



cutting through complexity

BOVESPA and the Novo Mercado

Devon Bodoh
Principal, KPMG LLP

Greg Featherman
Managing Director, KPMG LLP

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Background

Pre-Novo Mercado Capital and Equity Markets

- Brazilian companies issued predominately non-voting preferred stock
 - Prior to 2001, as much as 2/3 of a Brazilian corporation's equity could be non-voting preferred stock, allowing common stock holders holding a small amount of a corporation's total equity to control a corporation)
- Brazilian law did not generally protect non-controlling minority and preferred stockholders (especially in delisting transactions, squeeze-outs, and changes of control/tender offers)
 - Lack of corporate transparency also increased the risk of fraud and the perception of this risk
- By the mid-to-late 1990's Brazil's equity market was becoming irrelevant
 - There were only 8 IPOs on Brazilian stock exchanges from 1995-2000
 - Many Brazilian companies that did list on an exchange listed or simultaneously on foreign exchanges (like the New York Stock Exchange)
 - A significant number of listed Brazilian companies were delisted/taken private by their controlling shareholders (often as a result of low prices on the secondary market)
- Access to long-term financing for Brazilian companies generally was limited to reinvesting equity profits and loans from the Brazilian Development Bank

Novo Mercado

Development of the Novo Mercado

- The Sao Paulo Stock Exchange (BOVESPA) sought to identify solutions to the continued weakening of the Brazilian market and eventually decided to establish its own listing requirements
 - The Brazilian government could not be relied upon to institute the necessary regulatory reform BOVESPA
- The new listing requirements were designed to improve the governance of listed companies and thereby increase investors' interest and confidence
- This new system has three related tiers of listings (Novo Mercado, Level 2, and Level 1) that each have different requirements for corporate reporting and governance
 - The two lower tiers were designed largely to ease transition to the new requirements in the Novo Mercado and to increase participation
 - This new system was launched in 2000

- Issue more comprehensive financial statements including quarterly statements with cash flow demonstration and consolidated statements reviewed by an independent auditor
- Present annual financial statements according to International Financial Reporting Standards or U.S. Generally Accepted Accounting Principles
- Disclose information about the company's securities and its derivatives traded by insiders and controlling shareholders on a monthly basis
- Report to BOVESPA any contracts between the company and any related party that exceed R\$200,000 or one percent of company's net worth in a 12-month period

- Issue only voting shares (no non-voting preferred shares)
- Give tag-along rights to all shareholders at the full price of the deal
- Make a public tender offer at least at the economic value in case of delisting
- Have a minimum of five members on the Board of Directors
 - Members serve at least a unified 2 year term with re-election allowed
- At least 20 percent of the members of the Board of Directors must be independent
- Resolve through arbitration any shareholder-company dispute that arises related to the listing rules, the company bylaws, corporate law provisions, and other norms of the Brazilian capital market
- Maintain at least a 25 percent free float

Novo Mercado

Level 2 Requirements

- Level 2 companies may maintain existing preferred shares and issue new preferred shares up to the level permitted by the law.
- These preferred shares enjoy tag-along rights of at least 80 percent of the price received by a selling controlling shareholder and are entitled to voting rights at general shareholders' meetings in certain situations (*e.g.*, mergers and contracts between the controlling shareholder and the company)
- Level 2 companies must abide by all of the other obligations required for listing in the Novo Mercado Tier (described above)

Novo Mercado

Level 1 Requirements

- Level 1 companies must:
 - Issue more comprehensive financial statements including quarterly statements with cash flow demonstration and consolidated statements reviewed by an independent auditor
 - Disclose information about the company's securities and their derivatives traded by the insiders and the controlling group on a monthly basis
 - Report to BOVESPA any contracts between the company and any related party that exceed R\$200,000 or one percent of company's net worth in a 12-month period
 - Maintain a 25 percent free float
- In 2002, BOVESPA began requiring new listings involving a public share offering to at least be registered at Level 1

Novo Mercado Results

- 156 companies were listed on Novo Mercado, Level 2, and Level 1 by the end of 2007
 - Totaling 57% of BOVESPA's total market capitalization
 - BOVESPA itself went public in October 2007 based largely on the strength of the Novo Mercado
- Between 2004 and 2007, only 2 out of 27 Brazilian IPOs were listed simultaneously on the New York Stock Exchange.
- There has been a marked increase in secondary offerings
- Individual investors have increasingly invested in companies on the Novo Mercado
- Prices obtained by Brazilian offerings on the Novo Mercado have obtained higher prices than market averages