Aquin & Cie.
strategic finance ag

Advisory Notes.

N°14 | September 2011

The specifics of successful M&A in Brazil

Why Brazil?

Brazil's GDP grew 7.5% p.a. in 2010 reaching about USD 2.0 trillion combined with low unemployment rate of 5.3% and relatively stable public sector net debt of 40% of GDP. This performance comes with no surprise.

Today, Brazil has one of the largest consumption base with close to 200 million people, accounting for 60% of the country's GDP and a large diversified economy. The country not only plays a key role in major commodities, such as oil & gas, iron ore, bauxite, sugar, soybean and cotton, but also has a major manufacturing base for the automotive sector (#4/#5 in the world) and for the airplane industry (#3 in the world). The growth has been sustained by growing access to the developed capital market combined with a strong banking system.

At the same time, the Brazilian scenario still offers a lot of opportunities. Brazil has historically invested around 5-8% of GDP in infrastructure, not much has been done during the 1980s and 1990s, leaving ample room for investors to catch up on this sector. Education and health have also lacked the investments from the Government, so that the private sector is already playing a role in filling this gap. Last year, FDI reached close to US$ 49 billion and the projected performance for 2011 should be in the amount of at least US$ 60 billion. This shows foreign investors' confidence in investing in Brazil as well as an excellent opportunity for geographic diversification. Finally, consolidation of most sectors should happen.

Brazil's power to attract M&A

Brazil has seen a consolidation of several sectors, such as Retail, Financial Services, Food and Beverage, among others; but there are still many fragmented sectors that are starting to look at M&A as an option for a non-organic growth, like education, health and construction. Furthermore, in the eyes of investors, Brazil has been an interesting country in "specialized" sectors, such as renewable energy, oil & gas, sugar & ethanol. Summarizing, Brazil, as a relatively low risk country with high growth rates is booming Mergers & Acquisitions.

Following the accelerated economic growth in 2003/2004, Brazil restructured its capital market governance, which increased not only the cash inflow to the country but also brought credibility to real asset investments. As a result, most of the private equity firms landed in Brazil bringing a relevant amount of funds, corporate governance and high return to its investors, as now Capital Markets are a feasible way out for PE funds.

Facing this new scenario of local development, Brazil becomes a priority target not only for PE Funds, but also for the key multinational companies willing to be part of Brazilian new stage of progress, since the country will hold the FIFA World Cup in 2014 and the Summer Olympic Games of Rio de Janeiro in 2016 that will bring a strong demand for infrastructure and internal consumption.

In order to be part of these future growth expectation, many Greenfields are setting up operations locally, but an acquisition or a JV is always a faster way to catch up the growth trend and take over the desired market share in the selected industry.

As a result of a much appreciated local currency, the Real, Brazilian companies have evolved from generally being a target of international companies into a buyer - locally and abroad. South-to-south investments are a recent trend, and many Brazilian corporations have been looking for potential business in Latin American and African countries as well as in Russia, China and India. Cross-border mergers and acquisitions had consequently recovered the 2007/2008 level, accounting for around 40% of total announced deals and Private equity deals represented around 30% of the announced transactions.

M&A Business in Brazil

Doing M&A in Brazil generally follows the same guidelines as those in most western cultures, but some particularities are very important to be highlighted:

Valuation multiples are above world average

- **Deal Structure** – Most of M&A transactions are purely equity, although stocks swap are becoming more common. We have seen acquisition finance in large transactions, but not yet in mid-size transactions. Depending on the potential buyer, the seller would support the deal in an "earn out basis".
- **Players** – Large and public companies are generally sophisticated and the deals always tend to be accretive. Middle market players show a tendency to be conservative, especially regarding financing and payment.
- **Due diligence** – A local transaction due diligence usually takes longer than initially planned. It is always important to be closely supported, as Brazil has a very complex Tax and Labor laws. A potential liability not necessarily noted in the due diligence report has a high percentage chance to happen and become a real liability. In this stage of the transaction, it is very important to have local attorney support.
- **Valuation** – Supported by its internal growth rate, Brazil had considerably resisted the world crisis and for that reason valuation multiples are generally above world average, especially considering demanded industries as education, retail, construction and health services.

Investments as an alternative financing for Brazil

In the context of international crisis, the role of Development Finance Institutions ("DFIs") becomes of greater relevance - especially in an emerging economy like Brazil - since they provide financing on long-term basis at competitive costs. DFIs were created during the postwar period as a way to promote reconstruction by financing projects that not only were viable, but also would yield benefits for the whole society. Their mandates include investments in developing countries, poor regions, infrastructure projects and more projects recently related to reducing climate change effects like renewable energy, recycling and energy efficiency.

As a developing region, Brazil and all Latin America have attracted an overall large amount of capital inflows in the past years, reaching its peak in 2007 with US$ 217.5 billion of net capital inflows. These figures include investments in both private and public sectors. However, the lack of progress observed in some poor countries that have borrowed from DFIs has pushed these institutions to shift their support towards private sector investments.

By Richard Saito and Aleixo Vaquero

Aquin & Company has built a strong network of internationally renowned M&A-Advisors to guarantee direct access to the most appropriate investors worldwide. The authors of this article are counted among the network Aquin & Cie.

Over its 20-year experience Finenge has developed its business to provide a broad range of services, following local and global trends, always to provide the best solutions to its clients. The enrollment in Aquin & Cie's network is certainly another important milestone for Finenge's history.

Finenge is a financial advisory boutique with strong track record of private placement with international Development Financial Institutions (DFIs), and strategic finance advisory services in Brazil. It has recently joined Aquin & Companie's international network to provide additional services for its clients related to M&A and strategic JV with European, US and India players.

As a way to promote cross-border investments for Finenge's clients, Finenge has partnered with MIGA (Multilateral Investment Guarantee Agency) of the World Bank in providing advice to its clients going international by providing political risk insurance.

Contacts

Richard Saito
rsaito@finenge.com

Aleixo Vaquero
aleixo@finenge.com

ADVISORY NOTES.
RECORDS ON CORPORATE FINANCE.

Irregularly published by:
AQUIN & CIE. AG
Schackstraße 1
80539 Munich
Germany
Phone +49 (0)89.41 35 39 – 0
Fax +49 (0)89.41 35 39 – 29

www.aquin-cie.com
München | Lindau | Rheine | Paris | Chicago | São Paulo | Bangalore