How to launch a Brazilian Depositary Receipts (BDRs) program

Handbook | 1st edition

pwc

BM&FBOVESPA
The New Exchange

Contents

Introduction

Launching a Brazilian Depositary Receipts (BDRs) program can be a milestone event for an organization. Preparing to become a publicly-listed company on a non-domestic exchange requires a level of understanding and coordination from shareholders and management alike to assure rules and regulations are met and Key Performance Indicators - KPIs and commitments are measured. Options must be evaluated and business models adjusted for cultural differences and business practices. The Brazilian capital markets have successfully raised a growing volume of funding for companies in recent years, with BM&FBOVESPA showing a proven track record as one of the world's main portals for accessing capital markets. The process of registering the company with the Brazilian regulator and complying with regulatory requirements might at first glance seem daunting – however, as the company will already be listed in its home market it will be well accustomed to life as a public company.

Although foreign issuers of securities can greatly benefit from the liquidity of the Brazilian market by launching a Sponsored BDR program, there are pitfalls which need to be avoided. Understanding the different Programs offered, from the simple and straight-forward Level I which does not require full registration, through to the Level III which upon registration will permit funds to be raised in Brazil, is vital. A company will need to meet supplemental regulatory requirements and continuing obligations as a Brazilian publicly-listed company that may demand new skill sets from management and enhanced governance and controls. Whereas Sponsored Programs put the company in the "driver's seat", in the case of an Unsponsored Program, the company is a mere passenger. Thinking through these requirements in advance and developing an appropriate plan is the key to a successful entry into the Brazilian capital markets and will reduce unnecessary stress on the organization and inspire confidence among investors and other market players.

As the number of foreign companies looking to access Brazilian capital markets continues to grow, we are publishing this first edition of the guides: "How to Launch a Brazilian Depositary Receipts (BDRs) Program- A Handbook".

This Handbook, which is a companion publication to a more comprehensive Guide entitled "How to Launch a Brazilian Depositary Receipts (BDRs) Program", provides a summary of the issues a company will need to consider when it debates whether to register its shares in a Sponsored BDR program. The purpose of the Handbook and Guide are to help companies make informed decisions by addressing factors such as the advantages, disadvantages, costs, timing, and alternatives. They present the process of registration with the Brazilian market regulator and the listing with the Brazilian stock exchange. The publications are not, however, intended to address all aspects of a BDR launch or substitute advice from legal, accounting and banking professionals.

We hope you find this Handbook a helpful and an easy-to-use reference for planning and executing a registration of a Sponsored BDR Program as you determine the best path for sustaining your company's growth now and into the future. We recommend that it be read in conjunction with the Guide.

Sao Paulo, March 2016

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What is a BDR?

A Brazilian Depositary Receipt (BDR) is a negotiable instrument that represents an ownership interest in the securities of a non-Brazilian publicly traded company which must be backed by its own securities listed in its home or other markets. BDR's are quoted and traded in Brazilian reais, and are settled according to procedures governing the Brazilian market.

A BDR Program is a mechanism which can be used by a foreign company that wishes to have its securities traded in the Brazilian capital market. BDRs are receipts issued by a Brazilian depositary institution representing securities issued by a foreign domiciled company which have been deposited with a foreign custodian bank or institution. The securities underlying the BDRs must be deposited with institutions that are in countries which have signed agreements with the Brazilian Securities Commission (*Comissão de Valores Mobiliários* (CVM)) or have signed a memorandum of understanding with the International Organization of Securities Commissions - IOSCO.

The Rules in Brief

The different types and classes of BDRs are as follows:

Level I

Unsponsored BDRs

Unsponsored programs can be launched ***without*** the support of the underlying company and the securities are traded on BM&FBOVESPA. The depositary institutions that issue Level I BDRs are responsible for disclosing information to the market. Although the program is registered with the CVM, the foreign issuers of shares represented by Level I Unsponsored BDRs are not required to register the company with the CVM. Proceeds cannot be raised in Brazil through an issuance of securities. Only 'Qualified Investors' (as defined - see later) are permitted to trade Unsponsored Level I BDRs.

Level I

Sponsored BDRs

Sponsored programs are launched with the full and active support of the underlying company and are admitted for trading on BM&FBOVESPA. Although the ***program*** is CVM-registered, the foreign issuers of shares represented by Level I Sponsored BDRs are not required to register the ***company*** with the CVM. The company is required to disclose in Brazil the same information which it is obliged to disclose in its home country. Only Qualified Investors are permitted to trade Sponsored Level I BDRs. No new proceeds can be raised in Brazil through an issuance of securities.

Level II

Sponsored BDRs

These are admitted for trading on BM&FBOVESPA and can be bought and sold by any investor. Level II programs must be registered with the CVM and the underlying company is required to follow Brazilian listed-company disclosure rules and regulations (by registering the company with the CVM). No new proceeds can be raised in Brazil through an issuance of securities.

Level III

Sponsored BDRs

These are admitted for trading on BM&FBOVESPA and can be bought and sold by any investor. The company must be CVM-registered and the programs are registered with the CVM when securities are issued simultaneously in Brazil and abroad in accordance with Brazilian law applicable to securities offerings. Proceeds can be raised in Brazil through an issuance of securities.

What types of BDR programs are available?

	Unsponsored Level I	Sponsored Level I	Sponsored Level II	Sponsored Level III
Issuer involvement	No	Yes	Yes	Yes
CVM registration	Program		Program and Company	
Public offering	No	No	No	Yes
Trading market	BM&FBOVESPA			
Permitted investor	Only 'Qualified Investors'		No restrictions	
Financial reporting standards	GAAP in the country of origin		IFRS	

Is there a fast track for a public offering of a Level III program?

Yes. Instrução CVM ("CVM Instruction") no. 476 ("CVM no. 476") permits an offering to be launched and funds raised from Professional Investors in Brazil, as long as the Company is already registered, allowing for a much easier and quicker access to the markets, reducing costs, shortening lead times and making for a more agile market in Level III BDRs. Although the offering is not registered, the program is CVM-registered.

The restricted placement rules determine that the number of domestic investors that may be approached is limited to 75 investors of which 50 are eligible to subscribe to the offering. Other conditions also apply.

Who can launch and trade BDR?

Lanching

- Non-Brazilian listed companies are eligible.
    - Foreign company shares can be used as underlying securities for BDRs only when issued by publicly-held non-resident companies (or similar companies), which have been admitted for trading and are held in custody in countries whose regulatory bodies have entered into a cooperation agreement for consultation, technical assistance and mutual exchange of information with the CVM or are signatories of the IOSCO Multilateral Memorandum of Understanding.
    - Foreign publicly-held companies whose stock underlies BDR programs are subject to no specific requirements with regard to (i) date of incorporation or (ii) operational performance and results in previous fiscal years. Although greenfield companies or startups can use their own shares for purposes of the issuing BDRs, they may be required to file a feasibility study with the CVM.
    - In the case of Unsponsored Level I BDRs, the Depositary Bank is responsible for the lauching and maintenance of the program.

- Brazilian companies cannot register their own securities to be launched in a BDR program.
    - An issuer headquartered in Brazil <u>or</u> with more than 50% of its total assets located in Brazil (the definition refers to a substance over form evaluation), as reported in its individual, separate or consolidated financial statements, does not qualify as a foreign issuer under Brazilian law and therefore is not entitled to use its securities used for a BDR program.

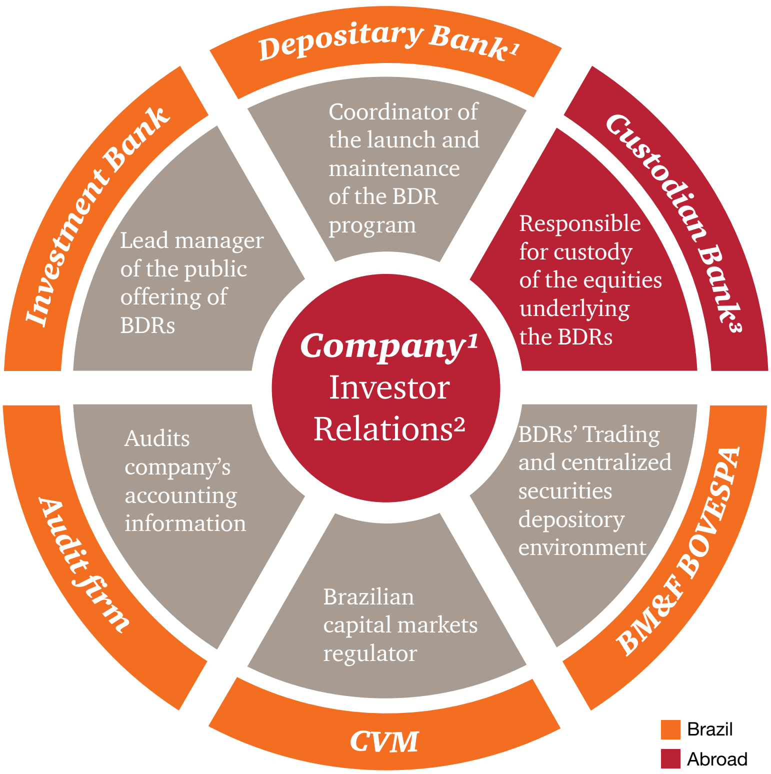
Trading

- Level I (Sponsored and Unsponsored) BDRs can be traded solely by Qualified Investors.
- Level II and III BDRs can be traded by any investor.
- Brazilian resident investors - the BDR programs facilitate Brazilian investment in offshore companies. Brazilian residents can buy the BDRs in Brazil or can declare and remit monies abroad to purchase shares of a non-Brazilian company, deposit such shares with a custodian, and have the depositary bank issue BDRs in Brazil to these residents.
- Non-resident investors - can trade BDRs in the Brazilian market. Alternatively can request that the depositary bank cancel these BDRs and they receive the underlying shares from the custodian outside Brazil.

It is prudent to seek professional tax advice in all cases.

The Players

BDR Program: participants and roles



[1]Both the company and the depositary bank also have legal advisors/representatives in Brazil.

[2]Area responsible for maintaining the visibility of the company.

[3]The custodian bank has a direct relationship with the depositary bank.

- ***The Company team (for Sponsored BDRs)***

  The degree that the host Company team participates in the process of preparing the registration document frequently depends on the expertise of the Company's personnel, although outside counsel will typically play a large part in the drafting process. In any case, Company personnel will have to provide the necessary information with which to prepare the document on a consistent basis and be actively involved in all aspects of the registration process and, principally in preparing the Prospectus.

- ***The Depositary Bank***

  The depositary bank will issue in Brazil the corresponding certificates (Receipts) based on the Securities held in custody abroad and is responsible for the filings with the CVM for purposes of registering the BDR program.

- ***The Custodian Bank***

  The Custodian Bank holds the shares which back the BDRs in the home or other country where such shares are traded.

- ***The BM&FBOVESPA***

  BM&FBOVESPABM&FBOVESPA is today the only marketplace for capital markets transactions in Brazil. Its role includes the listing of the BDR program (together with the depository bank), providing a secure trading environment including market monitoring. The BM&FBOVESPA is responsible for keeping the market updated as to all relevant facts submitted by the BDR issuer simultaneously with information placed with the exchange in the country of origin.

- ***The CVM***

  The *Comissão de Valores Mobiliários* (CVM) is charged with ensuring a fair and level playing field for Public Companies in Brazil and their investors. It has the authority to pursue civil and criminal prosecution against those who breach the law and regulations applicable to a Public Company.

Further for Sponsored BDRs:

- ***The Audit firm***

  The home office and the CVM-registered auditors will play a decisive role throughout the registration process in providing opinions, special review reports, comfort letters and advice on the transaction.

- ***The Investment Bank***

  In the case of public offering of BDRs, the Investment Bank will provide the underwriting services, define the characteristics of the offering and conduct the Due Diligence.

- ***The Law firm(s)***

  In the case of public offering of BDRs in the home market and in Brazil, there will likely be at least four legal firms working on the BDR launch. The Company and the lead underwriter bank will hire their Brazilian securities counsel and each will hire their firms of lawyers from the registrant's home country.

- ***The Professional Consultant***

  A specialized consulting firm is able to advise the Company on how to properly prepare for a going public in Brazil, the process, its respective steps and implications.

Why launch a BDR Program?

Investors are constantly looking for opportunity to diversify risks and expand into cross-border markets seeking new portfolio profiles, deeper liquidity, efficient trading platforms and broader currency exposures. From the companies' perpective, some of these reasons to launch a BDR Program are:

1. Enhance liquidity
2. Access Brazilian investors
3. Create a currency for M&A
4. Showroom the company
5. Expand regionally
6. Achieve a reference of value
7. Foster professionalization

Tip

The Level III Program requires the company to be CVM registered allowing it to raise equity capital through BM&FBOVESPA. The Level II Program also requires registration and only permits existing shares to be traded once the program and company are traded.

A much simpler route is to launch a Sponsored Level I program which does not require the company to meet Brazilian publicly traded company standards – information is mostly limited to disclosures provided by the company in its home markets.

Pros and Cons of launching a Sponsored BDR Program

The upside

To the Company

In the case of Level I and Level II programs

- Broaden and diversify the shareholder base.
- Increased visibility, promoting an environment for possible mergers and acquisitions.
- Increased visibility among international investing and consuming public.
- Attract new classes of institutional investors by offering deeper liquidity.
- Extend investor and analyst research outside the country of origin.
- Allow the corporate securities to be quoted and traded alongside Brazilian peers.
- Permit the company to be included in industry benchmarking studies.
- Align disclosures with global competitors and industry best practices.
- Provide a market based valuation comparable to international peer group.
- Creating an agile exchange currency for acquisitions.
- Ability to offer a new remuneration package to staff including shares options, in order to retain them.
- Use a valuable own currency (existing shares) for M&A activity.

In the case of a Level III program (cumulatively)

- Raise new cash proceeds in the case of a primary issue, and/or liquidity for the partners, in a secondary issue.
- Create funding sources (including optimization of the debt/equity profile) allowing for execution of growth strategies.
- Expand the funding spectrum spreading risk profiles.
- Mint valuable own currency (new shares) to be used in M&A activity.

To the investor

In the case of a Level I, II and III programs

- Portfolio diversification into regional markets providing a balanced portfolio exposure.
- Option to hold the shares in the issuer's home country upon cancelation of the BDR program.
- Operational rationalization includes negotiation in Reais (BRL), within the normal Brazilian settlement cycle (D+3) and proceeds received in Reais.
- Lower costs, as the BDR custodian structure provides for the deposit of shares held in the country of origin.
- Voting rights exercised via the proxy held by the Depositary bank, according to predefined procedures.

The downside

To the Company

In the case of a Level I program

- Recurring expenses and compliance costs.
- Need to align the Investor Relations function and designate a legal representative (officer) to conform to the rules and regulations of the Brazilian securities market.
- Need to meet specific information disclosure requirements, including disclosure of Material Facts which can affect shares prices.
- Only Qualified Investors can trade the BDRs.

In the case of a Level II program (cumulatively)

- Costs related to registering as a Brazilian publicly-traded company and on-going maintenance.
- Taking a company private can be difficult and costly.
- Less flexibility in the decision making process and pressure for performance.
- Vulnerability to hostile takeovers.

In the case of a Level III program (cumulatively)

- Costs related to issuing and distributing new shares.

Ready to Launch?

The first step is to perform a high-level self-diagnosis with the assistance on a professional consultant. This might involve:

1. Prepare a workshop based on the assumption that the Company will list a BDR Program.
2. Understand the requirements depending on the Program Level.
3. Develop and complete a self-assessment questionnaire.
4. Based on results of questionnaire evaluate course of action:
    - **Red:** Not ready at present.
    - **Yellow:** Not ready but path identified to become ready.
    - **Green:** Ready or ability to get ready reasonably shortly.

Nº	Example	Red	Yellow	Green
1	Corporate Strategy & Development	5	6	10
2	Accounting, Reporting & Financial Effectiveness	33	26	44
3	Governance & Leadership	26	3	1
4	Internal Controls & Risk Management	29	15	23
5	Media & Investor Relations	0	14	11
6	Treasury & Financial Risk Management	1	9	24
7	Legal	8	0	2
8	Tax	0	4	12
9	Human Resources	12	16	17
10	Technology	2	13	9
11	Project Management, Change Management & Communication	1	2	7
12	Listing in Brazil - Specific considerations	9	2	0
	Total	**126**	**110**	**160**

The BDR Workshop – to discuss/develop

Based on the findings of the self-assessment questionnaire, our knowledge of the complex history of your business and our understanding of various company initiatives, we consider the key areas to be:

- Coordination and knowledge of BDR launch process.
- Financial reporting timing.
- Quality and integrity of internal and external reporting (including KPIs).
- Accuracy and consistency of forecasting and budgeting.
- Compliance with Corporate Governance requirements (Boards & Committees).
- Quality of internal controls.
- Formalization of internal audit.
- Knowledge of Brazil public company requirements.
- Devolved Head Office structure and significant staff changes.

Making the Decision

In the final analysis, the decision depends on your consideration and evaluation of the reasons for your company to have your BDRs traded in Brazil. How will your decision affect the company itself? Is your intention just to seek deeper liquidity? Expand the company's operations in the region? Have status and prestige?

Brazil will play an increasingly important role in world markets. Its institutions are sophisticated and mature and ready to take on the weight of more responsibility. The various and varied BDR Programs on offer provide an excellent port of entry for non-resident listed companies seeking to establish a foothold in the Brazilian market.

Tip

Depending on the level of commitment and exposure that the company wants in Brazil, one or another program can be appropriate. Maybe, starting with the Level I BDRs could be an alternative to 'test the waters' and then, as a second step, evaluate the possibility of having a program with exposure to all types of investors.

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