



Seizing sell-side M&A opportunities in Brazil

Prepare to take advantage of increasing deal-making activity

May 2018

M&A





What's at stake?

Although 2017 M&A deal activity in Brazil may have been slowed, in part, by the country's unsettled political and economic conditions, in recent months there have been clear signs that M&A activity is resuming and has the potential to strengthen in 2018 (although this October's national election may help or hinder M&A, depending on the outcome). This promising trend is being driven by an expected improvement in Brazil's economy; an increase in the number of initial public offerings (IPOs), which often boost companies' available cash for M&A; and foreign investors' and private equity (PE) funds' appetites for acquisitions in the dynamic Latin America market.

As consumer confidence, income levels, and spending increase, Brazilian companies in consumer-based industries – such as packaged goods and apparel – should be able to attract the attention of domestic and foreign buyers, as should those in service-based industries such as health care, education, information technology, and financial services. And an improvement in Brazil's macroeconomic indicators including inflation, interest rates, and gross domestic product (GDP) could reinvigorate acquisition-focused investments in infrastructure, concession, and privatization programs.

It appears that growing numbers of Brazilian-based corporations and multinationals with in-country operations may divest non-core businesses in the coming year. Many local companies that acquired assets and/or diversified operations prior to Brazil's current financial crisis are selling select businesses to raise cash to pay down debt, strengthening their balance sheets, and investing in market segments where they can gain or grow a competitive advantage. With Brazil's debt and capital markets still in recovery mode, divestitures have become a faster way to reduce indebtedness; even for healthy companies, divestitures provide an opportunity to realign business and product portfolios and to concentrate on core operations. Similar to local companies, some multinationals are also divesting non-core operations as a way to refocus their portfolio on products, markets, and even countries where they want to concentrate efforts.





Our take

Business owners in Brazil considering a divestiture typically face numerous challenges leading up to and during the transaction. One big question: When is the preferred time to pursue a transaction? Oftentimes, the decision involves three considerations: company-specific variables, existing market conditions, and synergy opportunities with potentially interested parties.

A deal driver for many Brazil-based companies has been maintaining or generating liquidity. The country's recession has strongly impacted revenues and profits over the last several years, causing companies of all sizes to renegotiate debt service which, in many cases, involves divestments of assets or exiting a business segment. Other factors driving carve-out activity in Brazil are sellers' focus on optimizing costs and increasing productivity; realigning portfolio contents to release resources and capital to grow the core business and increase return on capital and cash-generation; and strengthening governance to enable transparency, control, and risk mitigation. The latter is gaining in importance, as severe penalties imposed by Brazilian authorities for companies' non-compliance with anti-trust statutes and other laws are motivating some divestitures.

According to Deloitte's 2017 Latin America Mergers & Acquisitions Study,¹ many of the respondents involved in divestiture deals (69 percent) say they divested because of financial needs or because the assets were non-core business units. For these respondents, the most important factors when choosing among prospective buyers are:

- Highest price
- Speed and certainty to close
- Ability of the buyer to leverage current customer or supplier relationships
- Ease of transition.

Survey respondents also cite five key seller tasks to execute a rapid and smooth divestiture transaction:

1. Perform detailed sell-side due diligence (see sidebar). Fifty percent of survey respondents say that the divestiture took longer than expected and that buyer due diligence was a principal component of the delay.²
2. Perform a detailed business valuation.
3. Perform a detailed financial projection.
4. Analyze potential deal structures and related costs/benefits.
5. Assign a dedicated team of internal resources to prepare the business for sale.³

Sell-side due diligence can boost credibility, deal value

The credibility of a seller can have a dramatic impact on deal value. Incomplete or inaccurate information, particularly financial data, may have a direct, negative impact on sale price. Conversely, reducing uncertainties about the accuracy and reliability of information being provided – company description, sales, cost, and profit figures – may make a potential buyer more willing to pay full consideration – or even a premium.

Sellers can expect that potential buyers will conduct due diligence on the data they provide; sellers, therefore, have a compelling reason to be thorough in their own analysis. Conducting sell-side due diligence before the sales process starts can help a seller anticipate issues that a buyer may raise and develop responses that can help to reduce uncertainty and enhance credibility during the buyer's examination of the company. Among main focus areas in sell-side due diligence:

- Understand intra-company transactions, allocated costs, shared services, and plans for providing support post-acquisition and during transition.
- Evaluate the quality of earnings and identify "non-recurring" items.
- Understand the assumptions in company forecasts and the bridge of detailed data from actual results to forecast information.
- Evaluate the cost structure for fixed versus variable costs, capital expenditure requirements, and the relevance of certain general and administrative activities to the business being sold.⁴

¹ Latin America Mergers & Acquisitions Study: Integration and divestiture best practices throughout the region, Deloitte, 2017

² Ibid

³ Latin America Mergers & Acquisitions Study: Integration and divestiture best practices throughout the region, Deloitte, 2017. The report refreshes a study about the main M&A activity in Latin America, covering deals from 2014 to 2017. Our first study, Brazil 2015 Integration Survey was used as a base to support the findings of the new research conducted in 2017.

⁴ Ibid



A path forward

Business owners are sometimes surprised to learn that executing a divestiture can be more complex than selling a company as a whole. In a divestiture, the seller needs to define exactly what is and is not part of the deal and estimate precisely the carve-out's impact on the remaining business. This estimating process can be complex and inexact – sometimes fixed costs are not entirely eliminated; both seller and buyer may suffer from the impact of lower sales volumes and weaker bargaining power; and revenues might no longer benefit from cross-selling or sharing distribution channels and sales forces.

Cross-border divestitures: Seller considerations

Carve-outs in general are challenging and working across borders can add more complexity to the process. Nevertheless, cross-border divestitures are becoming more and more common in today's increasingly globalized economy; many companies looking for potential acquisitions in Brazil are from the United States and other countries.

Sellers should be mindful that executing a cross-border divestiture usually takes more preparation and patience than an in-country deal. Such transactions often require more of everything, including greater due diligence; increased ability to navigate different financial and tax reporting structures to identify what is being sold;

additional regulatory filings to address potential anti-trust issues; and extra time to prepare the financials. Specific considerations include:⁵



Determining what's really for sale

- Geographies to be included
- Which shared country assets and resources are part of the transaction



Compiling the financials and considering the deal structure

- US GAAP versus IFRS
- Tax regime and consequence of asset versus stock deal



Knowing the laws at home and abroad

- Government intervention
- Foreign Corrupt Practices Act
- Regulatory filing process



Marketing the business and adapting to foreign buyers

- Cultural differences
- Time zones



Planning for the separation

- Entry rights and visa issues
- Pension, healthcare, and insurance liabilities

Cultural aspects also play an important role in cross-border negotiations. Understanding and respecting both the buyer's and seller's ways of doing business can be vital to achieving critical M&A milestones, facilitating the transaction closing, and helping avoid costly delays. In Brazil, establishing informal relationships is important to build trust between parties. When a buyer demonstrates that it values the history of the seller's company and shows a desire to build on that success, it helps to generate goodwill prior to, during, and after the transaction.

⁵For a detailed look at these considerations and steps sellers can take to address them, read *Sell-side considerations for a cross-border divestiture*, Deloitte M&A Institute, 2014, <https://www2.deloitte.com/content/dam/Deloitte/us/Documents/mergers-acquisitions/us-ma-sell-side-considerations-for-a-cross-border-divestiture.pdf>



Sell-side services in action: Hertz divests Brazilian car rental operations to Localiza

As part of a global strategic realignment of its portfolio, The Hertz Corporation (Hertz), a subsidiary of the US Hertz Global Holdings Inc. in the US, with car rental operations in approximately 150 countries, decided to sell its Brazilian car rental and leasing operations to Localiza Rent a Car S.A, a Brazilian car rental company and the largest car rental operator in South America. Both companies are considered premium brands in their respective core markets and shared the same view of the potential opportunities that the transaction could create in the long term.

Deloitte served as the financial advisor to Hertz in the negotiations with Localiza, leading a multi-functional team to assist Hertz in the transaction by providing sell-side advisory services, local market insights, financial modeling assistance, tax and accounting advisory, and transaction negotiation advice. We combined our US corporate development experience, industry experience, and strong client relationship with our Brazilian middle-market knowledge and local M&A execution capabilities to support Hertz.

In addition to the divestiture, as part of the strategic alliance between the two companies, Localiza and Hertz established a global and long-term agreement through: 1) a Brand Cooperation Agreement, which included the use of the combined brand "Localiza Hertz" in Brazil and the use by Hertz of the "Localiza" brand in the main airports in United States and Europe that have a significant flow of Brazilian clients; and 2) a Referral Agreement that established the rules for the exchange of inbound and outbound reservations between Localiza and Hertz.



Contact us

Deloitte has assisted hundreds of divestitures across the entire transaction lifecycle for companies in nearly every industry and geography. We offer more than just general knowledge; we offer practical, hands-on support rooted in experience with deals just like the one you may be facing. Our services include:

- Portfolio strategy assessment
- Buy-side and sell-side advisory support
- Carve-out financial statement development
- Organizational separation and reorganization strategies
- Transition service agreement development and optimization
- Day-1 planning and readiness preparation
- Stranded-cost identification and reduction

Deloitte Brazil

Reinaldo Grasson

Partner, Corporate Finance
Deloitte Touche Tohmatsu Consultores Ltd.
rgoliveira@deloitte.com

Ronaldo Rezende Xavier

Partner, M&A Transaction Services
Deloitte Touche Tohmatsu Consultores Ltd.
rxavier@deloitte.com

Deloitte US

Will Frame

Managing Director
Deloitte Corporate Finance LLC
wframe@deloitte.com

Hernan Marambio

Americas M&A Transaction Services Leader
Deloitte & Touche LLP
hmarambioa@deloitte.com

Jose Velaz

Specialist Leader, M&A Transaction Services
Deloitte Risk and Financial Advisory
Deloitte & Touche LLP
jvelaz@deloitte.com

Deloitte.

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited ("DTTL"), its global network of member firms, and their related entities. DTTL (also referred to as "Deloitte Global") and each of its member firms are legally separate and independent entities. DTTL does not provide services to clients. Please see www.deloitte.com/about to learn more.

Deloitte is a leading global provider of audit and assurance, consulting, financial advisory, risk advisory, tax and related services. Our network of member firms in more than 150 countries and territories serves four out of five Fortune Global 500® companies. Learn how Deloitte's approximately 264,000 people make an impact that matters at www.deloitte.com.

This communication contains general information only, and none of Deloitte Touche Tohmatsu Limited, its member firms, or their related entities (collectively, the "Deloitte Network") is, by means of this communication, rendering professional advice or services. Before making any decision or taking any action that may affect your finances or your business, you should consult a qualified professional adviser. No entity in the Deloitte network shall be responsible for any loss whatsoever sustained by any person who relies on this communication.