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Hostile M&A in Brazil

The Brazilian Pill

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BM&A
BARBOSA, MÜSSNICH & ARAGÃO
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- Given that public companies have historically had controlling shareholder, Brazilian regulation is more advanced in protecting minority shareholders, as compared to regulating takeovers of companies without controlling shareholders.

- There is a great deal of uncertainty as to how acquisitions of companies with dispersed ownership will be regulated and who principal actors will be: Boards of target; shareholders, despite difficulty in acting together; CVM; courts?
Hostile M&A Environment in Brazil

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Although Brazilian market has the ingredients for unsolicited M&A activity, to date there have been virtually no hostile deals

• 2009 attempted bid by Telefónica merely disrupted acquisition of GVT (Holding) S.A. by Vivendi;

• 2006 bid of Sadia for Perdigão was rebuffed by control group;

• 1982 acquisition of Lojas Americana by Garantia shareholders was sole successful “hostile” (actually “creeping”) takeover

As more public Brazilian companies become widely-held, hostile activity is likely to increase
Constituencies that support hostile bids and activist campaigns are present in Brazil:

- International strategic acquirors are accustomed to making hostile bids;
- Brazilian companies have made unsolicited bids outside Brazil, and can be expected to take unsolicited action in Brazil;
  - Romi bid for Hardinge (U.S.)
  - InBev bid for Anheuser-Busch (largest hostile cash bid in U.S. history)

- International and domestic hedge funds, arbitrageurs and other aggressive activist investors;
- International institutional investors that have experience supporting unsolicited bids and activists;
- No “cultural” impediment to hostile bids, like in Japan or Germany, except for international buyers of “national champions”
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➢ Like in U.S., acquiror of 5% or more of target company’s shares must publicly disclose its share holdings

  • Disclosure must be made immediately (vs. 10-day period in U.S.)
  • Additional disclosure required for 5% increments (vs. 1% in U.S.)
  • Disclosure must state whether purchaser intends to seek control or influence target

➢ If purchaser buys more than 1/3rd of target’s free float shares, it must make a mandatory offer for all other shares (a “drainage of liquidity tender offer”)

  • If target has a poison pill, threshold may be lower
The “Brazilian Poison Pill”

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- U.S., Brazilian and European regulators have common concern about stock accumulations and partial offers that give acquiring a significant minority stake and control or influence
  - Such "creeping" offers give acquirors effective control without providing public shareholders a change-of-control premium, and trap public as minority shareholders with limited rights

- Brazilian regulation addresses this concern in a way that is similar to Europe, but that differs from U.S.

- Alongside the increased number of IPOs in Brazil since 2004, various publicly-traded companies have inserted mandatory offer provisions in their bylaws. Often, such shark repellent provisions are mistakenly referred to as poison pills.

- Brazilian “poison pill” is structured traditionally to require purchaser of a stated percentage of shares (10–35%) to make a tender offer to acquire all other shares at a set price, representing a premium over current market price
The “Brazilian Poison Pill”

<table>
<thead>
<tr>
<th>COMPANY (EXAMPLES)</th>
<th>Shareholding required to trigger public tender offer</th>
</tr>
</thead>
<tbody>
<tr>
<td>Embraer</td>
<td>35%</td>
</tr>
<tr>
<td>Lupatech; Tupy</td>
<td>30%</td>
</tr>
<tr>
<td>São Carlos; Natura Cosméticos</td>
<td>25%</td>
</tr>
<tr>
<td>Tecnisa; Profarma; Estácio; Valid; Totvs; Brasilagro; BR Malls; HRT; Helbor; Brasil Insurance; Multiplan</td>
<td>20%</td>
</tr>
<tr>
<td>Rodobens; Marisa Lojas; Cyrela Commercial Properties</td>
<td>15%</td>
</tr>
<tr>
<td>São Martinho; Positivo</td>
<td>10%</td>
</tr>
</tbody>
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In zeal to protect new companies lacking a controlling shareholder, poison pills have been adopted with extreme or unworkable provisions:

- Pricing provisions that set unreasonably high prices, or prices that cannot be determined until after offer is made (usually, the price cannot be less than the highest of: (i) the economic value of the company, based on an appraisal report prepared in accordance with rules set forth in the bylaws; (ii) the equity value of the company, according to the company’s last audited financial statements; and (iii) the highest stock price at which the company’s shares have traded with a certain period of time prior to the tender offer).
- Provisions prohibiting amendments to remove pill, and providing that shareholders who vote to eliminate pill will, just by so voting, trigger pill on themselves.
- CVM has issued opinion stating that ability of shareholders to waive or eliminate the poison pill may not be restricted (cláusulas pétreas), and that CVM will not enforce triggering of poison pill against shareholders who vote to eliminate pill.
  - As this statement is advisory, not binding, its impact is not clear.
The “Brazilian Poison Pill”

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➢ Usually, “poison pills”/mandatory offer provisions have the following wording:

Any Purchasing Shareholder who acquires or becomes the holder of shares of the Company in an amount equal to or greater than [●]% ([●] per cent) of the total shares issued by the Company shall, no later than [●] ([●]) days from the acquisition date or from the event that resulted in the ownership of shares in an amount not less than [●]% ([●] per cent) of the total shares issued by the Company, make or request, as appropriate, the registration of a public offer to acquire all shares of the Company, in accordance with the provisions of the applicable CVM regulations, the Novo Mercado rules, and any other Bovespa regulation.
Example

EMBRAER: The tender offer price is the greatest of: (i) the highest quoted price for Embraer shares during the 12-month period prior to the tender offer among the prices quoted on any stock exchange trading such shares; (ii) the highest price paid by the Acquiring Shareholder during the 36-month period prior to the tender offer for a share or block of shares in Embraer; (iii) 14.5 times Embraer’s Consolidated Average EBITDA minus its consolidated net indebtedness, divided by the total number of outstanding shares; and (iv) 0.6 times Embraer’s backlog, according to the latest information disclosed by Embraer, minus the consolidated net indebtedness of Embraer, divided by the total number of outstanding shares.
The “Brazilian Poison Pill”

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- U.S. has no mandatory requirement for acquiror to make offer for target shares once purchaser exceeds an ownership threshold.

- Instead, law provides target Boards with mechanisms to limit ownership level below control thresholds.

- Form of regulation reflects primacy of Boards in U.S. corporate governance.

- Target Boards may adopt shareholder rights plan that prevents acquiror from exceeding ownership threshold (e.g., 10–20%).

- In U.S., poison pill prevents purchaser from acquiring target shares above ownership threshold; Brazilian poison pills require bidder to make an offer for all other shares at specified price.
Structure of Hostile Offer

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- CVM has indicated that unsolicited bids may take the form of a tender offer made directly to the target company’s shareholders, without any consultation with or agreement of Board.

- The unsolicited offer would be conditioned on:
  - A shareholder vote to remove poison pill, eliminating need to pay a higher price mandated under the pill.
  - Simultaneous demand for a shareholder vote to replace Board.
  - Will hostile bidders and activist shareholders in Brazil be able to use tactics now prohibited in U.S., given the lack of guidelines and established practice -- e.g., creeping acquisitions, partial offers, street-sweep, parking stock?
In the evolving Brazilian market, Boards of Brazilian public companies seek better definition of their role and duties.

Given absence to date of hostile activity, Brazilian law and practice have not yet developed clear guidelines as to proper role of Board in considering and reacting to an unsolicited offer.

Since 2010, however, the CVM’s regulations (ICVM 361/2002, article 32-D) have allowed Boards of Directors to issue their opinion on voluntary public tender offers governed by ICVM 361. In the case of companies listed in special listing segments of BM&FBovespa (Nível 2 and Novo Mercado), the Board of Directors is required to issue its opinion.

On paper, Boards of Brazilian companies have fiduciary duties similar to those of U.S. directors, but these have not been tested or developed.

Also, it is a fundamental rule of Brazilian corporate law that the shareholders are sovereign and may decide all matters relating to the activities of the Company. Accordingly, it is not clear how rights of shareholders and Board (which traditionally have not been strong) are balanced.
Board may consider interests of other stakeholders besides the shareholders, such as employees and communities in which the Company operates.

- It is not clear what significance this right will have in practice.

CVM guidance on role of target’s Board in a hostile offer has sometimes been confused, and even inconsistent.

CVM has stated that although Board cannot prevent a tender offer made directly to shareholders, Board may not remain passive either.

- Board is obliged to ensure that unsolicited offer is not abusive, coercive, illegal or manipulative.

CVM has stated that the current poison pill regime is intended to encourage bidders to negotiate with Board, which it believes is beneficial to shareholders.
Although CVM has spoken out against poison pills that cannot be amended, it has at same time said that a Board may legitimately defend against a proposal to amend a company’s poison pill in an unsolicited offer.

- CVM has also said it will itself police abusive attempts to circumvent poison pills.

- Proposed CVM regulations require Board to issue a recommendation to shareholders (as was done by Perdigão Board in hostile offer).

- Standard of review of Board conduct is not clear. Will regulators and courts defer to Boards, in a manner similar to business judgment rule?

- Under general Brazilian law, Boards are liable to shareholders for damages caused by their negligence, willful misconduct or breach of law or the by-laws. Application of this in takeover context is not clear.

- Role of litigation in hostile transaction is untested.

- Novo Mercado rules provide arbitration venue for some disputes.
Brazilian companies are increasingly engaging in anti-takeover planning, working with counsel and financial advisor.

If faced with an unsolicited bid, a Brazilian Board may have greater flexibility to pursue an alternative course that would frustrate the hostile bid (provided it believes such action is preferable for Company and its shareholders). These could include:

• Merging with a third party (subject to shareholder approval);
• Selling or spinning off assets of the Company;
  - Sale of “crown jewel” asset
• Acquiring assets of third parties or strategic alliances;
  - Acquisitions that create regulatory impediment
• Extraordinary dividends;
• Share repurchases (may require shareholder approval);
• Incurring debt; and
• Issuing equity to friendly investor or employee plan