specific demands for catering, transportation, media production and tourism, just to name a few examples.

The energy sector is another driver for the development of the economy. Because of the country's pioneering ethanol program, the majority of the vehicles sold in Brazil are "flex-fuel", running on ethanol or gasoline. Brazil also has vast offshore oil reserves (in the so-called pre-salt layer) which are under development and has established itself as a self-sufficient country for petroleum.

IPOs – A major opportunity for the middle market in Brazil

The initial public offering (IPO) market is an important option for smaller enterprises to obtain capital to leverage growth and improve their administrative and operational efficiency.

BM&FBOVESPA, the local stock exchange, estimates that 15,000 Brazilian companies will be qualified to launch an IPO within the next three years. If only 1% of this estimate becomes reality, the number of listed Brazilian companies will jump from 454 to around 600, an increase of approximately 33%.

The IPO process in Brazil is complex. A new public company must present three years of audited financial statements and adopt procedures to promote transparency and strengthen internal controls. In addition, many small and medium enterprises in Brazil are still managed by the families that founded them, and the resistance to sharing control or governance with new shareholders may be strong. These companies will need to go through an effective paradigm shift. Several initiatives are underway to support SMEs during this journey.

The Brazilian Securities Commission (CVM), which regulates the stock market, is considering simpler regulations and less demanding requirements to help middle market companies obtain access to the stock exchange. In the meantime, while these changes are still under consideration, the “Bovespa Mais” program is an interesting option. This program was introduced by BM&FBOVESPA. In addition to offering courses and speeches to guide smaller enterprises through the IPO process, the program allows a company to be listed for up to seven years before completing its initial offering.

There are other private initiatives to motivate SMEs to carry out IPOs. The most advanced one is the Growth Acceleration Program for Small and Medium Enterprises (PAC-PME), supported by PwC, that proposes a revolution in five years, aiming at making 750 IPOs possible.

An IPO changes a company forever and generally for the better. Before an IPO, a company has limited options to finance expansion. After the IPO, the company can access new forms of credit, such as investment funds, debentures, and follow-on sales of new shares. Additionally, in Brazil, where internal controls, external audits and transparency are rare among middle-market enterprises, becoming a listed company is equivalent to receiving a “seal of approval.”

The extensive list of opportunities described above indicates that Brazil is at a point in time with unprecedented possibilities that make it an extremely attractive and unique place to do business.

Our vision

Small and medium enterprises became an important vector of Brazil's economic growth in recent years. Many of those companies are family owned, operate in unregulated markets and use their own cash to maintain and expand their activities.

Because of these characteristics, these enterprises face many challenges to assure the continuity of their operations and promote their expansion sustainably. They lack, for instance, adequate structures of governance that would offer more corporate and legal stability. In this context, small and medium enterprises have room to advance by applying more effective practices to identify and control risks, especially in the legislative, tax, and labor areas.

Family involvement may also influence a company to adopt a highly intuitive administration model focused on the continuation of practices applied throughout the company's existence, which may not always be aligned with the most common practices in the market. This model may become a barrier to expansion, because it does not consider, for example, opportunities for mergers, acquisitions or even partnerships, since other companies are viewed as adversaries. Another significant barrier is the distant relationship between these companies and their financing agents, which is a fundamental element to

consider when promoting a cycle of expansion. This barrier often induces companies to limit themselves to organic growth only.

With a highly sophisticated capital market and a versatile, efficient and highly liquid financial services industry, it is quite surprising that small companies, especially the emerging ones undergoing rapid expansion, are still somewhat timid about accessing such resources. It is not surprising that, in many cases, the company's assets are not segregated from those of the owners and directors, which clearly create significant risks to the future of the business and the financial health of its owners.

Despite these major challenges, the interest in entrepreneurship remains strong in Brazil. Fortunately, transformations and a new attitude are starting to boost this market, as shown by the increasing number of companies seeking information on the IPO process.

Every day, innovative Brazilian enterprises with high potential for growth sprout up. To help these organizations become winners in the future, PwC's Private Companies Services - Middle Market (PCS-MM) offers solutions to overcome the challenges that they face. These actions clearly demonstrate our confidence in the continued, sustainable growth of the economy, and also in emerging groups of business with enormous potential for growth.

The achievability of our vision can be seen by the number of new clients we have obtained, averaging 300 new clients per year, as part of our strong growth process and the offering of useful solutions for the Brazilian middle market.

How PwC can help

Each company is unique and must be analyzed according to its activities, services, technology and products. However, on a recurring basis, all organizations face a common situation when they reach a certain size and need to face a critical transition.

We acknowledge that the middle market has been, throughout history and even more so today, the driving force of Brazil's economic growth. While keeping this value in mind, PwC Brazil's PCS-MM group have worked hard to support the continuous development of those companies in our country. To achieve that, every PwC office throughout the country has professionals specialized in this segment, with a full understanding of the challenges that emerging companies face.

We are aware that a practice that has worked well for a certain period of time may become outdated when the company reaches another size category. This is true for fundamental items such as information systems, administrative and operational structures, internal controls, tax strategies, and other new challenges.

The understanding of these challenges and a multidisciplinary vision among our different areas allow PwC to offer complete and integrated solutions. After all, one of our principles is to establish long-lasting relationships, and we aspire to work alongside the future outstanding groups of Brazilian companies.

Our services

We support the development of a company regardless of its stage of development: seed capital, start-up, early stage, development stage, buyout, and before, during, and after the IPO. Our multidisciplinary team is focused specifically on the small and medium enterprise segment and ready to assist family companies and partnerships.

Our proposals are tailor-made and consider the present stage of development and the company's objectives. We provide services to unregulated enterprises, family controlled businesses, fast growing portfolio companies, affiliates and organizations with the opportunity and interest in going to market.

What makes us different

We dedicate our time to understand the company and its future plans, and we work together to achieve its objectives. This is how we begin a relationship: establish a solid foundation, think about the long term, become involved with the daily activities of the organization, and be ready to help create new long-lasting values in a very close and personal way.

Services and Solutions

We offer a complete portfolio and dedicated teams specialized in small and medium enterprises.

1

Planning

Strategic planning is an essential factor for defining a business' direction and to assure that the key people understand its objectives.

We support entrepreneurs in identifying important planning techniques, such as clearly stating objectives, analyzing competitors' actions, identifying and understanding their customers' new demands, and discerning investment needs. Based on these points, as well as the understanding of the market reality and the organization's desired objectives, the planning decisions can be established.

We know that many enterprises begin with a well-defined focus, but, in many cases, only a few executives and the partners have a deep understanding of the planning. Failures to disseminate knowledge, develop coherent objectives, integrate operations, and communicate effectively may compromise the plan of action plan and limit the company's development.

That is exactly why we share our knowledge to help businesses build a solid strategic plan and ways to disseminate it, making the plan a point of reference for day-to-day business activities. This is feasible because we help corporate management take action on critical issues, defining and prioritizing objectives, analyzing competencies, strengths, weaknesses and risks, and defining real strategies that will translate into real gains.

Our solutions

- Strategic planning;
- Business analysis;
- Market positioning analysis;
- Budgeting;
- Benefit and salary planning;
- System planning and implementation; and
- Outsourcing.



2

Management

Without consistent management, there is no sustainable growth. Unfortunately, for many Brazilian entrepreneurs, this apparently obvious statement has not been transformed into an absolute truth.

It is possible to find many small and medium enterprises that lack executives and managers, including a visionary owner, that have the business skills necessary to maintain long-term growth.

Ideas and people are fundamental, but organizations also need to manage assets, processes and, above all, risks. Many enterprises focus on market opportunities, but forget to analyze the internal aspects, which can be silent risks that, although hidden, may have profound impacts on the company's future. In other words, the companies have deficient or inexistent controls, process analysis, and even tools for routine monitoring. These deficiencies often result in missed growth opportunities or even financial and operational losses.

For this reason, our PCS-MM professionals apply distinctive analysis and diagnostic studies to identify current and potential risks. With a high-quality team, we support executives and managers in developing processes and adjusting business measures, according to their stage of development, using monitoring and managing tools for multiple and distinctive risks.

We offer to entrepreneurs our experience in areas such as cash, asset and risk management, when we assess the compliance with legal and tax regulations. In the long term, we support organizations in defining the verifications, necessary controls, and adjustments that must be carried out to ensure that business activity continues to follow the established plan.

Our management solutions

- Audits;
- Internal audit;
- Best practices (benchmarks);
- Budgets;
- Audit of business processes;
- Cash flow management;
- Cost reduction and monitoring;
- Internal controls;
- Regulatory compliance;
- Risk management;
- System planning and implementation;
- Tax planning and compliance;
- Corporate governance;
- Managerial information systems;
- Fraud prevention and investigation;
- Troubled business recovery;
- Corporate restructuring;
- Support in legal disputes;
- Outsourcing of support activities;
- Logistics;
- Project management;
- Sustainability.



3

Expansion

Globalization, and consequently the deep transformation promoted by the financial system, caused a major change in the minds of Brazilian entrepreneurs, which also is reflected in small and medium enterprises. The entrepreneur is increasingly aware that the sophisticated financial industry can offer important and innumerable ways to ensure business expansion. At the same time, the perception of opportunities beyond national frontiers is growing.

This recognition can be seen, although somewhat timidly, in the expansion plans of Brazil's middle-market companies. Management must confront various questions: How can we identify, hire, and retain talents? How can we access financial resources? How can we resolve our tax and fiscal issues? Where can we expand our geographical reach? Should we acquire competitors? Should we form a joint venture?

These questions are more difficult and complex to answer when they refer to international expansion of the company. Important considerations include regulatory aspects, tax requirements, exchange risks, adequate and competitive logistics, complex financial reports and even cultural factors. Opening the door to new investors, who could help leverage the business, may also raise anxiety and uncertainty for many entrepreneurs.

In this context, PwC can support businesses in evaluating and planning its strategies, both locally and internationally. We help the company identify and prevent potential difficulties, analyze opportunities, and access the financial system and the capital markets. We work together with the company to obtain effective and sustainable growth.

Our expansion solutions

- Mergers and acquisitions;
- Strategic alliances;
- International acquisitions and restructuring;
- Project financing assistance;
- Investment analysis for plant location;
- Due diligence for acquisitions;
- Post-acquisition integration;
- Revenue growth;
- International trade;
- International taxes;
- Expatriate taxes;
- Identification of fiscal incentives; and
- Human capital strategies.

4

Financing

PwC helps small and medium enterprises identify and discover the best opportunities, at the right time, to raise capital in a coordinated way and without surprises.

Unfortunately, despite the huge improvement in the quality of the financial system and the capital market in Brazil over the last few decades, many entrepreneurs and even stockholders still underestimate the need for capital and cash generation. Many also are skeptical about welcoming new investors or strategic partnerships.

In these projects, we aim to share our knowledge, including our experiences with major corporations, to support emerging organizations in identifying capital needs and where and how to obtain financial resources with attractive conditions, or just to restructure themselves to qualify for these resources.

Accordingly, we support our clients in accessing a wide range of sources of capital and financial resources, and even use our network of contacts to enable access to strategic investors.

Our financing solutions

- Corporate finance;
- Company valuation;
- Support in obtaining credit; and
- Initial public offering (before, during and after).

5

Governance

In Brazil, the history of a company is often confused with that of its founders. The structure and culture of the family and the company's management structure have a symbiotic relationship. Some highly successful family organizations also have difficulties in implementing succession planning or even the transfer of leadership. The DNA of many companies contains both the family fortune and the organization's assets, a mixture which generates risks.

An important focus of our work with small and medium enterprises is to evaluate the personal and family aspects of the business and

introduce an adequate and efficient management structure which will assure the sustainability of the enterprise.

We help entrepreneurs and executives to create a personal pension plan and the family succession plan. We also provide consulting on divestiture planning, to ensure that the business is transferred on a fair basis that will maximize results.

Such support is also offered for companies that need to restructure themselves to attract new partners and institutional and strategic investors, as well as preparing them to comply with the regulatory requirements for a possible IPO. Consequently, the company can become more solid, more transparent and more attractive.

Our governance solutions

- Corporate governance;
- Succession planning and management;
- Shareholders' agreements;
- Tax planning;
- Succession financing;
- Family governance;
- Objective identification;
- Successor selection; and Business divestitures.

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