



9 key aspects for foreigners in Brazilian M&A transactions

Brazil is seeing an upsurge in M&A transactions, including asset purchases, equity acquisitions and joint ventures. Much of this is a result of Brazilian currency depreciation, attractive asset prices and international companies willing to expand their business.

Based on our experience as Brazilian law firm acting as legal counsel to foreign investors, we listed below 9 key aspects for them to consider before a potential M&A transactions with Brazilian companies.

1. Understand local culture. Brazil is a large country, divided into 26 States. Each State has its particular culture and way of doing business. As example, first contact and negotiation approach with a potential seller sitting in the City of Sao Paulo, State of Sao Paulo, will fairly differ from one located in the City of Porto Alegre, State of Rio Grande do Sul, or in the City of Fortaleza, State of Ceara. “Paulistas” tend to be receptive to initial calls and offers made by unknown foreign sources and are generally familiar with international M&A negotiation standards and process (as they live in Brazil’s main business center). “Porto Alegrenses” and “Cearenses” are more likely to

distrust first contacts and offers made by foreign strangers, what results in a longer negotiation process when compared to with “Paulistas”. Similar culture variances apply to the other States, including Minas Gerais, Rio de Janeiro, Paraná, Santa Catarina, Mato Grosso, etc. So, understand the regional business and approach culture at which the target is inserted may define whether the acquirer will have successful contacts or not.

2. Have a Portuguese speaker in your team. Most of the Brazilian small to middle size companies do not have controlling shareholders, senior officers or

employees with English language skills sufficient to enable them to make the initial contacts, prepare and furnish basic target information or negotiate a M&A transaction with foreign investors. Large companies generally do. A large percentage of potential M&A transactions are turned down or do not move forward simply because the investor and the selling party cannot communicate in the same language. If the target company does not have English language capabilities, foreigners should consider retaining Portuguese speaking advisors (such as lawyers and accountants) to assist them throughout the deal process. It will certainly make the other party more comfortable with the negotiations and fully understand the terms and conditions of the M&A transaction.

3. Sign preliminary contracts. Two preliminary contracts are key in Brazilian M&A transactions. Confidentiality Agreement (“CA”) and Letter of Intention (“LoI”) (also named as Memorandum of Understanding and Term Sheet). CA seeks to protect, among other aspects, (i) the target company and shareholders for confidential information they may share with the potential buyer, and (ii) the buyer for avoiding the target company to disseminate in the market that the buyer intends to make an offer, particularly if one or the other is publicly held company. LoI is an instrument typically signed after the Confidentiality Agreement is in effect, as the involved parties aim to demonstrate to each other the seriousness of the negotiations. The purpose of LoIs is to (i) provide a road map and timeline for the transaction, (ii) determine what the buyer is willing to acquire (total, majority or minority equity), (iii) establish the price range, valuation method and form of payment, (iv) give the buyer the right to access the target companies information, (v) provide for binding or non-binding obligations (ex. seller’s exclusive dealing to buyer, expense allocation and break-up fee), and (vi) identify the definitive documents to be signed as condition to closing.

4. Make risk assessment: Experienced and sophisticated buyers, including companies and private equity firms, tend to save time in M&A transactions by making detailed assessment of the risks involved with the target company prior to engaging in negotiation. How do they do it? They look at strategic public information. Although public data from privately held companies in Brazil is not substantial as it is in developed countries, public records are accessible to foreign investors and the information available is key for risk assessment purpose. As example, it will save the buyer’s time if it identifies before the due diligence phase that the target company has substantial “deal breaker” tax and labor liabilities. From a legal perspective, foreign investors may rely on their Brazilian legal counsels to access courts and other public authorities’ records to search for material tax, labor, environmental, commercial, financial, criminal and insolvency claims involving the target company, subsidiaries and the shareholders.

5. Retain local lawyers and accountants. Foreign investors should consider retaining the service of local legal counsels and accountants prior to starting the contacts and the negotiations of M&A transaction with Brazilian companies. Local experts (lawyers and accountants) will assist buyers in a variety of ways, including (i) enhancing risk assessment, as lawyers may identify material claims against the target, subsidiaries and shareholders, and accountants may analyze, among others, credit history reports from a Brazilian accounting standards and point out relevant (in)consistencies, (ii) contributing or making the initial contacts with the target company’s senior officers or shareholders on behalf of the buyer, and throughout the negotiation process, and (iii) advising from a legal and accounting perspective during the entire negotiation and documentation process, due diligence and transaction closing.

6. Add Anti-Corruption/Compliance Diligence to your Due Diligence process. Due diligence is part of M&A basic “to do list”. From a legal standpoint, no

M&A deal should be closed without buyer's detailed diligence and verification on the target company's information, documents, contracts, environmental matters, intellectual property, commercial, records, charters, licenses, filings and others. On top of that, foreign investors should consider adding another relevant area to be checked: target and shareholders' anti-corruption/compliance practices. Brazilian legislators have passed new laws and regulations to (i) prevent bribery and corruption practices in the relationship between private companies and government and (ii) urge companies to implement compliance practices. Although local targets may take anti-corruption/compliance due diligence personally and can feel offended by it, recent developments in the Brazilian business community and the new set of Brazilian laws in effect should demonstrate that it is part of normal due diligence and not something specific related to the target company or shareholders.

7. Think carefully about the form of transaction.

Whether it is going to be an asset purchase, equity acquisition or joint venture, the form of the M&A transaction will impact on the acquirer's legal rights and liabilities, level of control and involvement and tax. Brazilian business legal environment is complex. Such complexity results from the large number of codes, laws and regulations at Federal, States and Municipalities' level, which potentially generate conflicts of laws, interpretations and how they apply to business. Because of it, foreign investors must carefully study the form they select for the M&A transaction based on those impacts. For example, in an asset purchase case, depending on (i) the characteristics of the specific asset, (ii) the situation at which it is going to be acquired (if at Judicial Recovery/Bankruptcy proceeding or in normal course of business) and (iii) how the transaction is formalized, it will have different tax and labor treatment/implications. Thus, planning the form of transaction is foremost for its success in Brazil.

8. Consider the tax impacts. It is a fact that the Brazilian tax system is complex. For tax on capital gains related to M&A transactions, foreign buyers must understand its impacts (i) at time the acquisition is made, and most importantly (ii) at time the buyer decides to sell off the acquired equity/asset. At time the acquisition is made, the party affected is generally the seller, who seeks to negotiate gross up provisions in order to offset the tax effects. At time the buyer decides to sell off the acquired equity/asset, there are two major tax considerations to bear in mind: (i) existence of double taxation treaty between Brazil and the acquirer's jurisdiction and (ii) tax on capital gains. Double taxation treaties have the purpose of preventing an entity from being taxed in both its home jurisdiction and the jurisdiction in which it generates income. Brazil has no many double taxation treaties in effect currently, but foreign investors should check the existing ones to see whether they apply to their home jurisdiction. Regarding capital gain tax, the percentage applied by the Brazilian tax authorities to foreign buyers is subject to whether the acquirer's home jurisdiction is considered or not a tax heaven by the Brazilian tax authorities. The assistance of a Brazilian tax lawyer jointly with a tax lawyer of the acquirer's jurisdiction is essential to prevent tax pitfalls.

9. Be careful when selecting the contracts' choice of law and jurisdiction.

M&A transactions have to be strategically negotiated and documented. The negotiations' terms and conditions are documented in a broad sense within the preliminary instruments (CA and LoI) and precisely within the definitive documents (e.g., equity purchase agreement and the shareholders' agreement (if applicable)). In cross-border M&A transactions, the choice of law and jurisdiction of each legal contract is crucial for protection of the parties' rights. Overall, foreign investors doing business in Brazil have the tendency of choosing their home country's laws and courts to govern all documents and resolve potential litigation in connection with the deal. However, before making the decision they should bear in mind that the purchased assets and seller's assets

are probably located in Brazil, so if any legal remedy is to be taken quickly, it will have to be filed and processed locally not in the acquirer's home country.

So, think carefully when selecting the contracts' choice of law and jurisdiction for a Brazilian M&A transaction.

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Feijó Lopes Advogados is a premier full service Brazilian law firm with highly regarded foreign investments in Brazil's practice, including M&A, Structured and Trade Finance, Capital Markets, Direct Investments, Commercial Contracts, Tax, Labor and Civil Litigation.

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