PIPE Transactions: Alternative Source of Capital for Brazilian Public Companies

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As Brazil's economy goes through a rough patch, public local companies are facing difficulties in accessing more traditional sources of capital. Interest rates keep going up and banks are more selective in handing out loans. The Brazilian stock market does not seem to be open to public offerings. PIPEs, an acronym for Private Investment in Public Equity, could be a solution.

From an investor's viewpoint, troubled times can mean good bargains. While private equity firms normally focus on private companies, there is a growing tendency of PE asset allocation in public companies, especially considering that their market prices have gone down significantly and the devaluation of the Brazilian *Real* renders them cheaper for investors holding hard currency.

PIPE transactions are normally structured through a private placement of shares or other securities in an already-public company to selected investors. The great advantage of PIPE transactions is the fact that they can be accomplished expeditiously and for a lower cost. Since private placements do not fall within the realm of complex public offering regulations, registration with the Brazilian SEC, the CVM, is not required.

In PIPE transactions carried out in the United States, investors are subject to initial resale restrictions. This means that the acquired shares carry a restrictive tag, preventing the purchaser from reselling them unless the tag is removed. The issuing company usually commits to file a resale registration statement within a certain time period to allow the investor to resell the shares. Investors assume a liquidity risk until the sale restrictions are lifted. To compensate for these restrictions, investors usually buy the shares in a PIPE transaction at a discount to their current market price.

In Brazil, shares acquired in private placements are normally not subject to a restrictive tag; in principle they can be immediately traded in the stock market, although restrictions may be contracted. Such shares can be issued at a discount to their market value in light of the then existing market conditions; however, unjustified dilution of the company's existing shareholders is prohibited.

An important aspect that needs to be considered in structuring PIPE transactions in Brazil is the preemptive right attributed to the company's shareholders. Even though such right can be suspended in public offerings, it is mandatory in private placements. As a result, in many cases a PIPE transaction will involve the assignment of subscription rights by the controlling shareholders (or other relevant shareholders).

A problem that used to represent a hurdle to PIPEs in the past was the fact that the CVM required a public auction for apportionment of unsubscribed shares in private placements. In other words, if investors subscribed only a portion of the issued shares, the unsubscribed shares had to be sold in a public auction in the stock market.

The CVM has recently reconsidered its position on this matter. Examining a case involving the construction company João Fortes Engenharia S.A.[1], the CVM's Board ruled that the partial subscription of private placements is possible, provided that the company establishes the minimum amount of shares that has to be subscribed, among other requirements. If such amount is reached, the capital increase is considered effective and unsubscribed shares do not have to be put for sale in a public auction, making it even simpler to implement PIPE transaction.

PIPE transactions can also be accomplished through the so-called public offering with restricted placement efforts, which stands in the middle between a private placement and a regular public offering. They can be implemented through offer letters, being much cheaper than a full-blown public offering, but may only be targeted at accredited investors. Existing shareholders of the company will have either a preemptive right or a priority right (which is similar to the preemptive right but cannot be assigned). The shares issued in this special public offering, though, may only be traded in the first 18-month period between accredited investors, which is usually not an issue for PE investors.

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[1] CVM Proceeding RJ 2013/6295.