M&A and Private Equity in Brazil

An overview

Introduction

Brazil has developed into the largest market for private equity in Latin America, accounting for more than Mexico and Argentina combined. In 2012, according to Thomson Reuters, total PE investments in the country were US$8.3 billion, representing 72% of the Latin American PE industry.

With a first stage during the 1994-2000 period, the Private Equity industry in Brazil benefited from a faster learning curve. Its landscape is leveraged by a later start and affected by positive and negative characteristics/conditions – inomerous consolidation opportunities, capital for growth demands and high interest rates favoring all-equity deals are some examples.

The emerging middle class, eager to benefit from ever increasing disposable income and credit availability, is increasing internal consumption of a broad range of products, from food to government-subsidized housing, making Brazil one of the leading consumer markets worldwide.

At the same time, Brazil's economic conditions and potential are the main drivers behind the growth of the Brazilian PE industry. More recently, this potential created social challenges. New demographic conditions and recent social demands will require not only substantial government changes, but is afecting potential of growth and consumption of products and services (like healthcare, education, infrastructure, logistics, oil and gas, among others).

Growth, consolidation, and governance. These elements form the landscape of the industry. Exit opportunities are there. Albeit much more cautious markets, IPOs are a good alternative. Sale to trade/buyers are getting momentun, as well as funds of funds and sale to other funds.

More recently, the Brazilian Central Bank introduced two resolutions for public consultation that will bring expectations to improve sustainability disclosure and accountability to the financial sector. The first resolution proposed that all financial institutions will be required to create and implement socio environmental responsibility policy well-matched with their extent and the issues to their business. The second one is concerned to the elaboration and assurance of Socio Environmental Responsibility Reporting.

The private equity landscape has changed. Regulatory pressure, calls for transparency, erratic markets and increased competition mean that private equity funds need to cast their net further to find untapped sources of value.

PwC has an established private equity practice with a proven track record. Our capabilities go from fund structuring through to deal origination, deal execution and post-deal services. We work with our private equity clients to help them to refinance and exit from their investments. In a country with an extremely complex tax system, our taxation advice extends across the private equity deal continuum, from fund inception and going on compliance to tax due diligence, structuring and exit planning.

From a portfolio company perspective, in addition to audit services, our specialists can support and implement bolt-on acquisition strategies, valuation discussions and execution, tax reviews and post-acquisition integration services - all of them backed by a well-structured risk management and independent processes and policies. A full IPO readiness and governance compliance is a must on Private Equity portfolio companies, and PwC has a unique team of multidisciplinary professionals.

With significant resources to invest and with the aim of transforming entire sectors of the Brazilian economy, private equity investors have become a significant force in the market

Total committed capital reached ***US$ 40 billion*** *in 2012*

Main characteristics are platforms/ bolt-on strategies with capital for growth and controlling acquisitions.

Exit strategies are from IPOs, trade sales or secondary PE transactions. Fund of Funds transactions are becoming more common.

PEs in Brazil have to have a hands-on approach and targets usually need general corporate governance improvements.

PEs were present in around

40%

of announced deals in 2012 (15% in 2007)

US$ 18 billion

available for investment in the country

(represents some **45%** of committed capital, which totals US$ 40 billion, with a growth of **31%** in comparison to previous year).

Divestitures (IPO, trade buyers or to other PE) totaled **US$ 3 billion** in 2012 – with PE to trade buyers transactions being the most common.

Focused on adding value to companies, private equity has made strong gains in terms of its share of transactions, taking part in 40% of all transactions in 2012, compared to just 15% in 2007.

Even though the intense growth of the private equity market is notable, it is still seen in Brazil as an asset class with vast capacity for expansion.

In the past, private equity house investments were concentrated in food services and the real estate sector, but today PE houses are investing in a wide range of sectors such as: IT, health, education, energy, infrastructure, logistics, oil and gas, mining, reforestation and consumer goods, among others.

The PE industry has been experiencing significant developments over the last few years in Brazil.

Target companies' weknesses are oportunities for PEs

Strengths

- PE is an important source of capital (capital/ debt markets very selective in Brazil and PEs have larger importance).
- Brazilian companies (mostly family owned) need a partner with capital for growth and to leverage operations.
- Market growth and multiple companies as targets.
- PEs perceived today in the Brazilian market as a "good partner" to leverage value and give long term value to founding shareholders.

Weaknesses

- Companies need support to implement better levels of corporate governance.
- Companies lack of qualified sr. management professionals; requires more investment/ hands-on monitoring.
- Exit strategies: trade buyers are the most common; capital markets are selective and only for larger deals (accessible for PE portfolio companies after several bolt-on acquisition strategies).

Opportunities

- Alternative for capital for growth, with several investment structures (VC, PE, mezzanine, acquisition finance, etc.).
- Operational effectiveness/margin improvement.
- Proprietary deals/relationship are critical in Brazil, and the right ones can allow managers to have more attractive deals.

Threats

- Recovery of debt and capital markets.
- Competition is getting stronger, with all international PEs analyzing Brazil.
- Brazil not performing as expected may delay harvest/divestiture.
- Need to implement bolt-on acquisition to create attractive target/exit: risk.

Brazil

Business Perspectives and the M&A Market

Since the middle of the 1990's, Brazil has achieved progress in several areas including control of inflation, consolidation of democracy, the end of economic plans that used to be launched every other year, among other achievements that led the country to stabilization, growth of the middle class and internal consumption, recovery of the IPO market (also fueled by new regulations protecting minority shareholders) and economic growth.

During this period, Luiz Inácio Lula da Silva from the Labor Party was elected and re-elected as President of Brazil without causing any disruption to the previous government policies. Country risk decreased significantly, international reserves skyrocketed and Brazil was awarded the organization of FIFA's World Cup in 2014 and the Olympic Games in 2016. In addition, the significant discovery of the pre-salt oil reserves is expected to require investment of hundreds of billions of dollars in the next 10-15 years.

Brazil became an appealing destination for foreign investment. Some 450 deals were completed in the first half of 2013 with a 6.47% increase in the participation of foreign capital (compared to H1 2012). Foreign investors were present in 37.3% of announced transactions and PEs record presence in 56.1% the transactions.

The Brazilian M&A Market

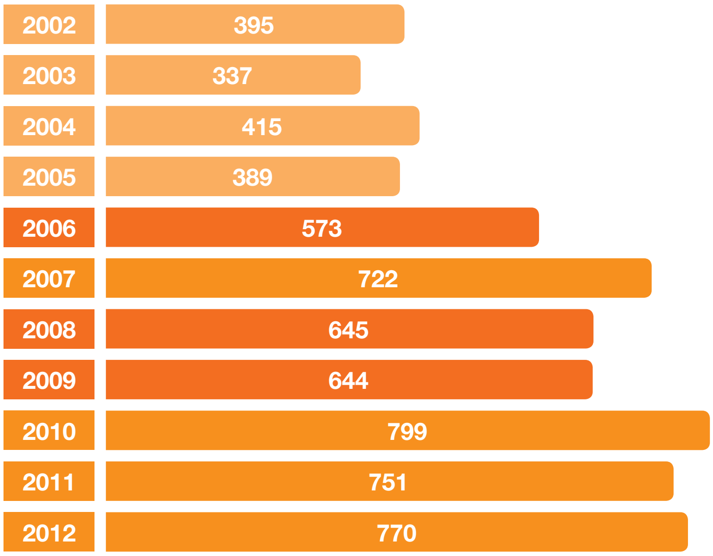
As Brazil's economy has continued to strengthen, the M&A activity has continued to grow year after year. The following analyses provide an overview of the Brazilian M&A market.

There were 770 announced transactions in 2012, which was 2.5% increase in comparison with 2011. It is expected that M&A activity will continue to increase in 2013, at similar growth levels of 2012. The majority of these transactions, 72%, occurred in the southeast region of Brazil, which includes the cities of São Paulo and Rio de Janeiro.

Although transaction volume did not reach the record levels of 2010 (which included transactions postponed from the crisis years of 2008 and 2009), 2012 saw some one-off events in the Brazilian M&A market, such as changes to the antitrust Brazilian policies overseen by the antitrust regulator CADE (the "Conselho Administrativo de Defesa Econômica"). The new changes became effective in May 2012, which spurred M&A activity in the preceding months, as companies sought to close before the regulatory changes.

The European economic crisis also contributed to a reduction in global investment flows and many industrialized countries went into recession. Even in this environment, Brazil remained attractive in the international market, being competitive compared to traditional M&A markets, consolidating its status as an attractive country for M&A.

Number of deals announced by year

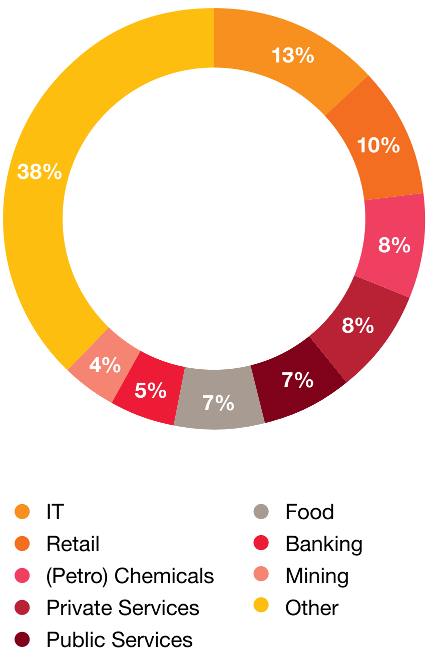


The M&A activity in Brazil thrives across many sectors. In 2012, information technology, retail and petro/chemicals (fueled by pre-salt oil potential) were the sectors where we saw the most volume, accounting for 31% of the M&A activity. These sectors continue to show high activity in 2013.

To summarize some of the key takeaways from recent M&A activity and looking into 2013:

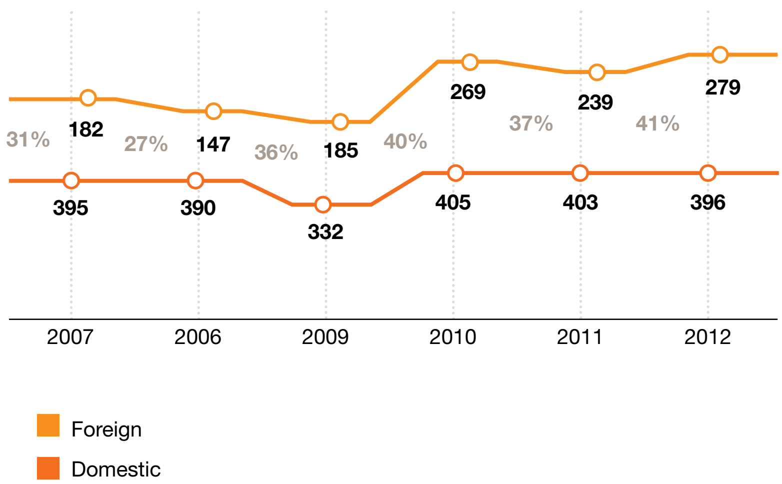
Foreign investors accounted for 41% of the announced transactions, consolidating a larger participation of foreigners in the Brazilian M&A market, up from around 30% 4-5 years ago.

Brazil 2012 M&A Activity, by sector



M&A in Brazil by Origin of Buyer

(Includes only acquisition of 100% controlling or minority transactions)



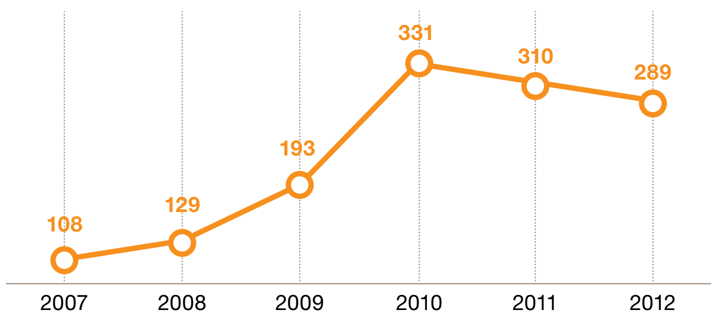
Source: PwC research

Brazil has huge needs for investment in infrastructure such as railroads, highways, ports and airports.

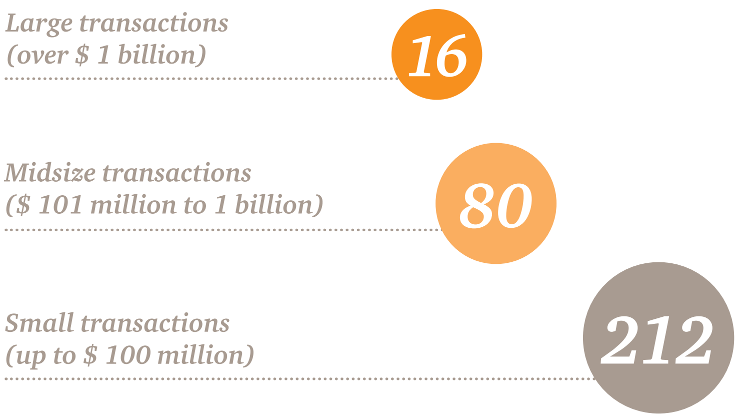
Infrastructure has become a bottleneck for many industries.

- Private Equity firms accounted for 38%, of the Brazilian M&A activity in 2012, participating in 289 of the announced deals. It is expected that cross-border PE funds will continue to invest in Brazil across sectors.
- Of the 770 total announced transactions in 2012, 308 had their values disclosed. The majority of the disclosed transactions (212) were small transactions (up to $100 million). This is indicative of the fact that Brazilian companies are still growing and there is still a great amount of opportunities for consolidation.

Number of PE deals



Number of transactions with value disclosed
308 deals of a total of 770 deals - 2012



Source: PwC research

How PwC can help

Deal Cycle

PwC specialists aim to assist Private Equity clients in the Deal Continuum experience, supporting their needs beyond the deal. By assisting PEs to understand the local realities and liaising with PwC expert teams in other country, we aim to help our clients to succeed in their expansion ambitions beyond the deal, into integration, operational, tax, strategy and compliance needs.

1 *Fund Structuring*

- Help you navigate the maze of tax issues
- Advise on designing the optimal deal structure
- Support a broad range of transactions
- Looking closely at the specific transaction objectives to be achieved

2 *Deal Origination*

- Expose our sell side deal flow
- Help you to identify and assess potential acquisition and bolt-on targets
- We advise you on your investment search, business planning and financial modeling

3 *Due Diligence*

- Our integrated service includes financial, operational, commercial and environmental due diligence, maximizing advantage within sale and purchase agreements

4 *Post-Deal*

- We advise private equity stakeholders throughout the duration of their investments in order to optimise value on exit and help them become top quartile performers
- We can call upon a whole range of PwC experts to add value, improve operations, minimise any value detractors and prepare the asset for sale

5 *Exit Planning*

- Our services are designed to ensure that you, the vendor, remain in control of the process and are able to dictate the timetable and issues to be negotiated
- For vendors undertaking a disposal or selling off a part of their own business, vendor assistance provides tailored solutions to assist you in successfully completing your divestments
- We also provide advice on Initial Public Offerings (IPOs) covering all stages of the process

Many experienced professionals, one solution

In order to manage the complexities of doing business in Brazil, along the entire business lifecycle of a Private Equity, Private Equity firms need a cash culture and an integrated plan for managing funds, improving portfolio company performance and ensuring flawless transactions. PwC provides a single point of access for bringing our experience to all three areas. Our knowledge spans a range of disciplines and industries to help private equity clients:

Deals

- Prepare for upcoming deal opportunities: Examine markets and industries, consider IPO readiness and anticipate IFRS requirements.
- Maximize deal value through effective due diligence, valuation and M&A integration.
- Structure or restructure deals to address the impact of debt and legislation.
- Invest in distressed companies.
- Pursue divestitures from strategy through execution.

Portfolio Companies

- Free up working capital, reduce costs and put cash at the heart of your management reporting.
- Improve effectiveness, processes and strategies for IT, operations, tax function and finance to drive revenue and reduce costs.
- Restructure underperforming portfolio companies.
- Put the right incentives in place to attract and retain talent.
- Achieve consistent and effective portfolio audits.
- Supporting activities outsourcing and shared services centers (SSC) implementation.

PE Funds

- Across the entire portfolio, capture management information, ensure data security and controls, and provide timely, accurate reporting to LPs.
- Protect brands by anticipating and managing reputational risk across key areas such as environmental, country-related risk, and sector risk.
- Navigate valuations and financial and reporting requirements.
- Access capital markets for an IPO or to fund expansion and operations.
- Explore global investments.

PwC Brazil differentiates itself in this market by having a unique CF+TS approach, with a deal flow pipeline shared with PEs on a monthly basis and long-term relationships.

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