



# Mergers & Acquisitions

# 2018

Seventh Edition

Editors:

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# Brazil

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## Overview

### Brazilian law applicable in M&A transactions

The purchase and sale of companies or businesses in Brazil is governed mainly by the chapter on law of obligations of the Brazilian Civil Code (Law No. 10,106 of January 10, 2002), and by certain provisions of the Brazilian Corporation Law (Law No. 6,404 of December 15, 1976).

Some M&As require regulatory approval (either prior to the closing or as a post-closing action), and these include financial institutions, insurance companies, certain telecoms activities, and certain concession holders. As a general rule, foreign-controlled buyers are not restricted from investing in most industries, subject to a few exceptions (namely, nuclear energy, post office and telegraph services, and the launch and orbital positioning of satellites, vehicles, aircraft and related activities). Brazil does not have a Committee on Foreign Investments (as is the case, for example, with the United States' CFIUS) but the prior consent of the General Office of the National Security Council is required for acquisition of lands along frontier areas (or of equity in a company that holds such lands).

Listed companies (either as acquirers or targets) are subject to securities and disclosure rules. Brazilian Corporation Law ensures a 80% tag-along for holders of common shares in the event of a sale of control. By virtue of having adhered to a superior governance standard on the Brazilian Stock Exchange (or “B3”), several listed companies have increased such percentage to 100% and included all types of shares, if applicable.

Most deals (including those involving public company targets) are privately negotiated with controlling or large shareholders. Tender offers to acquire control of Brazilian companies are still rare. The main rule dealing with tender offers (CVM Rule No. 361/2002) requires any tender offer to be fully guaranteed by an intermediary (broker, dealer or financial institution) and to be irrevocable and not subject to conditions (except for conditions which are not under the offeror's control). Mandatory tender offers after a sale of control are sometimes combined with a delisting tender (which requires the acceptance of  $\frac{2}{3}$  of shareholders who show up for the tender auction to be effective, and a report stating that the offer is being made at a fair value).

Since 2011, the pre-merger consent of the Brazilian Competition Authority (“CADE”) is required for M&A transactions involving parties that meet certain net revenues criteria (before 2011, approval was made post-merger). CADE has been extremely quick in reviewing fast-tracked transactions (usually 15-20 days, but sometimes less). In more complex transactions, the decision by CADE can take six months or more. CADE has recently issued gun-jumping guidelines stating what is permitted and what is not, pre-approval.

## Overview of M&A activity in 2017

The number of M&A transactions in Brazil in 2017 has shown a slight growth from 2016, which may indicate a reversal of the decreasing trend in the number of M&As that Brazil has seen in years 2015 and 2016. A similar conclusion can be drawn when one looks at the amounts involved:

Year/M&A Volume	2013	2014	2015	2016	2017
Number	811	879	742	597	643
Amount (US\$ billion)*	88.1	108.3	34.8	37.6	48.9

\*Transactions with disclosed amounts only. Source: <https://www.pwc.com.br/pt/estudos/servicos/assessoria-tributaria-societaria/fusoes-aquisicoes.html>.

Based on our perception, Chinese investment has grown significantly, particularly with respect to deal size.

### **Significant deals and highlights**

2017 continued to be a year of large deals, partially driven by the sale of rarely available assets from companies that were forced to sell because of corruption allegations.

#### State Grid/CPFL

The largest cash M&A of 2017 was State Grid International Development's acquisition of CPFL Energia S.A. (the largest privately owned electricity conglomerate in Brazil). The two-step deal was concluded in 2017, both through a private acquisition of control (from Camargo Correa, a Brazilian conglomerate, and certain Brazilian pension funds) for R\$14.1 billion and a mandatory tender offer for the remaining shareholders of CPFL Energia S.A. amounting to R\$11.3 billion. The mandatory tender offer for the shareholders of CPFL Renováveis S.A. (a publicly listed subsidiary of CPFL Energia S.A.) is expected to occur in 2018.

#### Paper Excellence & Eldorado Papel Celulose

In 2017, J&F (a holding entity controlled by the Batista family who allegedly participated in corrupt acts) concluded the sale of Eldorado Celulose e Papel, a large pulp and paper company, to Paper Excellence (owned by the Widjaja family). The amount of the deal was R\$15 billion. The sale by the Batista family is part of the plan to liquidate certain assets and revert the gains towards the cooperation agreement executed with Brazilian and foreign authorities, involving an amount of approximately R\$10 billion.

#### Itaú Unibanco/XP Investimento

Brazil's biggest bank, Itaú Unibanco S.A., acquired 49% of XP Investimentos, a security broker, for the amount of R\$6.3 billion. Itaú also secured a call option for the purchase of 100% of the shares in 2033.

The transaction was approved by CADE, subject to restrictions. The decision was not unanimous and was criticised by sections of the Brazilian media, as the banking segment in Brazil is perceived to be highly concentrated.

### **Key developments**

#### New rules of the “Novo Mercado”

Novo Mercado is the most prestigious listing segment of the B3, and has recently undergone

a change in its regulations following a long process of public hearings with member companies and other market participants. As it concerns M&A, the opinion of the Board of Directors in a public tender offer is now required. Such change in regulations also provides for new mechanisms for the sale of control of companies, withdrawal of the Novo Mercado and certain corporate reorganisations.

### Tougher CADE

Several market commentators have noted that CADE has been more strict in its decisions in 2017. Before that time, it very rarely rejected mergers. In 2017 alone it rejected: (a) the R\$5.5 billion merger involving Estácio and Kroton Educacional, the two biggest companies operating in Brazil's higher education sector; and (b) the R\$2.17 billion acquisition by Ipiranga Produtos de Petróleo S.A. of retail fuel distributor Alesat Combustíveis S.A.

In the *Estácio/Kroton* case, CADE argued that the new company would be almost five times bigger than the second competitor in the sector, and that both companies had purchased a relevant number of other companies in the past few years. The decision was not unanimous.

In the *Ipiranga/Alesat* case, CADE rejected the deal, considering that an increase in the level of market concentration would favour the adoption of collusive strategies within a market that already has a history of collusion. It also concluded that entry barriers were significant, and that the transaction would not generate any efficiencies.

It remains to be seen whether CADE's tougher stance reflects a shift in the thinking of the commissioners. If that is the case, buyers must start thinking about rapidly securing M&A assets in the market before a market becomes too concentrated for further M&A activity to be allowed, much like a game of musical chairs where the last one to act remains standing.

### Non-binding nature of LOIs

In the *Univar/Coremal* case, in December 2016 the São Paulo Appeals Court denied an indemnity request by a Brazilian group that was negotiating the sale of two chemical distribution companies valued at R\$100 million with an American company. The indemnity request was made because, after two years of negotiations (having provided detailed information for due diligence, including financial information, clients and management), grounded on a letter of intent ("LOI") executed by the parties, the American company decided to interrupt the negotiations and, months later, acquired another entity in Brazil.

The Brazilian group filed a lawsuit requesting the indemnification of R\$16.5 million for the reimbursement of lawyers' and financial advisors' fees and for loss of the chance to sell the companies on the same conditions, as they previously had other investors interested in the deal.

The Court analysed the case based on contractual and non-contractual liabilities, the signed documents, and the facts presented by the parties. As the LOI provided that until the final agreement there would not be any legal obligations of the parties to the deal and there were many negotiation points not defined by the parties up to that moment, the Court found that the Brazilian group could not argue that they expected the final execution of the deal.

### Private equity comfort letter

A leading case (*Carlyle/Itaú*) relating to the binding nature of private equity comfort letters is under analysis by the Superior Court of Justice ("STJ").

Itaú is requesting that Carlyle honours its comfort letter (in the amount of R\$40 million), stating that it is in effect a guarantee. Carlyle's view is that the comfort letter does not create a binding obligation to provide funding.

The outcome of this decision may be critically important for the private equity industry in Brazil, as the use of comfort letters is very common in M&A involving private equities, and GPs may not be willing to issue them if they are understood as a firm commitment to fund. In any event, it is more important than ever to include clarifying language in any such letters to avoid future misunderstandings or disputes.

### **The year ahead**

On a local or national level, the resumption of good news relating to the Brazilian economy stimulated the M&A ecosystem during the year 2018. The better economic scenario of 2018 (when compared to 2016 and 2017) contributed to renewed foreign interest in Brazil.

Furthermore, the Brazilian Central Bank has aggressively cut interest rates, which are now at an all-time low (6.5% p.a.), which has made M&A financing cheaper.

These factors have brought about M&A involving large, once-in-a-generation assets, such as the recently announced acquisition of Fibria by Suzano Papel e Celulose (two of the biggest world producers of eucalyptus pulp), the announced hostile and friendly tender offers for Eletropaulo (a large electricity distributor), and the announced intended acquisition of Embraer (a airplane maker) by Boeing.

2018 is a general election year in Brazil and, given the large number of candidates, it is difficult to anticipate results. Depending on who gets elected to the presidential chair and Congress, Brazil may experience market-oriented reforms and continuity (which could bring about robust M&A activity) or, conversely, if the next president is not well perceived by the markets, the impact on M&A would be quite negative.

\* \* \*

### **Sources**

This articles is based on reports in the press, specialist reports, company and financial websites.

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Mr. Pinsky has advised clients in dozens of completed M&A transactions, in various different perspectives including buy-side, sell-side, public company M&A, control and minority stakes, inbound and outbound investment. He advises clients in a wide variety of industries, notably pharma. He is also active with CVM compliance and investigations, particularly involving hedge funds, and has counselled clients in several high-profile crisis-management situations. Lior practised as a foreign associate at Cravath, Swaine & Moore LLP, a leading NY-based law firm, from 2004 through 2006. Mr. Pinsky also has been active in firm management, including on the firm's Management Committee.

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