Lacerda plays a grown-up game

The downturn in Brazil does not faze Ricardo Lacerda, founding partner of local investment bank BR Partners. Advisory remains the bedrock of his business, but political instability makes him think the next five years could undermine the last 20

By: Rob Dwyer **Illustration:** Pete Ellis

"Brazil went back 20 years with the downgrade, and we are in a low-growth environment with a lot of volatility and a lot of political uncertainty. We have a government with a very bad fiscal situation. Families are very indebted and many companies are very, very leveraged… Yes, there are good opportunities in a market like that, but it's not for everyone – it's for grown-ups."

There have been many bleak assessments of the Brazilian macroeconomic and financial landscape over the past couple of years. But when Ricardo Lacerda, founder and CEO of BR Partners, warns against rising levels of optimism about the country it is worth listening.

Lacerda has seen the rise and fall of Brazil's markets. He started out in banking straight after graduation in 1990 with Chase Manhattan Bank before switching to investment banking at Goldman Sachs after receiving an MBA from Columbia Business School.

He saw the evolution of a market based on structured products and a little M&A in the 1980s, the arrival of private equity in the 1990s, before firms like Garantia and Pactual were founded to take advantage of the opportunities in trading rates and FX markets in the 2000s. M&A and private equity continued to grow and in the middle of that decade a steady trickle of equities emerged, before exploding in volumes between 2007 and 2010.

Lacerda's career grew at a similarly rapid pace. He became head of Brazil for Goldman Sachs in 2001 before taking the same role for Citi in 2005, finally becoming Citi's head of Latin America. Both of those firms headed the M&A league tables under his watch. The relationships he built at the leading Brazilian companies enabled him to get the backing – financially and commitment to business flow – to launch BR Partners in 2009.

The new firm's business plan did not envisage a subsequent two-year recession and the collapse of deal volumes but the bank (it has a full licence after buying Bunco Porto Seguro in 2011) has made a profit in every year of operation.

That profitability is down to a few things. The bank is lean, paying its members relatively low basic wages and incentivizing through share options. It is focused on its niches – advisory and structured credit products – and it has responded quickly to the changing market, for example by closing its loss-making equities business and opening a financial restructuring division instead.

Possibly the biggest reason for profitability is its equity structure. Half of the shares belong to Brazilian blue-chip companies; that has cemented the close working relationship that Lacerda and the other senior investment bankers enjoy with these companies and kept the deal flow coming.

HOWEVER, LACERDA INSISTS THAT the model is sufficiently flexible to enable the bank to grow beyond the core shareholding constituency. He points to the fact that the bank has advised companies that are on the other side of M&A deals to his shareholders such as Hypermarcas, Qualicorp and Suzano, as proof that growth will not be constrained by any conflict of interests.

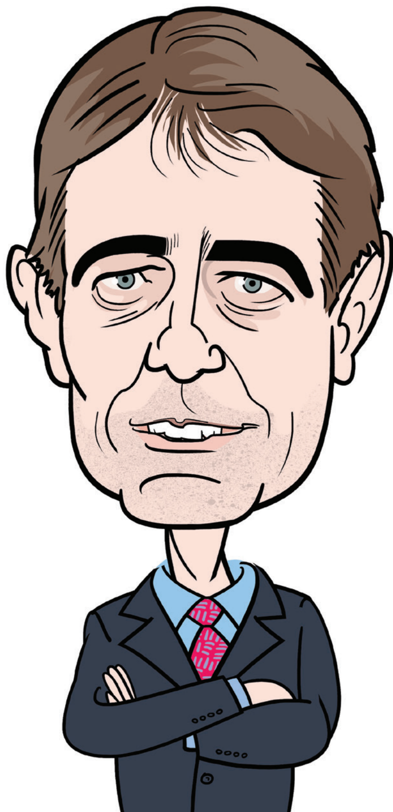
"Part of my team and I have been around for some time, and that's why we have a good portion of this [M&A advisory] flow – and the fact that we are backed by Brazilian entrepreneurs," says Lacerda. "There is another side of the coin that wasn't obvious to me when we started BR Partners. Sometimes multinationals come to us because of those relationships [with our shareholders]. They want to have more granularity in terms of relationships in Brazil to prospect business, and they see that we have that through our relationships with these entrepreneurs."

It has even led to cold-call business. Femsa Group contacted Lacerda in 2015 after seeing a purely local bank doing well in the M&A league table rankings. "They started working with us and liked it, and ended up working with us on several deals," says Lacerda. "Our model is to be a niche player but also to have global clients. Last year we did a lot of cross-border deals with clients like Hypermarcas, the Casino Group, Femsa and Affinia."

The 'entrepreneurial' shareholders comprise nine rich families, with interests spanning many industries, from pulp and paper, healthcare, logistics, financial institutions to consumer, pharmaceuticals, real estate and agribusiness. "It's a small investment for them and it's not an exclusive relationship – they don't have to hire us and we don't have to work only for them," explains Lacerda. "Sometimes we do work for their competitors."

Is it really viable to be on the other side of the table to a shareholder when negotiating an M&A transaction? "It's OK," responds Lacerda phlegmatically. "I prefer to be on their side, they are more aligned with our interests and we have a very close relationship… these are top-tier companies that we follow very closely. But sometimes other banks bring them ideas, and because of our knowledge of these companies others want to hire us on their side because we have an open channel. I think it provides for a very healthy relationship."

Lacerda says other factors have boosted deal flow in other areas, such as the bank's fixed income division. The deepening reces-



"Our model is to be a niche player but also to have global clients. Last year we did a lot of cross-border deals with clients like Hypermarcas, the Casino Group, Femsa and Affinia"

Ricardo Lacerda

sion has led to a severe tightening of credit in Brazil, forcing even the largest companies to look creatively at debt solutions. The bank has seen a huge rise in structured products sized at between R$30 million ($9.2 million) and R$120 million that it can sell on into its asset management client base.

"Initially when we started the bank, it was very difficult to get traction with the client base that we have for M&A advisory – where we talk to the blue chips – because they saw little reason to do business with such a niche player. They took meetings as a favour because of our relationships on the advisory side but not really because they were excited about having us as a counterparty. Now credit is so tight that they prefer to use their lines of credit with the big banks as pure credit and when they want to do structured products they come to us. So we have seen some of the clients that were very tough to break into coming to us and starting to become a counterparty."

HOWEVER, THE BANK'S MAIN revenues are still from M&A advisory, and Lacerda has the perfect vantage point to assess the market and the attractiveness of Brazilian companies.

First the good news. Strategic buyers are still very interested in Brazilian companies. These corporate buyers were frustrated in the M&A boom between 2010 and 2013 as financial sponsors were snapping up Brazilian companies at multiples at which international corporates could not compete.

Now there is less competition from private equity firms and much better nominal valuations thanks to the appreciation of the dollar against the real. This has enabled BR Partners to sell companies, such as Hypermarcas' beauty business to Coty for R$3.8 billion, for large multiples, while cross-border interest remains strong.

"The reason the strategic buyers are coming back is very simple," says Lacerda. "Brazil is still a very large market with more than 200 million consumers. Unfortunately we are in the middle of this crisis and there has been some backtracking economically, but it's a very large market with established rules and large consumer companies have to be in Brazil."

He points to the sale of Hypermarcas' condom and lubricants business to Reckitt Benckiser for R$675 million as an important example.

"The multiple was astonishing [6.7 times 2014's sales] because there are not many good, established assets and many of those are family owned," he says. "It's not like the US where you can go to a sector and have 20 listed companies that you can buy. Here it is very different. So maybe the multiple looks high but the nominal amount is not that huge – especially in dollars – so why not make that bet? If you can buy a position in this market for $1 billion, it's not the end of the world – and that business could be worth $10 billion in a short period of time."

The continuing financial volatility is keeping financial sponsors away, especially international dollar-based firms. Those buyers' much shorter investment horizons mean that the lack of clarity and economic growth has kept them on the sidelines. The economics of many of the last crop of private equity deals have been destroyed by the movement in the real, as well as the deterioration in the economic climate.

Lacerda does not see these buyers returning soon.

"If you are managing your own money and taking that kind of risk that's one thing," he says. "But managing third-party money and making that decision… most financial sponsors like to pay high prices in a booming market rather than pay low prices in a very volatile market like we are in right now."

That withdrawal opens opportunities for local, real-dominated investors, and BR Partners has a growing private equity business. Lacerda also points to the little-appreciated segment of Brazilian corporates that are well-positioned to consolidate industries through M&A activity.

"We have a good number of companies that are cash rich and completely debt-free," he says. "For example, Hy-

permarcas became cash positive with these [divestitures] and there are many other companies like this."

Lacerda estimates that between 20% and 25% of companies are in the cash-rich category, with much of the rest being over-leveraged and subject to a lot of pressure in the credit markets, facing "absurd" borrowing rates that start around 17% to 18% for the strongest credits: "We are talking about equity rates of return – it's incredible."

So why are we not seeing domestic opportunistic buying of leveraged companies? "Because the environment is so bad – it's so uncertain – that people are not investing."

Lacerda says the large, private banks have been a strong buffer to the extremely poor economic environment.

"No one is really lending," he says, "and people are doing what I call Brazilian restructuring – purely extending maturities and getting some grace periods with no change in interest rates and no hair cut – just to gain time."

Structured deals are also growing due to the credit squeeze, which Lacerda has already noted as a source of growth for his bank.

"But at some point things need to get rolling again," he says. "Many of the companies with high debt are good companies, but the issue is what happens if we stay in this state of paralysis for too much longer. Then the buffer of the big banks will lose steam – they can't sustain it for ever – and we might start to see a lot of losses in the banking sector and some additional bankruptcies in the corporate sector."

"One of the very important things that we now have in place is the most capable economic team," he says. "I am not only talking about [finance minister Henrique] Meirelles, but also a lot of the lower-profile people below him. I know many of these guys and they are top quality. They know what needs to be done. So that's the good news.

"The bad news is that, unlike two or three years ago – when you could have flicked a switch and put the country back onto sustainable fiscal and monetary policies because people were still investing – a lot of that confidence has now gone. There is not a lot of fiscal flexibility and, because of that, monetary policy is constrained. Also, a lot of things that this extremely competent economic team needs to do have to go through Congress, and it is an incredibly insane political environment."

That politics now trumps economics in Brazil is the realization of many people's fears, including Lacerda's. A pluralistic political system is compounding the paralysis that stems from corruption enquiries and the impeachment process. Under acting president Michel Temer there has, as yet, been no progress in legislating the unpopular measures needed to make the necessary fiscal adjustment.

"The former president [Dilma Rousseff was suspended in May] had no political skills whatsoever," says Lacerda. "This president is the quintessential Brazilian politician, he knows everyone and what to do and how to do it. But he is not elected, he is not empowered by the people and he is surrounded by people who are being questioned for corruption. He could succeed, but I also don't see him confronting the Congress to try to get approval for extremely unpopular measures."

What does Lacerda think is the most likely political outcome?

"You have two scenarios. Actually you have hundreds, but you have one in which things start to improve a little bit, with some results from the stability of the economy that has to happen at some point and a return of confidence from the new economic team.

"In this scenario, the country starts to feel benefits and then the president gets gradually empowered and stronger and viewed more as a legitimate president who could then push for less popular reforms.

"Or, if he remains in this position either because the economic crisis doesn't show any signs of improving or because he gets hit by additional scandals, then he is the type of guy who will stop moving to try to save his mandate to the end of 2018. And that would be a very bad scenario, with no hope to put things on the right track until 2018. And even after that it would take a long time and make the outcome of the 2018 election extremely uncertain."

Lacerda points to the plural political system as a potential source of weakness in the next presidential election. He expects that the presidential election in Brazil will be similar to the 1989 election that saw 12 candidates; indeed, there could be more in 2018 as there are 28 political parties in Congress (compared with 21 in 1989).

Then, the second-placed candidate secured just 17% of the vote to get into the final round – making it more possible for a populist or fringe politician to make it into the final round of two candidates.

"That's why it is really unfortunate that the country compromised on the very important intrinsic values that were established since 1994 and were kept until 2014 – the values of low inflation and fiscal austerity and transparency in the agencies," says Lacerda. "All of sudden that blew up. That's why it's going to be a rough ride in the coming five to 10 years." EM