

BRAZILIAN CORPORATE REVIEW: 2019

Lior Pinsky
lior.pinsky@veirano.com.br

Vitor Rozenthal
vitor.rozenthal@veirano.com.br

Levi Santos
levi.santos@veirano.com.br

VEIRANO
ADVOGADOS

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1. INTRODUCTION

This report, prepared by **Veirano Advogados**, presents an overview of the main developments that are of interest to practitioners of mergers and acquisition (M&A), private equity (PE), venture capital (VC) and capital markets in Brazil, as well as recent data concerning the results of these industries in 2019.

We first address M&A transactions, with emphasis on the data and charts that show their strong growth in 2019. After that, we discuss the performance of the PE and VC industries.

In respect of capital markets transactions, we discuss some developments of 2019: the year with the largest number of stock offerings since 2017 and with an unprecedented growth of the Bovespa Index; which, unfortunately, is falling sharply in 2020 due to the crisis triggered by the spread of the COVID-19 virus.

Finally, we discuss certain legislative and regulatory developments in Brazil, mainly the Economic Freedom Act and resolutions by the Brazilian SEC (CVM).

This report is based solely on public information and is not and should not be interpreted as a legal opinion or an investment guidance.

2. M&A

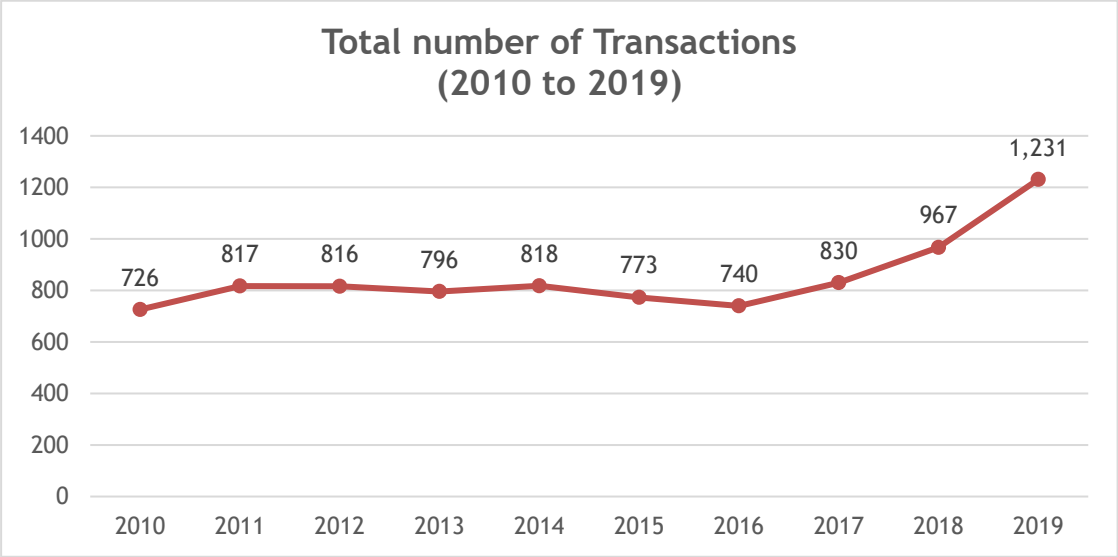
2.1. M&As transactions by numbers

Brazil has set a record in 2019 with 1,231 reported M&A transactions, according to data from KPMG Brazil[1]. This number represents an increase of 27.3% compared to 2018 (967 reported M&A transactions) and of 48.3% compared to 2017 (830 reported M&A transactions).

Part of this increase can be attributed to a more stable political and economic environment (compared to previous years) and to the perception that local assets had attractive valuations. In addition, good expectations at the beginning of the year about the approval of the pension reform by Congress - which was effectively passed on November 12 - and the announcement of privatizations and asset sales by state-owned companies (particularly at the federal level, but also at the state and city levels) helped boost the M&A market.

The following chart shows the evolution of the number of transactions in recent years:

[1] https://www.jornaldocomercio.com/_conteudo/cadernos/jc_contabilidade/2020/01/722184-fusoes-e-aquisicoes-batem-novo-recorde-em-2019-diz-kpmg.html



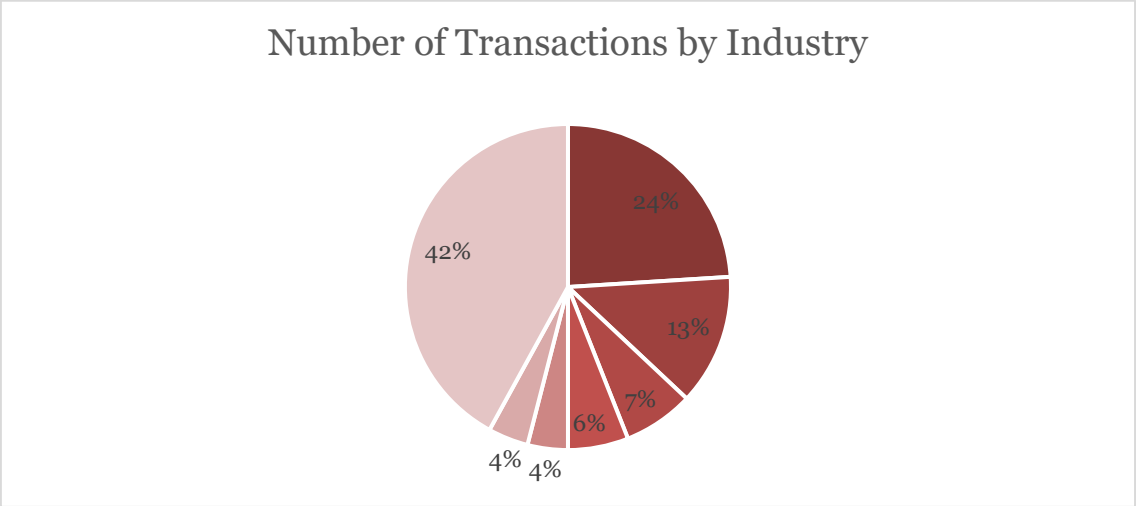
According to data from the Transactional Track Record platform, the value of M&A transactions in 2019 more than tripled compared to 2018. M&A transactions in 2019 reached a total value of R$ 136,599.48 million, while the amount recorded in 2018 and 2017 were, respectively, R$ 43,200.37 million and R$ 57,562.09 million.

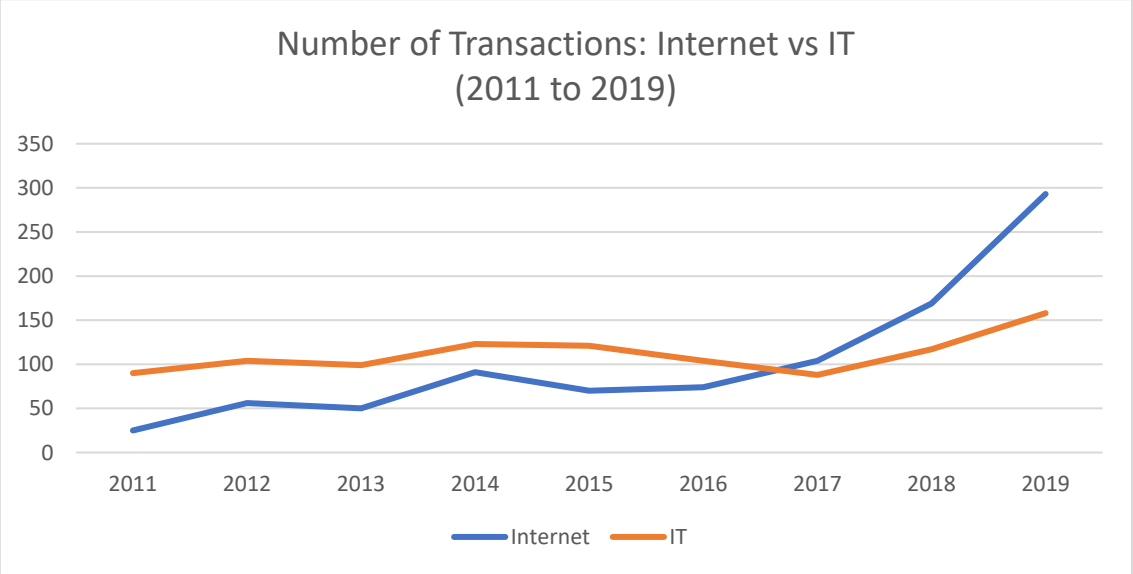
A highlight from 2019 was the record number of domestic transactions. Also, according to data from KPMG Brazil, 782 domestic transactions were recorded, an increase of 42.2% compared to 2018. Transactions involving foreign players were also up, with 374 transactions recorded, an increase of 19% compared to 2018.

2.2. M&A transactions by industries and regions

According to public data, the industry with the largest number of transactions was Internet companies, that is, those that have their business hubs in the digital environment, which jumped from 169 in 2018 to 293 in 2019, an increase of 73%. This follows a trend started in 2017, the year when the internet industry took the lead from the IT industry, which registered 158 transactions in 2019. Other notable industries were health care, with 87 transactions, real estate with 77, food and beverages with 52 and energy with 51.

The following graph shows the percentage of transactions by industry in 2019 and the evolution of the number of transactions in the Internet Services and IT industries since 2011:





With respect to regions, the Southeast recorded the largest number of transactions, led by São Paulo with 750, followed by the Southern region with 170 transactions.

2.3. Selected transactions

Transportadora Associada de Gás (TAG)

Petrobras made the main divestment planned for the year and sold 90% of its stake in TAG to a consortium formed by the French group Engie and the Canadian fund Caisse de Dépôt et Placement du Québec (CDPQ) for US$ 8.6 billion.

With an infrastructure of about 4,500 km of pipelines, gas compression facilities and 91 delivery points, TAG is the largest natural gas carrier in Brazil. The sale by Petrobras was part of the government's goal for

the state-owned company to make US$ 27 billion in divestments in order to reduce its indebtedness and concentrate its resources on oil production.

The acquisition of the stake by the consortium was leveraged in a 30%/70% ratio, with the debt portion of the consideration coming from local and foreign banks, based on TAG's[2] own revenues.

Liquigás

Petrobras made another relevant divestiture in 2019, selling its entire stake in Liquigás, a wholly-owned subsidiary that operates in the bottling, distribution and marketing of liquefied petroleum gas (LPG), to a consortium formed by Itaúsa, Copagaz and Nacional Gás Butano for R$ 3.7 billion.

The transaction followed an attempted R$ 2.8 billion sale of Liquigás to the Ultra Group, which was blocked by the Brazilian antitrust authorities in 2018.

Natura & Avon

The Brazilian cosmetics company Natura&Co acquired its US competitor Avon through a merger valued at US$ 3.7 billion. The combined company is now the largest group exclusively dedicated to the beauty industry in the world[3], with a market value of around US$ 11 billion.

The transaction includes an exchange of shares in a new holding company, Natura Holding, with Natura's shareholders owning 76% and Avon's shareholders owning the remaining 24% of the combined company.

Continuing the trend started with the acquisition of Aesop and The Body Shop in 2013 and 2017, respectively, Natura resumes its expansion in door-to-door distribution with a total of 6.3 million resellers.

Nextel Brazil

In December 2019, NII Holdings announced the sale of Nextel Brazil to América Móvil, the parent of Claro, for US$905 million. Due to market overlaps, the transaction was subject to a long and complex approval process before CADE.

With the conclusion of the transaction, America Móvil now holds 26.4% market share in the mobile market, consolidating its presence in São Paulo and Rio de Janeiro – Nextel's main markets.

Chapada Mine

Located in the State of Goiás, the copper and gold mine Chapada Mine was sold by the Canadian mining company Yamaha Gold to the Swedish-Canadian Lunding Mining for US$ 800 million, with an additional earn-out payment of US$ 225 million if certain conditions are met.

[2] https://www.valor.com.br/empresas/6199593/petrobras-vende-tag-para-engie-e-caisse-por-us-85-bilhoes
[3] https://brasil.elpais.com/brasil/2019/05/23/economia/1558606597_597104.html

The transaction is part of Lunding Mining's strategy to strengthen its portfolio in basic metals[4]. At the time of the acquisition, the Mine was expected to produce 54,500 tons of copper and 100,000 ounces of gold in the year.

Nufarm & Sumitomo

Japan's Sumitomo Chemical acquired Nufarm's South American's agricultural defensive operations for $800 million, after eight years of partnership in the region, especially in Brazil[5].

The funds received by Nufarm are to be used to invest in its North American and European agricultural defensive production operations and in Nussed, a remaining subsidiary of Nufarm in the South American seed industry[6].

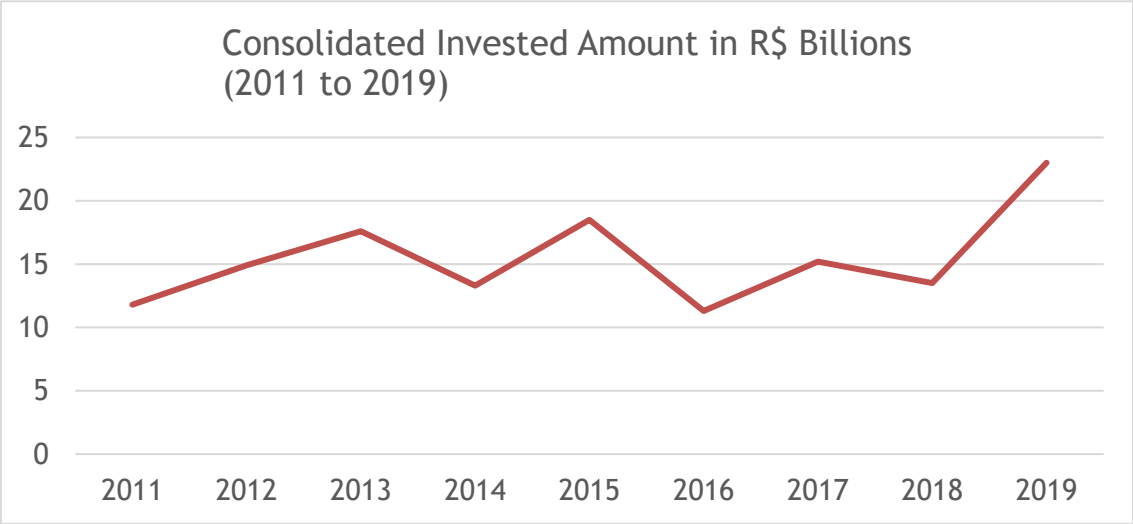
New Steel

In early 2019, Vale concluded the acquisition of dry iron processing New Steel from Hankoe Fund, for US$500 million.

The acquisition is part of Vale's strategy to grow the production and sale of higher quality iron ore, which has lower environmental impact and good cash flow generation rates, especially to Chinese customers.

3. PE AND VC INDUSTRIES

The PE and VC industries registered an increase in investments in Brazilian companies. According to data from KMPG Brazil and the Brazilian Private Equity and Venture Capital Association (ABVCAP), the investments made by PE and VC funds reached R$ 23 billion[7].



[4] https://extra.globo.com/noticias/economia/lundin-mining-anuncia-compra-de-mina-da-yamana-gold-no-brasil-por-us1-bi-23600465.html
[5] https://www.grupocultivar.com.br/noticias/sumitomo-chemical-adquire-operacoes-da-nufarm-na-america-do-sul
[6] https://www.agrolink.com.br/noticias/sumitomo-compra-operacoes-da-nufarm-na-america-do-sul_424730.html
[7] Consolidação de Dados 2019.

This amount is 70.3% higher than 2018 and 51.3% higher than 2017.

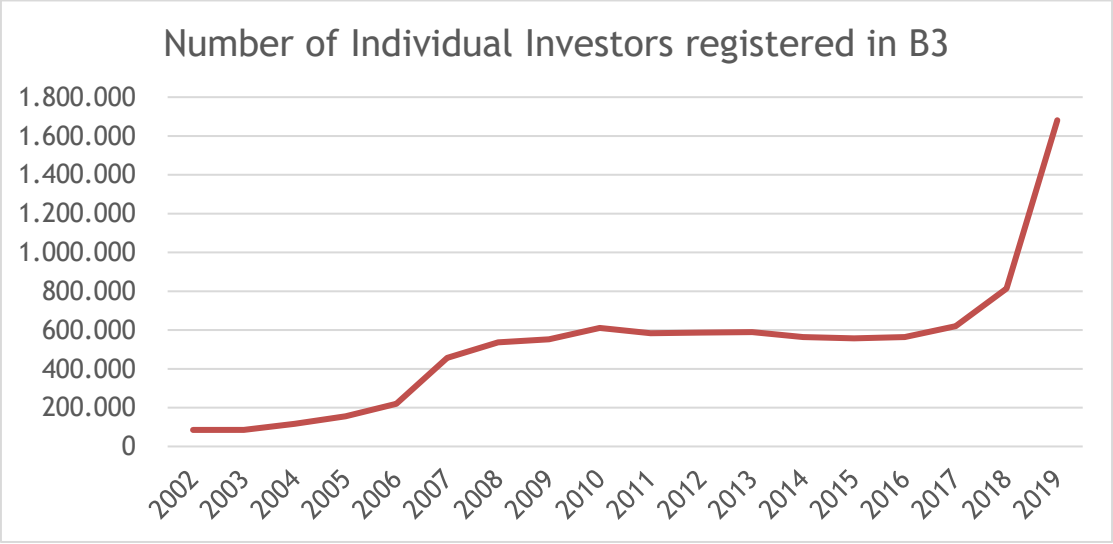
On the other hand, the fundraising of the PE industry dropped significantly compared to 2018. In 2019, the industry raised R$ 3.1 billion, less than 25% of what was raised in the previous year. On the other hand, the VC industry maintained its fundraising growth trend, especially in the second half of 2019, reaching a total of R$ 2.3 billion, an increase of 155.5% compared to 2018.

Finally, the number of invested companies continued to grow in both industries, a trend that began in 2017. In the PE industry, the number of investments grew 18.7%, reaching the total number of 95 investees, while in the VC industry the number jumped from 140 to 216, resulting in a growth of 54.2%.

4. CAPITAL MARKETS

The year 2019 was historic for the Brazilian capital market in several respects. First because, for the first time in history, the number of individual investors in the Brazilian stock-exchange (B3) exceeded the one million mark.

The record number reflects the migration of retail investors to variable-income investments, a direct result of the lower returns in fixed-income investments. The year 2019 closed with around 1.6 million individual investors, an increase of 100% compared to 2018.

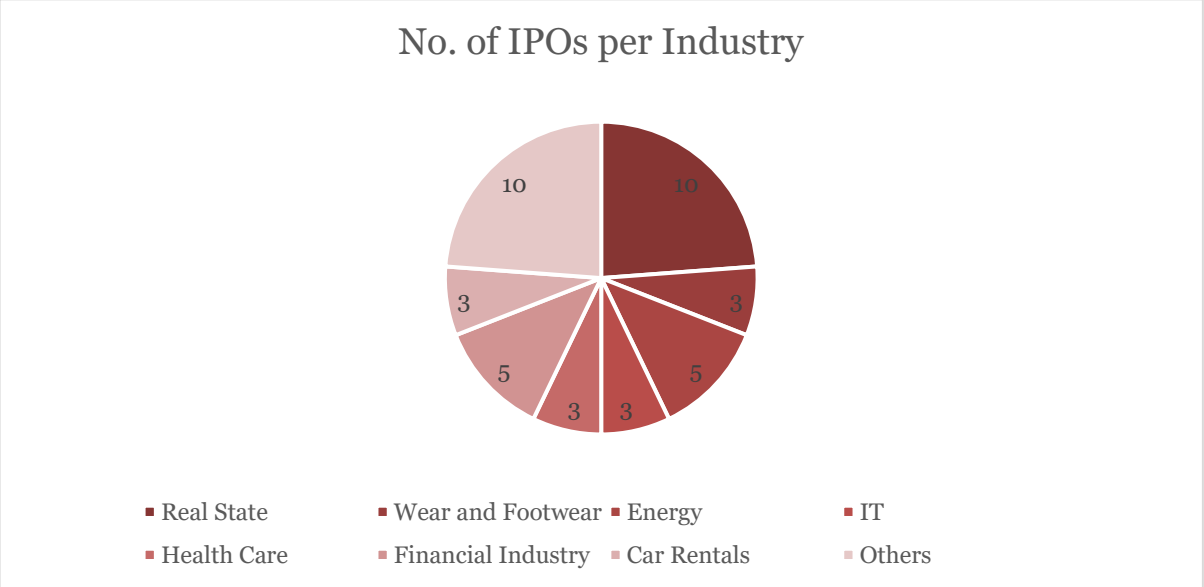


In addition, B3 registered 1,369 public offerings of equity, debt and quotas of investment funds, a number that is 27.7% higher than 2018 and 53.3% higher than 2017[8]. According to CVM data, the offerings were generally carried out in the form of "public offers with restricted efforts"[9].

The highest growth, in relative terms, happened in primary share offerings, which went from 5 in 2018 to 42 in 2019 - the largest number since 2007, when 76 offerings were registered.

[8] http://www.cvm.gov.br/export/sites/cvm/publicacao/boletimmercado/anexos/BoletimdeMercado_75_012020.pdf
[9] http://www.cvm.gov.br/export/sites/cvm/publicacao/boletimmercado/anexos/BoletimdeMercado_75_012020.pdf

The amounts involved in share offerings also increased significantly, from R$ 10.2 billion in 2018 to R$ 90.1 billion in 2019. The most active industries in 2019 are highlighted below:



Also worth noting is the 83% increase in real estate investment fund offerings (the Brazilian equivalent to REITs) in 2019 compared to 2018, from 103 offerings to 189.

Finally, the Bovespa Index (IBovespa), the most important index measuring the performance of the Brazilian stock market, rose sharply, reaching the 100 thousand points mark for the first time in its history. The rise of the Ibovespa underscored a positive expectation from investors in the federal government's structural reforms agenda and in the resumption of the Brazilian GDP growth, which in 2017 and 2018 registered an anemic growth of close to 1%.

5. ECONOMIC FREEDOM LAW AND LEGISLATIVE CHANGES

In the quest for economic liberalization, the government issued Provisional Measure No. 881 (MP), later converted into Law 13.874 of September 20, 2019 or the Economic Freedom Act.

The law seeks to reaffirm the economic freedom already provided for in the 1988 Brazilian Constitution, and to give individuals and companies the autonomy to develop economic activities with less state-interference.
The also law requires the public administration to review the impacts of state regulation on economic activity and to avoid using its regulatory power to, *inter alia*, create market reserves, create entry barriers for domestic and foreign competitors, or to increase transaction costs.

With respect to M&A transactions, Section VIII of Article 3 of the Economic Freedom Act provides that rules of corporate law will only have subsidiary application to the terms of agreements freely negotiated

by the parties, and that no law shall be used to benefit the party that has agreed against it, except to protect public administration's rights or the rights of third-parties.

In the same direction, the Economic Freedom Act added paragraph 1 to article 421 of the Brazilian Civil Code, providing that state intervention in private contractual relationships shall be minimal, and that contractual revision by external agents shall be an exception.

The purpose of all these changes it to limit the application of corporate law as the basis to limit or exclude the effects of contractual stipulations freely agreed by the Parties, except in very limited instances.

Thus, there is an expectation that judicial interference in M&A transactions, which is commonly based on unclear and general provisions such as "objective good-faith", "social function of contracts" and "reasonability", will be more limited, and, as a result, that legal uncertainty in M&A transactions will be greatly reduced.

6. CVM REGULATION

In 2019, The CVM approved an amendment to article 12 of ICVM 361 to exclude the possibility of buy-side interference in tender offers. The idea is to provide greater predictability and security to the target and to the shareholders to whom the offer is addressed.

This amendment has its origin in the competitive bid for the acquisition of Eletropaulo Metropolitana Eletricidade de São Paulo S.A. (Eletropaulo) - currently Enel Distribuição São Paulo - held in 2018.

Through the disclosure of different tender offer notices and buy-side interference, the Italian Enel and the Spanish Neoenergia had a long battle for the acquisition Eletropaulo. During this process, the CVM had to repeatedly instruct the competitors on how to proceed, to make sure that the rights of Eletropaulo shareholders were being respected.

In addition, the CVM decided that buy-side interference in take-private tender offers or offers for increase of participation shall now necessarily cover all the shares intended to be acquired in the original tender offer; while, in other types of offers, buy-side interference may still cover any number of shares (inclusion art. 12, § 8, ICVM 361).

7. OUTLOOK FOR 2020

Despite the bull market of 2019, and the promising start of 2020 with several transactions and stock offerings in the pipeline, the global dissemination of the new coronavirus (COVID-19) has negatively affected the expectations for the Brazilian market. Several transactions and offers were cancelled or suspended indefinitely and the stock market took a big hit, with the Ibovespa slipping 50% to reach 63 thousand points on March 23, 2020.

The direct impacts of COVID19 and the measures to contain its spread also hit the expectations for the Brazilian GDP's growth, which is already expected to be negative in 2020. The current crisis may also

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deliver a blow to the proposed structural reforms planned for this year, such as the tax and the administrative reforms.

To the PE and VC industries, the prospects for 2020, previously excellent due to the lower returns in fixed-income investments, have now become uncertain.

In the general M&A industry (including PE and VC) expectations now are that the effects of the crisis, in particular lower valuations and a potential record number of distressed assets and distressed sellers, may generate attractive business opportunities and more traction in the industry.

Veirano Advogados' M&A and Capital Markets teams have extensive experience in advising companies, banks and investment funds in various M&A, PE, VC, tender offers and capital markets transactions, and are available to answer any questions you may have.