

www.pwc.ch

PwC Deal Talk











Doing Deals in Brazil from a
Swiss Investor's Perspective

Edition: 6/2017



pwc

Key facts about Brazil

		
 Area	8,516 k km ²	41.3 k km ²
 Population	206.1 m	8.4 m
 Capital	Brasília	Berne
 Primary languages	Portuguese	German, French, Italian
 GDP	USD 1.8 trillion	USD 0.67 trillion
 GDP per capita	USD 8,730	USD 80,945
 Economic ranking	9th	19th
 Exports*	USD 1.65 bn to Switzerland	USD 1.89 bn to Brazil

*Source: SECEX (Brazilian Foreign Trade Agency)

Large economy with track record of change

“Bem vindo ao Brasil” – the world’s ninth largest economy, the largest in South America, its most populous country and a prominent BRIC member.

While still an export nation, Brazil has developed into a much more diversified economy underpinned by impressive growth in its dominant agricultural, mining, manufacturing, and service sectors.

In spite of its promising development, there remain substantial economic and political challenges that will call for swift and well-targeted counteraction in the near future. However, Brazil continues to offer great potential for growth and fertile ground for successfully implementing cross-border M&A strategies.

Strong bilateral trade relationship

At present, Brazil is the 24th most important trading partner of Switzerland with 22% of Swiss

trade negotiations in Latin America being in Brazil.

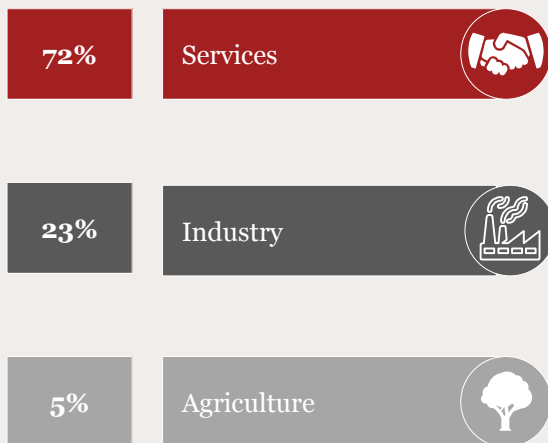
What is more, in the last decade, bilateral trade between both countries has more than doubled. Indeed, Brazil is attracting an increasing number of small and medium-sized Swiss companies because of its growing consumer market, while Brazilian firms continue to show a keen interest in Swiss technology and services firms that could be either catered to or acquired.

In terms of numbers, SECEX (Brazilian Foreign Trade Agency) reports that Brazilian exports to Switzerland peaked at USD 1.65 bn in 2016, while imports amounted to USD 1.89 bn during the same period.

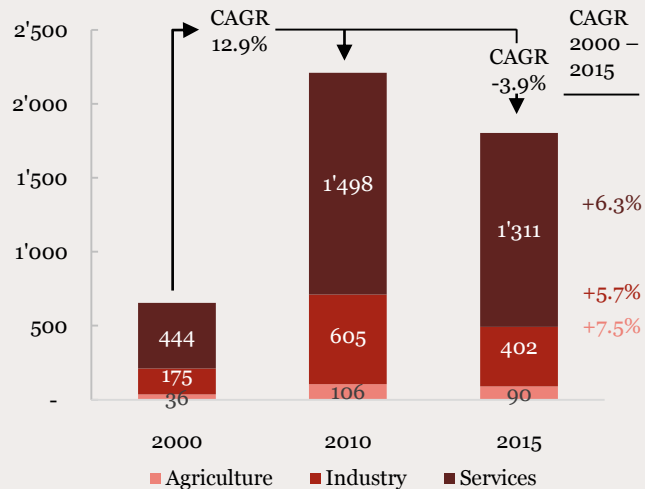
Exports to Switzerland mainly consist of port equipment and facilities, gold bars, aluminum, tobacco, rice, beef, machinery and mechanical appliances, coffee, and oranges. Switzerland mainly exports pharmaceuticals, chemicals, pesticides, coffee, and machinery to Brazil.

Embracing economic change, Brazil attracts businesses and investments alike, providing fertile ground for future growth

GDP contribution by sector (FY 2016)



GDP contribution by sector (2000-2015) (in USD bn)



Brazilian economic policy is more market-oriented, but bears political burdens

The past 30 months have been characterised by abundant unfavorable news reports about Brazil's economic and political state. However, Brazil is, in many ways, its own natural market and has tangible potential for growth despite, or indeed because of, its current shortcomings.

As an illustration, Brazil's GDP grew 237% between 2000 and 2010 with a CAGR of 13% during the same period. This impressive development is reflected in most industry sectors. Although the country's economy dipped into recession in 2015 and 2016 for a number of reasons, growth is set to continue in 2017, while there still remain substantial challenges.

Today, initiatives responsible for swift economic uplift only a few years ago have come to a point of exhaustion. Increasingly, socio-economic patterns like privileging consumption over investment, giving preferential treatment to sectorial policies over structured, nationwide reforms, or shielding the domestic market from global trade have caused the country's development to come to a halt. This has caused Brazil's GDP to drop considerably over the last 5 years.

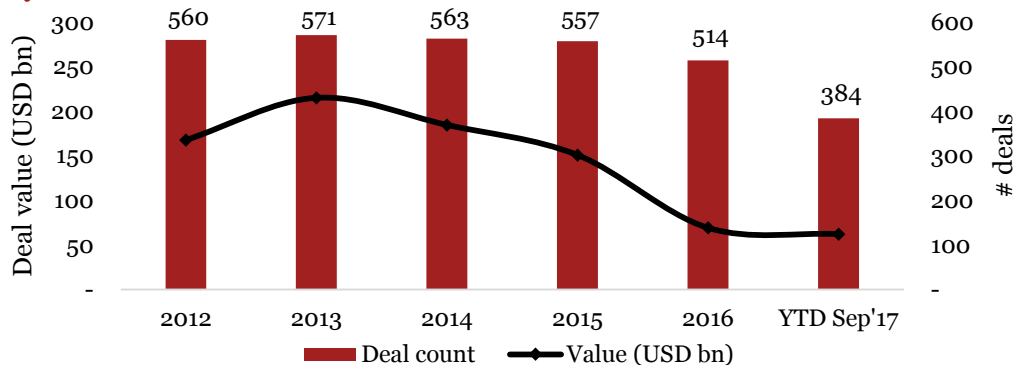
Clearly, the way out of the current stalemate must address urgently needed pension, tax and labour law reforms. In addition, a path to effectively counteract the country's massively unequal distribution of income must be found.

To this end, the government is in the process of managing concession-type arrangements more effectively to privatise sectors with monopolistic tendencies. Secondly, Brazil has brought in a number of highly experienced and distinguished executives to lead Brazil's government-controlled operations in oil & gas, development banking, and its energy sector. This has yielded major performance gains in institutions such as Petrobras, BNDES (Brazil's Development Bank), and Eletrobras. Thirdly, a new team steering the country's macroeconomic development in times of major policy changes has taken office.

As a result of these market-oriented policy changes, the Brazilian economy has attracted the attention of international businesses and investors, which may contribute to higher employment rates and investment levels. Nine months into 2017, the implemented changes are beginning to bear fruit.

Stable M&A activity in recent years

M&A activity



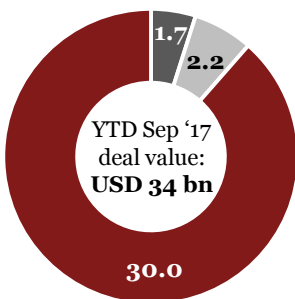
Note: The number of transactions includes joint ventures, mergers and spin-offs.

Cross-border and private equity activity YTD September 2017

Top 5 target countries¹⁾:



Outbound deal value



Inbound deal value



Top 5 investor countries¹⁾:



■ PE buyout ■ PE exit ■ Pure strategic

1) By deal value YTD September 2017

Deal flow

Brazil's M&A activity reflects its economic development. Due to the slowdown starting in 2015, deal count, sluggishly adjusting, started pointing downwards in 2016. That aside, the country has a track record of stable and healthy deal volume peaking in 2013 with almost 600 closed deals.

Nine months into 2017, just short of 400 deals were recorded. Stricter legal and regulatory scrutiny may continue to hamper Brazil's M&A market, effectively compounding the impact of the recession and lingering political turmoil.

M&A dollar volume hit a record in 2011, surpassing the USD 100 bn mark thanks to a few mega deals in the telecommunications, transportation and energy sectors. Since 2011, M&A dollar volume is trending downwards, reflecting economic challenges and greater regulatory hurdles for large deals.

Sources: MergerMarket, CapitalIQ, Reuters

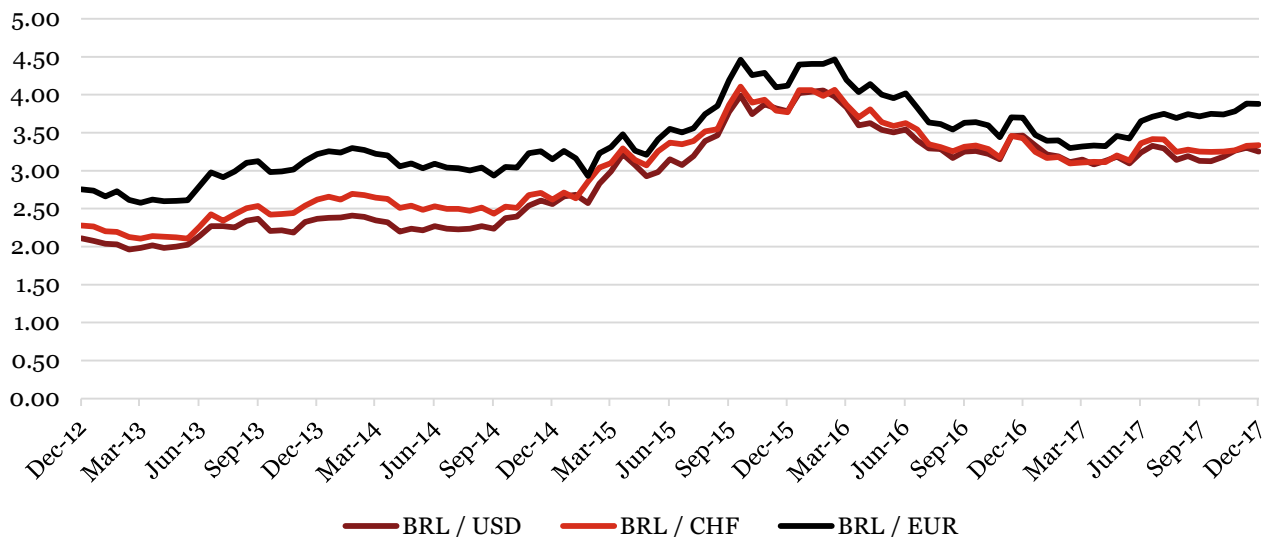
As a growing economy, Brazil's M&A landscape is dominated by middle market deals that, first and foremost, have a consolidating effect on the market. As such, strategic M&A deals make up the vast majority of recorded deals in the first nine months of 2017.

The US is by far the most active foreign acquirer in Brazil in terms of number of deals, whereas Canada is currently ahead of them in terms of value, driven by Paper Excellence Canada's USD 4.3 bn investment in Eldorado Brazil Cellulose. Canada is followed by the US, China, Argentina and Mexico. In terms of outbound transactions, Brazilian companies were most active in the UK, US, Turkey, Uruguay and Paraguay in 2017.

Brazil saw 27 private equity buyouts in the current year worth USD 1.7 bn based on announced deal values.

Privatisation, healthcare sector regulation changes and continuing market consolidation likely to boost M&A activity

Currency development



Currency development

After years of appreciation of the Brazilian Real and a continuous ramp-up of the country's current account deficit, this tendency has come to a point of inflection in 2015.

The substantial devaluation of the country's currency was, among other reasons, caused by the strengthening of the US Dollar in global markets, the discussed deterioration of Brazilian terms of trade, and the high current account deficit.

In 2017, the development seems to have stabilised with the Real showing signs of appreciation.

Since Brazil is a key exporter of raw materials and agricultural products to the rest of the world and as commodities are usually dollar-denominated assets, investor confidence in the US market and its currency will continue to strongly affect Brazil.

Lastly, the Real moved in very similar patterns to the Euro and Swiss Franc, as well as the US Dollar, suggesting largely similar effects on the BRL/CHF FX rate to events hitting the BRL/USD rate, *ceteris paribus*.

Source: PwC: *Doing Deals in Brazil - 2017*

Brazil has a multi-sector profile in M&A

Strengthened by the abundance of its natural resources and the extensive possibilities created by the country's sheer size and population, M&A activity is due to increase across several sectors, despite current structural pitfalls.

The largest investments in 2016 have been in IT, financial services, general services, retail and logistics, with consolidation in all these sectors continuing to be a key driver for deals.

In addition, a new law introduced in 2015, designed to abandon limitations to foreign shareholdings in domestic companies in the healthcare sector (i.e. hospitals and medical plans), has considerably stimulated and accelerated private equity activity in those sectors.

Lastly, ongoing privatisation efforts will further propel Brazil's M&A market going forward. Brazil is also in the process of inviting tenders for infrastructure concessions, which will further advance foreign direct investments, especially in the cash-strapped utility sector. In 2017, foreign direct investments into Brazil are expected to exceed USD 60 bn.

What's the deal in Brazil?



The main investment challenges

Despite significant progress, investors still face numerous challenges when they approach Brazil. There is a complex regulatory environment with regards to tax and labour, as well as high taxes and social charges on payroll, sales, and income. Multiple taxes and fast-changing legislation can affect business plans and increase risks on contingent liabilities, potentially blocking the success of both asset and stock acquisitions. Brazil also has complex transfer pricing and foreign capital registration rules. It is important not to underestimate the time needed to execute and complete a deal.



Quality of financial information

The quality of historical financial information of businesses in Brazil varies considerably and does not always fully adhere to generally accepted accounting principles (i.e. extensive use of cash accounting). A significant number of small and/or family-owned businesses may require post-deal investment in areas such as corporate governance, internal systems, integration of IT platforms, and HR-related matters, among others.



Labour reform

Aimed at the creation of new jobs and a reduction in unemployment rates, through the implementation of less restrictive rules, Law n.13.467/2017 amended the Brazilian Labour Code (*Consolidação das Leis do Trabalho – CLT*) and related regulations.



Anti-bribery and corruption regulation

Brazil implemented an anti-bribery and corruption act (Law n.12.846/2013) that entered into force on 29 January 2014, better known as the “Clean Company Act”. The law does not have a criminal perspective for companies, like the FCPA or the UK Bribery Act, but provides for severe civil and administrative responsibility and consequences for a company that is found to have committed or been involved in acts of fraud or corruption involving a public official in Brazil or abroad. Additionally, the law includes a successor liability clause in which an acquiring company can be held accountable for the misdeeds of an acquired company.



The future

Despite the recent lack of growth, Brazil is still a significant market for foreign companies to be present in due to its massive population and its fast-growing consumer market with high growth potential, especially among the middle class. Many local companies are undervalued and in need of restructuring, capital and technology.

Once Brazil leaves corruption behind and starts improving governance at all levels of politics and economy, it will resume its growth trajectory and remain an attractive market for a long time to come.

Contacts and credentials

Key contacts



Sascha Beer

Partner, Corporate Finance / M&A

+41 58 792 1539

sascha.beer

@ch.pwc.com



Nico Psarras

Partner, Head of Transaction Services

+41 58 792 1572

nico.psarras

@ch.pwc.com

Contributors



John Tavares

Director, Transaction Services

+41 58 792 9386

john.tavares

@ch.pwc.com



Grasielle Neves

International Tax Services – Brazilian desk

+41 79 350 5138

grasielle.neves

@ch.pwc.com

A Portuguese native speaker and fluent in Spanish, since 2011 John is supporting Swiss clients with their investments in LATAM, blending with local teams on due diligence projects.

From 2004 to 2016, Grasielle worked at PwC Brazil in charge of different tax projects including M&A transactions.

Selected Brazilian deals with involvement from PwC Switzerland team members

RICHEMONT
acquired the Brazilian distribution business of

MONT BLANC

Buyer advised by

pwc

PwC provided buy-side due diligence services to Richemont on their acquisition of Mont Blanc's distribution business in Brazil

KABA
acquired

Task

Buyer advised by

pwc

PwC provided buy-side due diligence services to Kaba on their acquisition of Brazilian-based Task Sistemas

BUCHER
acquired

MONTANA AGRICULTURE

Buyer advised by

pwc

PwC provided buy-side due diligence services to Bucher on their acquisition of Montana, a manufacturer of agriculture machinery

syngenta
acquired the seeds business of

NIDERA

Buyer advised by

pwc

PwC provided buy-side due diligence services to Syngenta on their acquisition of the seeds business of Nidera

e.BRICKS
acquired

Mocoffee
MAKE MY DAY

Buyer advised by

pwc

PwC provided buy-side due diligence services to Brazilian Private Equity firm e.bricks on their acquisition of Swiss-based Mocoffee

G GUNVOR
acquired a minority stake on

MONTEALEGRE

Seller advised by

pwc

PwC provided buy-side due diligence services to Kaba in connection with their minority investment in Paraguay-based Monte Alegre

