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Corporate Finance in focus
An overview of the economic, M&A, credit, debt and investment scenarios

June 2016

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Macroeconomic Scenario

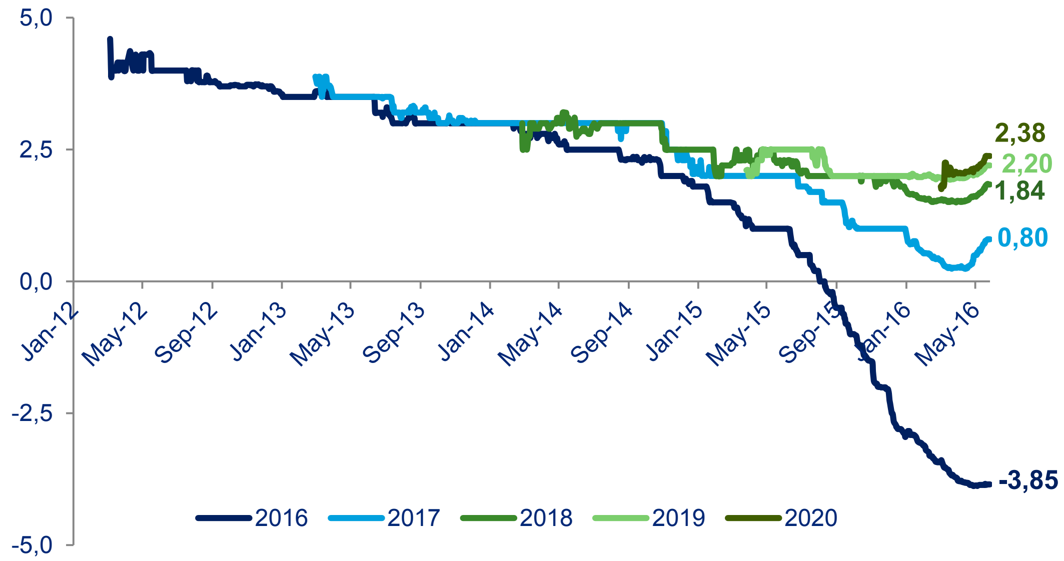
Economic activity indicators for the first quarter of 2016, recently published by the IBGE, have signaled a possible improvement in economic performance by the end of this year, with GDP slowing down less than initially estimated, allowing the economy to grow more than expected in 2017.

The 0.3% drop in GDP in the first quarter of this year, compared to the last quarter of 2015, was less than the market expected, and may be an indication that GDP will start to grow in the last quarter of the year. As such, the forecast decline of around 3.9% in GDP in 2016, as shown in the graph below (based upon expectations for the end of May), is already being revised to 3.5% or less, depending upon the measures the government will implement in the next few months, primarily vis-à-vis fiscal and monetary policies.

This smaller drop in quarterly GDP benefitted from an increase in exports (6.5%), which in turn is benefitting from the exchange rate and the flow of production to other countries, because of the local recession, and a continued decline in imports, which is also impacted by a shrinking local market. The indicators that continue to spark concerns are household consumption and investments (Gross Fixed Capital Formation – "GFCF") which continue to fall: in the last quarter they were off 1.7% and 2.7%, respectively, compared to the previous quarter.

Increased confidence for investment in industry will be essential for this activity to resume, since household consumption is still a major challenge, given unemployment near 11%, declining income, high indebtedness, and scarce credit, which is all reflected in the fact that household consumption has fallen every quarter for more than a year.

GDP Expectation
(in %)



Source: Central Bank Database. * through 05/27/2016

Within this context, cutting interest rates and stabilizing the exchange rate will be important, though any inflection point will happen in the midst of limited fixed capital in the economy, owing to the strong retraction in GFCF over the past 2 years, the number of companies undergoing court-supervised reorganization, and others that are renegotiating debt and repurposing installed capacity for a new level of potential economic growth over the next few years.

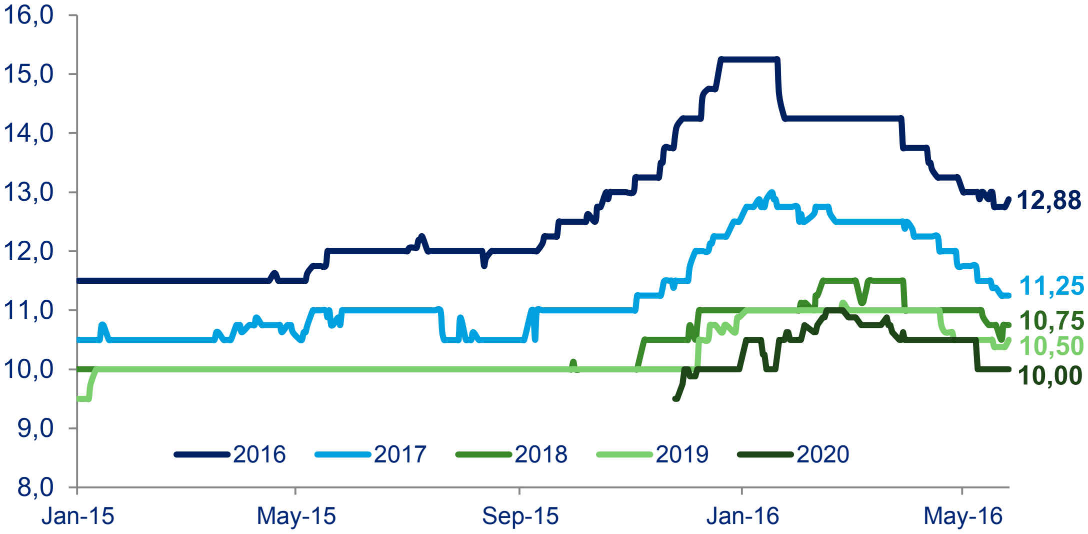
Some of the government's ongoing measures are intended to contain the public debt and federal government expenditures, and to revert funds to Brazil's Treasury through the payment of R$ 100 billion of BNDES debts to the Treasury (out of a total of nearly R$ 500 billion), which is to take place between 2016 and 2018. Among the measures are a Proposed Constitutional Amendment to limit public expense growth to the inflation rate from the preceding year measured by the Consumer Price Index (IPCA). In other words, there won't be an actual increase in expenses, which helps contain the rise of public debt on GDP seen over the past few years. Social security reform, which is still in the discussion phase, is considered key to rebalancing public accounts over the medium and long term.

On the other hand, the recent valuation of the *real* against the U.S. dollar reflects not only positive and growing commercial balances, but also the news that the Fed will put off rate hikes in the United States in light of the jobs market not reacting as expected.

In its last meeting before Brazil's new Central Bank President, Ilan Goldfajn, took office, the Monetary Policy Committee held the benchmark interest rate (Selic) at 14.25% per year, which still signals concern about inflation and an anchoring of market agents' expectations.

However, at the end of May, the market was still expecting monetary policy to loosen up this year, with the Selic benchmark rate falling below 13%, followed by continuous reductions over the next few years, perhaps reaching 10% in the medium term.

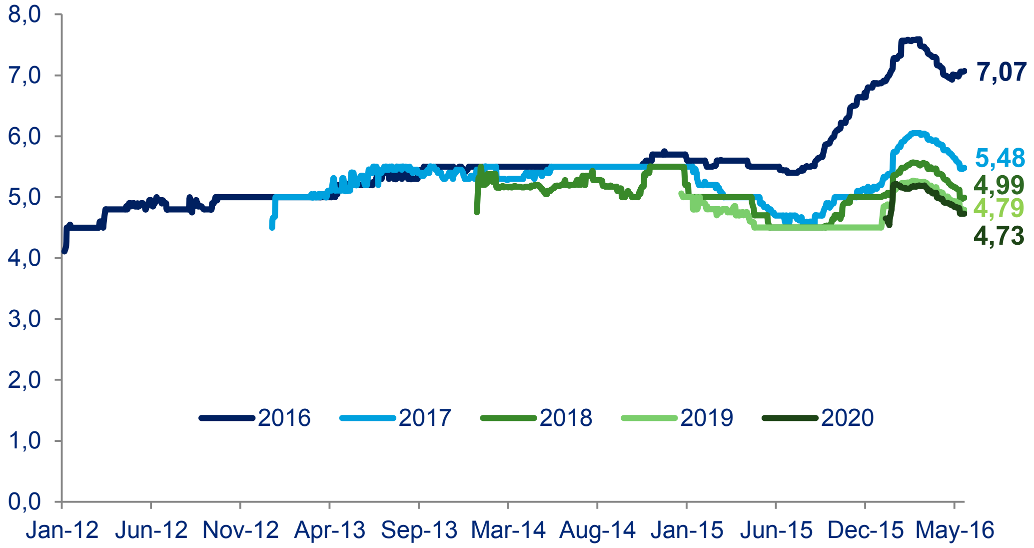
Selic Benchmark Rate expectations
(end of period, in %)



Source: Central Bank database. * through 05/27/2016

Of course, the lower interest-rate trend shown above is directly related to a convergence of inflation to the middle of the target, saving one of the key pillars of the government's economic policy.

Inflation expectations (IPCA)
(in %)



Source: Central Bank database. * through 05/27/2016

At the end of May, the markets expected inflation near 7% in 2016, and a continuous deceleration from 2017 onward, to levels already below the target ceiling (6.5%) in 2017, converging to the middle of the target (4.5%) by 2020.

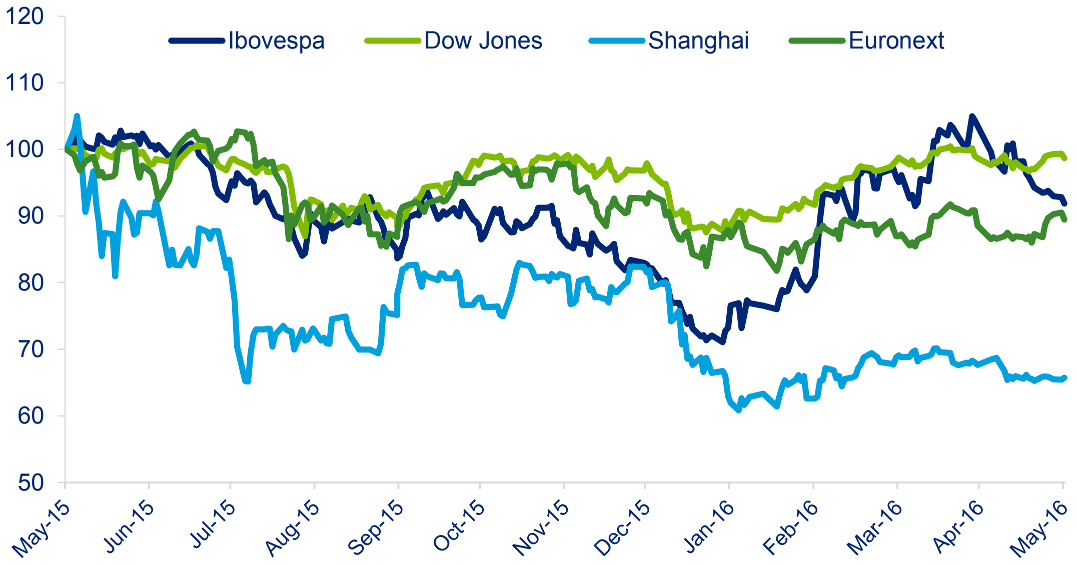
First quarter GDP results, which were better than the market expected, and the start of renewed confidence from economic agents, may be an inflection point for the economy and have a positive impact by the end of this year

This drop in inflation is in part related to the slowdown in domestic demand, despite occasional issues that might cause prices to rise in certain months as a result, for example, of a drop in harvest yields resulting from climate issues, with a corresponding increase in food prices.

After surpassing the 53,000 mark at the start of May, the Ibovespa index closed the month at 48,000; a significant drop and a reversal of the upward trend in place through April.

Other global stock indicators remained largely stable in relation to the previous month.

Global Stock Markes
Index 100 - May/2015



Source: Deloitte Research - (prepared based on data from the Central Bank, Ipeadata, Investing, sse exch).

Mergers and Acquisitions Market (M&A)

Based upon the transaction volume recorded through May, the first half of 2016 is expected to confirm the downward trend in the volume of M&A transactions compared to previous years, even though private equity funds have a larger share and interest in the acquisition of local assets.

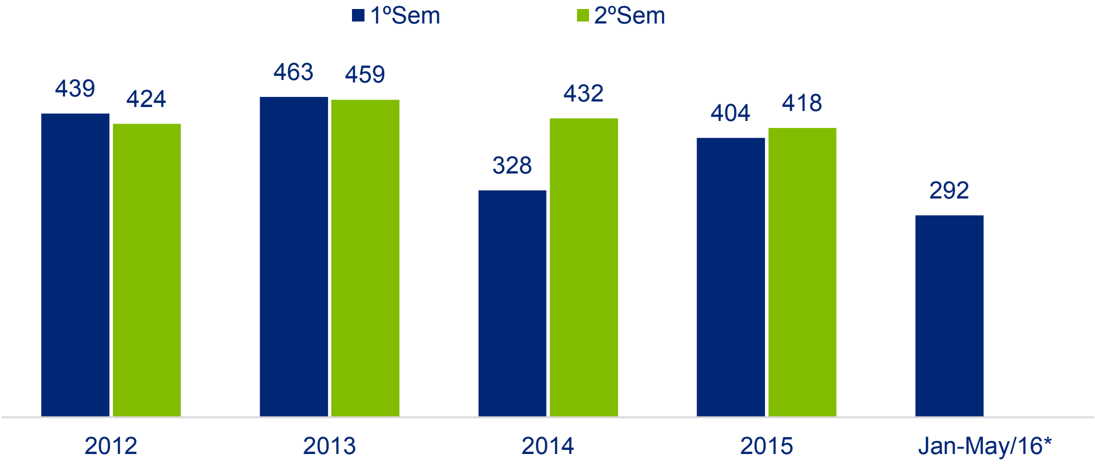
This downward trend on the M&A markets persists, despite the fact that assets are much cheaper in a strong currency and company valuations are more attractive because of the recession and weak operational results in various sectors. Those companies are not motivated to sell in the short term, either for reasons of indebtedness, family succession, or cash needs to finance other activities, are waiting for the best time to close the deal.

In May, Gerdau announced the sale of 100% of its capital stock in Gerdau Aceros Spain to a Spanish firm, Clerbil, for € 155 million, with the possibility of receiving up to € 45 million at the end of five years, depending on the company's performance. With this transaction, Gerdau is strengthening its capital structure at a time when Brazilian steel mills are facing high idle capacity and declining international prices, owing mainly to the high volume of steel output and exports by China.

Despite the drop in the number of transactions this year, the expected improvement to the economic scenario, associated with political stability, may untangle numerous ongoing transactions, enabling them to be closed more quickly and attracting more international investors

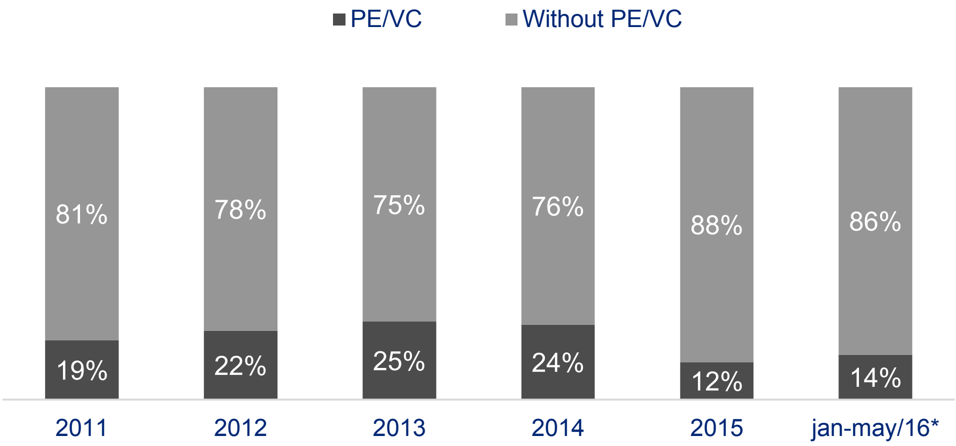
Despite the negative figures up to this point on the mergers and acquisitions market, recent improvements to GDP, interest rates, and inflation forecasts for the second half of this year and into 2017, along with signs that the political scenario will stabilize, may begin to reverse this trend, allowing more deals in the negotiation phase to be closed that might be waiting for the right time to be finalized. This improvement to the macroeconomic and political scenarios may also favor acquisitions by multinationals, which have high liquidity and few opportunities for growth in their own markets, owing to timid growth in mature markets.

Total - Mergers & Acquisitions in Brazil
(by semester - Number of transactions)



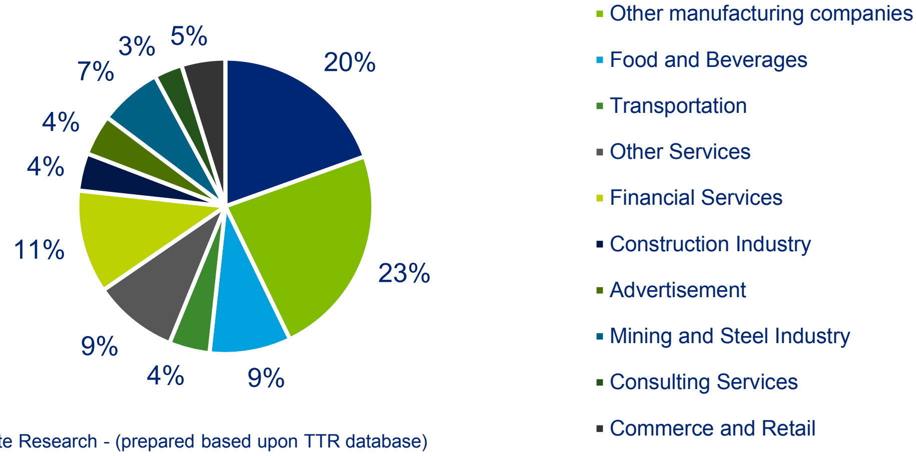
Source: Deloitte Research - (prepared based upon TTR data) *accumulated during the period

PE/VC percentage in M&A Transactions
(% of total)



Source: Deloitte Research - (prepared using TTR database) *accumulated during the period

Mergers & Acquisitions
May 2016



Source: Deloitte Research - (prepared based upon TTR database)

Debt and Capital Market

Although there is less credit for companies in the financial system, as shown in the graph below, the good news continues to be the funding via CRAs, and more recently, funding by Brazilian companies on the international market, like those by Marfrig, Cosan, Vale, and Eldorado, in the wake of this market being reopened by Petrobrás, with a placement of $ 6.75 billion.

Local credit and capital markets continue to be sluggish, feeling the effects of the recession, which is reflected in the constant uptick in defaults, renegotiations, and reclassification of debts by companies of all sizes. Companies are finding it difficult to roll over loans or to get new financing, given the guarantees required and the cost of debt, and local and international investors have little appetite for private papers, given the risk and uncertainty of companies' expected performance, as well as the attractive payouts on public securities like the NTN-Bs, which end up absorbing private savings that could be used for investments or even buying papers, such as infrastructure debentures for example.

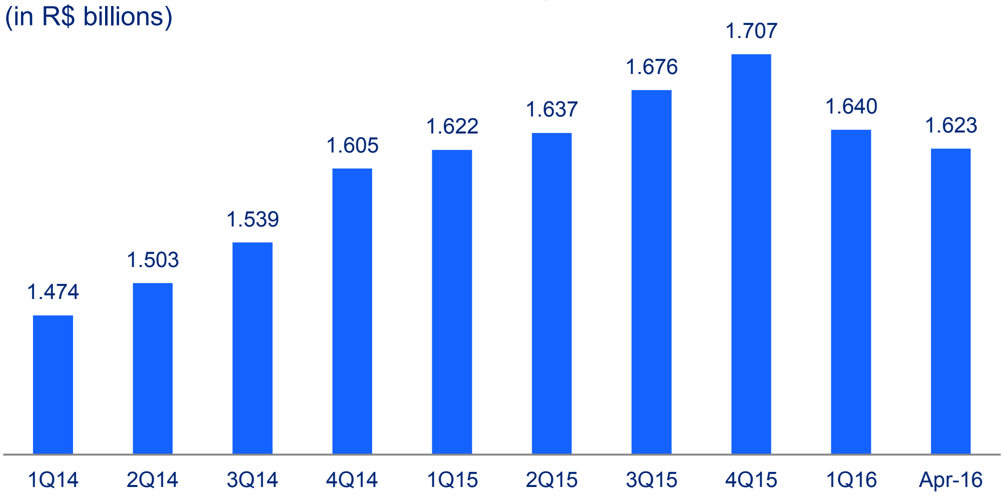
Current interest rate and required guarantees are the biggest obstacle to local funding. As such, the focus continues to be renegotiation and lengthening short-term debts

The corporate loan balance fell in April compared to March, and returned to practically the same level as the first quarter of 2015. The volume of new loans also fell, from R$ 134 billion in March to R$ 121 billion in April.

Company default rates continue to be high, rising from 2.9% in March to 3.1% in April.

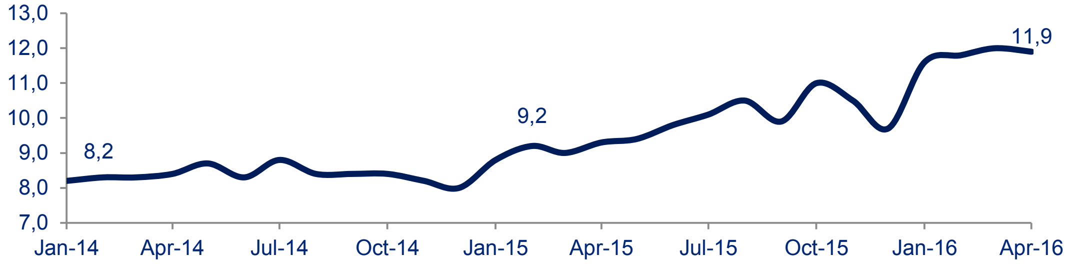
The loan spread remained nearly the same at around 12%, though it is still quite high compared to the past few years.

Corporate Credit Balance in the financial system
(in R$ billions)



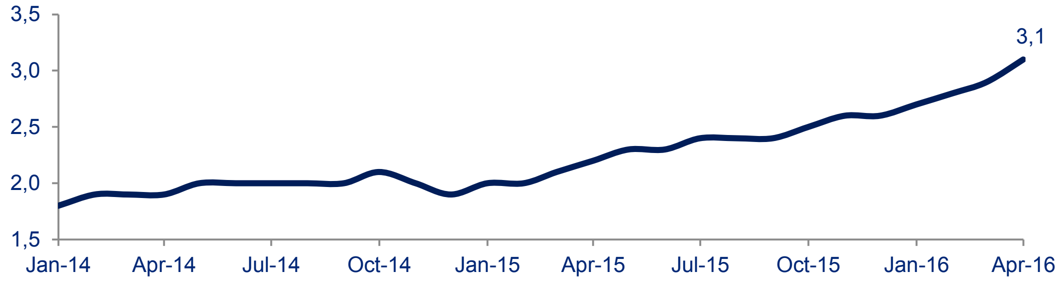
Source: Central Bank

Average corporate spread
(in %)



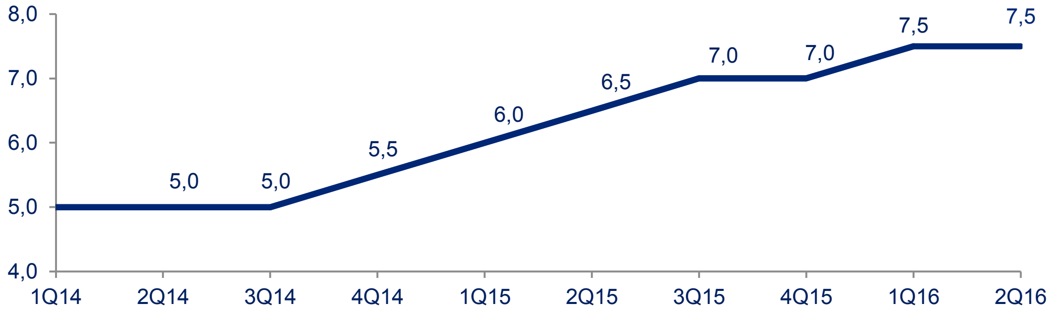
Source: Central Bank

Corporate Defaults
(in %)



Source: Central Bank

Long-Term Interest Rate
(in %)



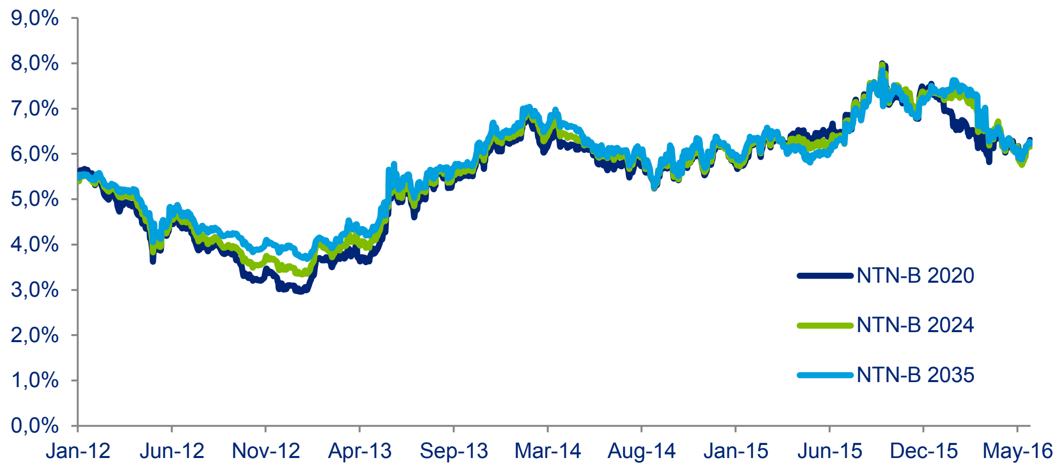
Source: BNDES

As mentioned above, funding via corporate bonds abroad has been good news for the debt market. With the funding obtained by Petrobrás, Marfrig (US$ 750 million), Vale (US$ 1.25 billion), Cosan (US$ 500 million) and Eldorado Brasil Celulose (US$ 350 million), the volume of issues is close to exceeding US$ 10 billion, which would already be up more than 30% in relation to all of 2015.

In large part, this funding is being used to lengthen companies' current debt. Even with costs higher than what could be obtained in the past, in part owing to the country's having lost its investment grade, these issuances are positive in of re-profiling short-term debt, given that all of them were made with 5 to 10 year terms and investor yields between 6 and 9% per year.

The reduction in NTN-B spreads continued in May. The security with the longest maturity (2035), for example, which were being traded with an average spread of 6.36% in April, went to 6.07% in May. The market continues to price in a cut to the Selic benchmark rate and a drop in inflation over the next few years.

NTN-B yield curves (IPCA+)
(in %)



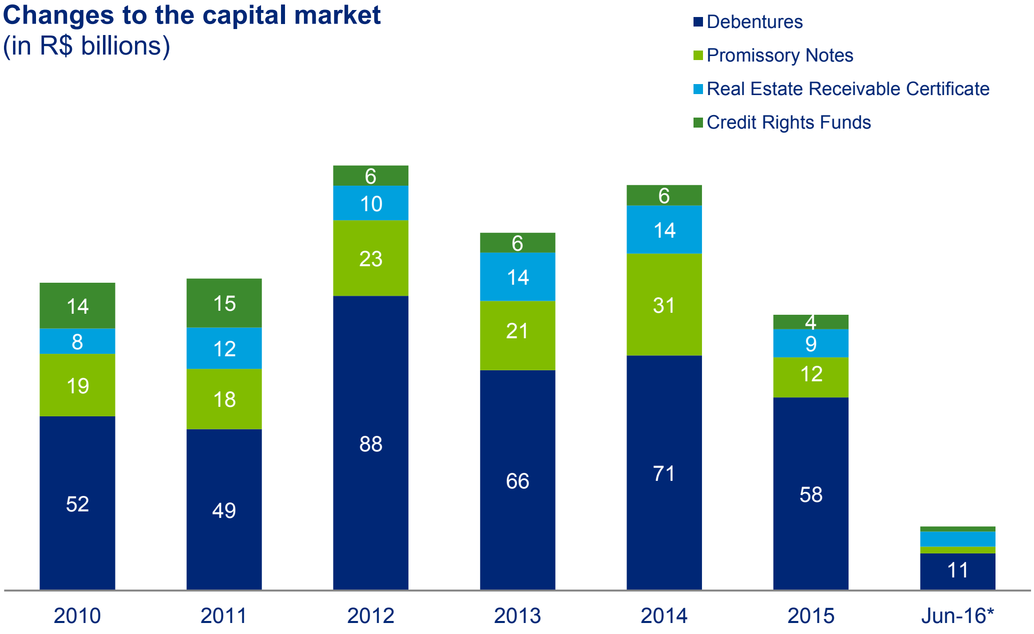
Source: National Treasury

The capital market remains far below where it has been over the past few years. In debentures, the energy sector has been the most active, given its need to finance investments in projects with ties to the sector’s auctions. However, what one sees is that a great deal of this financing is from bridge loans, while waiting for the release of longer term lines, mainly from BNDES, where release terms have been longer than in the past.

The best bet for jump-starting infrastructure investments are concessions, especially airports, ports, and roads, plus investments in the energy sector. At a time of low interest rates on global markets and excess liquidity, local projects may attract interest from various players, from strategic, international parties to Chinese ones, private equity funds, institutional investors, family offices and large domestic business holdings seeking to diversify their portfolio.

For that to happen, regulatory frameworks and lower interest rates (that absorb private savings through investments in public bonds with attractive returns and low risks, in addition to making long-term financing more expensive) are essential.

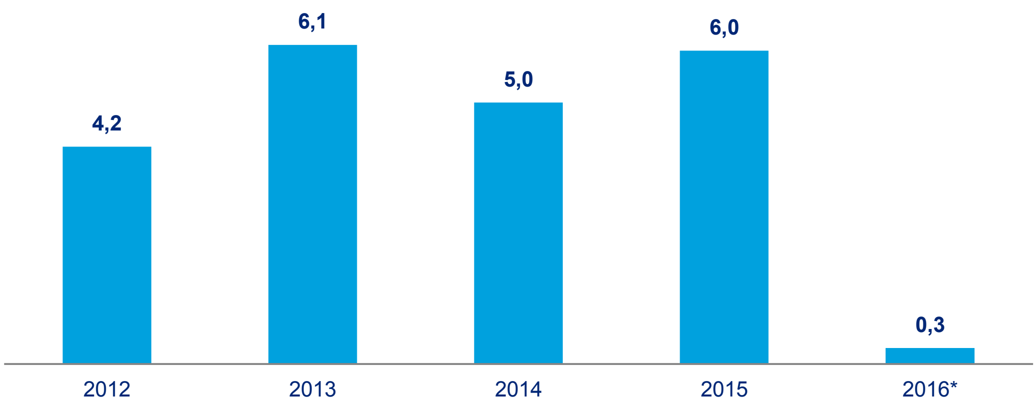
Changes to the capital market
(in R$ billions)



Source: debentures.com.br. data base; *cumulative through 06/09/2016

With respect to infrastructure debentures, funding totaled approximately R$ 300 million through May, a volume far below what was recorded in the past few years, as can be seen in the graph below.

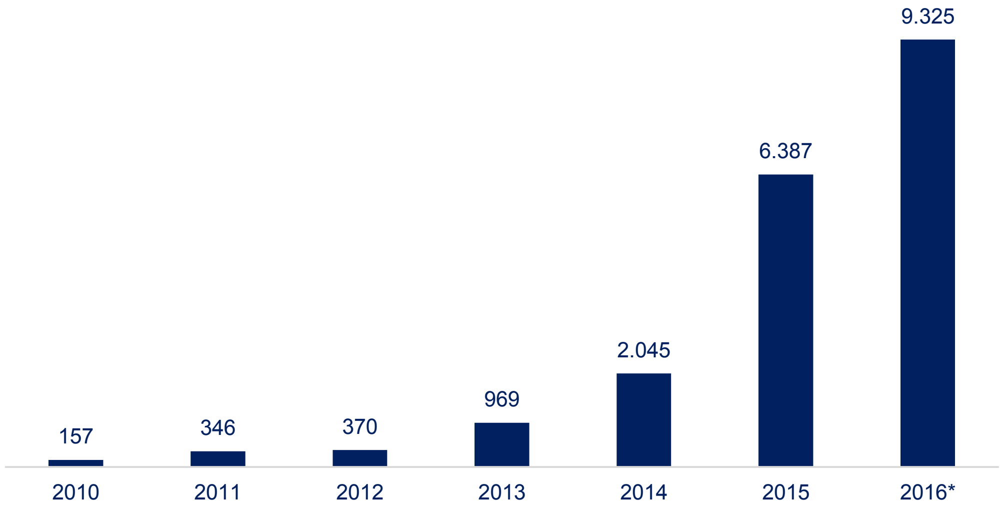
Changes in Infrastructure Debentures
(in R$ billion)



Source: debentures.com.br, *cumulative through 05/31/2016.

The stock of Certificates of Agribusiness Receivables (CRAs) rose to R$ 9.3 billion in May, mainly resulting from the new Raízen issuances, which totaled R$ 675 million.

CRA Stock - Certificates of Agribusiness Receivables
(in R$ million)



Source: Cetip. *cumulative through 05/31/2016.

The main issues through May:

Issuer	Date Issued	Term (years)	Annual rate	Principal (R$ MM)
Bayer	Feb-16	3	CDI + 0.29%	102.0
Duratex	Apr-16	6	98% CDI	675.0
BRF	Apr-16	3	96.5% CDI	1,000.0
Suzano	Apr-16	4	98% CDI	600.0
Raizen	May-16	6	98% CDI	465.0
Raizen	May-16	7	IPCA+ 6.16%	210.0

Main M&A Transactions during the Period

Target	Buyer / Investor
Migrate	Daruma
ODATA	P2Brasil
Único Fidelidade	Brasil/CT
FirstCom	CasaDigital
Gerdau Aceros España	Clerbil
Mednutrition	Go-Liberty
Mobils	Glispa
Amazon Flavors	Archer Daniels Midland
Terminal Uso Privado São Luís	China Communications Construction Company
Iorga	Condat Lubrificantes
Banco Gerador	Agiplan
CM Log	TCP Log
Petrobras Chile	Southern Cross
Solvay Indupa	Unipar

Source: TTR

Daruma acquired 40% of the capital stock in Migrate, an IT company that specializes in technological solutions for tax management and issuing systems. With this acquisition, Daruma is expanding its commercial automation sector, with the possibility of offering a cloud-based system for electronic tax document issuance and management systems, in conjunction with automation equipment.

Pátria Investimentos, through P2 Brasil, paid in R$ 200 million to ODATA to build a data center in the city of Santana de Parnaíba. ODATA specializes in data storage and processing infrastructure.

Brasil/CT, which works in the online retail market, announced its acquisition of 100% of Único Fidelidade.

CasaDigital, a communications and marketing agency, announced it was acquiring FirstCom, a public relations and corporate communications agency. The transaction strengthens the two agencies' services by combining digital marketing, content, and public relations.

Gerdau announced the sale of Gerdau Aceros España to the Spanish firm, Clerbil, for € 155 million, with the potential of receiving up to an additional € 45 million at the end of five years, depending upon the company's performance.

British Go-Liberty, which operates in the nutritional supplements sector, announced it was acquiring Mednutrition, which operates in the same sector and also sells products and training programs focusing on health and well-being.

Glispa, headquartered in Berlin and working in marketing and advertising, acquired Mobils, which offers mobile marketing and advertising solutions.

American Archer Daniels Midland acquired the remaining 60% capital stock of Brazilian Amazon Flavors. ADM has already had 40% of Amazon Flavors since 2013.

China Communications Construction Company will acquire interest in the Private Use Terminal from WPR São Luís Gestão de Portos e Terminais, through capitalization of R$ 400 million.

Condat Lubrificantes acquired Iorga, which specializes in lubricant engineering. Condat's focus, in turn, is the development, manufacture, and sale of lubricants used for cold working metals.

Agiplan purchased all the capital stock of Banco Gerador, a multiple-service bank that operates mainly in the north and northeast of Brazil. Through this acquisition, Agiplan now expects to have over R$ 1 billion in assets.

TCP Log acquired a 25% interest in CM Log, held by Columbia.

The private equity fund Southern Cross announced the acquisition of 100% of Petrobrás Chile's capital stock for about US$ 490 million. This transaction is in line with the Petrobrás divestment strategy and capitalization.

Unipar signed a deal to acquire 70.59% of Solvay Indupa for approximately R$ 142 million. Solvay Indupa is headquartered in Buenos Aires and makes chemical products.

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