

Brazil: a changing landscape for private credit



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“Brazil is one of the larger markets in private credit, where we continue to see demand for capital.”

I recently travelled to Brazil where I met with local corporates, fund managers and lawyers. Brazil is one of the larger markets in private credit, where we continue to see demand for capital.

Below are the key takeaways from the trip:

Macro and political uncertainty pushing borrowers offshore

Political uncertainty ahead of next year’s presidential elections has had a substantial impact on local risk appetite and on the corporate sector’s willingness to expand through capital expenditure or M&A. This subdued investment climate is further exacerbated by the high local rates with the CDI (local reference rate) sitting close to 15%¹ and inflation running just north of 5%. This makes Brazil’s real rates amongst the highest in the world. Despite liquidity substantially improving over the past 1-2 years, given the migration of capital from equity markets (e.g. there hasn’t been an IPO locally for almost two years now) into local debt markets, local corporates are still borrowing in BRL at 17-20%. Anecdotal evidence points to substantial amounts of credit raised in the local markets: for top-tier blue chips, the liquidity available is USD500m-1bn in BRL equivalent, up from USD200-400m equivalent just a few years ago.

For corporates with USD revenues, given the FX has strengthened this year alone by more than 10%, the effective rate of borrowing in USD equivalent would be in the high teens/low 20s% per annum, which is prohibitively high for many. As such, we’ve seen a number of corporates borrowing in local capital markets (via local bonds called debentures) and swapping the BRL into USD, achieving similar borrowing rates as in international markets. This avenue is notably only open to top-tier Brazilian corporates, given the “wrong-way” nature of the swap and the reluctance of banks to enter into swap agreements, outside of blue-chip corporates. Whilst the need for USD borrowings has actually increased, most medium-to-large corporates are tapping the offshore markets.

¹ CDI - Interest Rates - Interbank deposit - Portal de Finanças - Since 1986.

Shifts in private credit

Activity in the Brazilian corporate market is increasingly characterised by the contrast between the ‘haves’ and the ‘have-nots’:

1. **The ‘haves’:** large healthy corporates with low leverage and exports or commodity-driven businesses are finding the local markets too expensive or have limited capacity to swap into USD. These companies are diversifying their funding needs by tapping offshore lenders. While the Brazilian market is well covered from a banking perspective, the large banks are nevertheless subject to capital limits. As a result, we are increasingly seeing interesting private credit opportunities as banks reduce positions to make way for new lending. Moreover, over the last six months, we have seen a number of Brazilian corporates looking to expand their operations in the US in order to avoid tariffs by falling under the “buy-built American” strategy. These situations represent a rich opportunity set for managers such as ourselves, given the lack of appetite from US lenders for what is, in effect, a project-financing by an offshore sponsor into the US. At the same time, local Brazilian markets are reticent to conduct this cross-border lending.
2. **The ‘have-nots’:** these are generally highly-leveraged businesses in industries that are experiencing a cyclical downturn (such as chemicals) or idiosyncratic challenges (such as the agricultural sector facing a fall in soft commodity prices). The stress on these companies’ operating cashflows, coupled with the high rates they are paying on the local debt, has pushed a few to seek court-driven restructuring processes or judicial reorganisation (RJ) processes, the equivalent of Chapter 11 in the US. The potential opportunities here would be in select stressed names or rescue financings, where private credit providers can lend on a super-senior and secured basis at the top of the capital structure to companies that can show a convincing path to recovery.

Local restructuring environment and RJ process evolving

The local courts, especially in Sao Paulo, are fairly sophisticated and advanced when it comes to in-court restructurings from consensual, extrajudicial reorganisation (E) or bankruptcy-driven (RJ). Moreover, the infrastructure around these restructurings (from lawyers to local financial advisors) is fairly well developed, with a long track record of successful restructurings.

“Creditors prefer Sao Paulo, which is more creditor friendly and also more sophisticated.”

In addition, the legislature has been fairly business friendly, in an attempt to make the court process smoother. As an example, following one of the largest restructurings in the country for Oi Telecom in 2019-2020, new legislation was put in place limiting the amount of time a stay on enforcement can be granted by the court; this made the process much faster and more efficient than in the past.

At the same time, there are still discrepancies in the levels of sophistication of various courts across the country. In a recent filing, we have seen companies expressing a preference for Rio de Janeiro, which is typically more debtor friendly, in contrast to creditors who prefer Sao Paulo, which is more creditor friendly but also more sophisticated.

Last, but not least, as the bankruptcy legislation was heavily influenced by the US, we have seen a number of debtor-in-possession (DIP) financings. These are recognised by the courts with security granted on a post-petition basis and, thus, are recognisable even in a liquidation.



Local opportunistic credit market is getting more focus

With the development of the local capital markets and increased sophistication of the restructuring processes in Brazil, we have also seen increased activity locally in a variety of instruments from non-performing loans (NPLs), to claims (precatórios) to performing private credit (for performing, high-quality credits) and DIP-style financings (rescue financings for stressed and distressed companies).

Together with a more global approach by many of the local banks, managers, and financial advisors, we have seen an increased number of these credit opportunities being executed either in the international markets or as joint onshore-offshore structures.

“Brazil is a large and increasingly sophisticated market with a large opportunity set.”

One unwelcome development that seems to have come back to haunt the Brazilian market is high profile fraud-driven defaults: we witnessed the impact of fraud in the Americanas case a few years ago, where under-reporting debt levels and abusing the working capital financing route led to a freeze locally in working capital financings available from banks. More recently, another alleged fraud story around the waste management company, Ambipar, is creating similar ripples locally.



Summary: moving parts as trends evolve

Brazil is a large and increasingly sophisticated market with a large opportunity set. High local rates, coupled with noise around some names, has exacerbated volatility in the local markets and is creating opportunities for active managers such as ourselves. It was a busy week, fully packed with meetings and company visits, but softened by the sunny, warm weather in Rio – a stark contrast to the gloomy grey skies and strong gusts of wind I returned to in London!





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