M&A in Brazil – the Real Deal?

BY KRISTIAN KNIBUTAT

Brazil is a nation transformed. At one time characterized by macroeconomic instability and closed trade policies, Brazil's economy is now among the strongest globally. In fact, PwC analysts forecast that Brazil will achieve more than 7-per-cent economic growth this year, eclipsing that of Canada and all other developed nations. By 2050, PwC expects Brazil's economy, measured by GDP, to outpace all other G7 nations except the US.

Brazil's evolution began in earnest in the mid-'90s and was briefly interrupted by the 2008 credit crisis. During this period, government commitment to sound policies – including the introduction of its modern-day currency, the real – effected manageable inflation, an accumulation of foreign reserves, a reduction of debt profile and enviable growth across nearly all economic metrics. Consider, for example, that in 2006 Brazil's GDP outpaced inflation for the first time in 50 years, and in 2008 Brazil became a net external creditor. The nation's sovereign debt is now rated investment grade, for the first time, by all three main rating agencies. The Brazilian government's successful strategy was amplified by a steep appreciation in the prices of energy, mining and agricultural commodities — key drivers of Brazil's economy.

> **Brazil may be the last untapped market for financial buyers. It is one of the few places in the world where private-equity activity is on the rise.**

It's no surprise that Brazil's prosperity has been accompanied by a significant rise in M&A activity this decade — such was the experience of almost every nation. From a Canadian perspective, however, the Brazilian deal market has several features that suggest it is an ideal destination for investment.

First, Brazil's deal market was only "quietly" impacted by the 2008 credit crisis, and it rebounded sharply, winning the trust of traditionally risk-averse Canadian deal-makers. In the year ending October 31, 2010, we tracked 384 deal announcements worth more than $50 billion — a decade high for M&A.

Second, middle-market M&A – Canada's "sweet spot" – is set to rise in Brazil. Currently, deals with undisclosed values or values less than $100 million represent nearly 85 per cent of Brazilian deal volume. The majority of these transactions were "tuck under" acquisitions of early-stage consumer and commodity ventures. The "middle market" segment – comprising deals between $100 million and $1 billion – represents only 13 per cent of activity. This is not for lack of demand, but due to the nascence of Brazil's private sector. We anticipate that, as businesses continue to develop, this segment will be busier.

Another feature of Brazil's economy that makes it attractive for Canadian deal-makers is the potential for a high level of activity in the agriculture, energy and materials sectors. Why? The third known industrial revolution in modern history, currently underway in the emerging world, may result in a prolonged rise in the prices of commodities. Brazil, like Canada, is well positioned to provide the world with these basic building blocks of industrialization — together, our nations could arguably form the "superpower" corporations of the next millennium.

Finally, Brazil may represent the last untapped market for financial buyers. During the peak private-equity years in North America, most financial players were inactive in Brazil (only 6 per cent of deal activity). Today, Brazil is one of few places in the world where PE activity is on the rise — representing 12 per cent of activity in 2009, a decade high. Recent fundraising from many North American pension and private-equity funds suggests that further Brazilian acquisitions are on the horizon.

Yes, the accepted view is that Brazil is a nation transformed. However, only a select few Canadians have participated in Brazil's growth. Going forward, lawyers would do well to engage clients in meaningful discussions about opportunities in this fascinating part of our world. ▪

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