

IPO market set to revive in second half

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Share issuance on Brazil's capital markets has come to a screeching halt this year after a record-busting 2007 which saw the country come from nowhere to be one of the most significant issuers of new deals in the world. Faced with a hostile market environment, companies are hobbling along without new cash, fingers crossed for a second half reopening of markets.

The numbers speak for themselves. In the first five months of 2007, there were just three initial public offerings (IPOs), one of which was a tiddler.

Throughout 2007, there were 64. With one exception, this year's IPOs have met a decidedly lukewarm reception compared with last year's deals, with rock bottom pricing.

The blame for the IPO drought lies in large part with the US subprime crisis and a consequent drop-off in foreign interest. Foreigners remain vital for the Brazilian market, accounting for 70 per cent of IPO buying last year. Jittery investors have led to a jump in volatility, which has killed bankers' ability to get a clear pricing on deals.

It comes at an awkward time for banks, which were betting hand over fist on Brazilian markets to make up for weaker performance elsewhere in the world.

Merrill Lynch has been particularly aggressive and big local bank franchises, Bradesco and Unibanco, have both been staffing up in a belated attempt to catch up with Itaú, the local market leader.

"We are having a difficult year, mainly if you compare it to 2007," admits Gilberto Mifano, CEO of Bovespa Holding, the stock exchange company. "But we are very optimistic about our future, even our near future," he insists.

There are plenty of reasons to predict a turnaround. Although Brazil is held back by global investor gloom, it is not showing signs of the developed world's stagflation: although inflation is on the rise, the economy continues to sail along nicely with gross domestic product growing at 5.4 per cent last year.

The banking sector has avoided the shoals of the credit crunch, and better economic management saw the republic clinch an investment grade, allowing a far wider base of investors to at least consider investment. Despite gyrations, the Bovespa index was up, if by a modest percentage point year on year at the end of June - very much a global exception.

And Brazil is big in fashionable sectors such as oil, gas and commodities. This has allowed Eike Batista, a prolific entrepreneur, to pull off the feat of listing an untested oil company holding a clutch of licences and some good staff but no track record: investors, many of them foreign, paid \$3.9bn for shares in his OGX last month.

That suggests the IPO market will revive in the second half, but selectively and not at the level of 2007.

"International investors were optimistic last year and accepted almost any kind of IPO. They are now much more selective. They won't accept just any kind of company, but want very good business prospects and large, liquid offers," says Mr Mifano.

Smaller companies, which made up a large part of last year's IPOs, face specific difficulties in Brazil, says Jean-Marc Etlin, executive VP at Itaú's investment bank. There are very few funds dedicated to small- and mid-caps in Latin America and that has stymied interest, he notes. "When you have large funds taking \$15-\$20m positions in small deals, you don't leave much liquidity," he says.

Rodolfo Riechert, head of investment banking at UBS Pactual in São Paulo, points out that interest may be revived because smaller companies are starting to report better-than-expected earnings.

Bankers say they are not twiddling their thumbs. There has been a surge of M&A activity, Mr Riechert says, as Brazilians snap up competitors at home and expand overseas.

Meanwhile, there is hope that the debt markets, traditionally terra incognita for Brazilian companies, open up with longer tenures and more competitive rates thanks to the investment grade.

Corporate debt market volumes remain low because Brazil's chronically unstable past has led the central bank to adopt particularly hawkish monetary policies.

The toxic combination of global inflation and higher interest rates could derail Brazil's economy and capital markets.

Luiz Fernando Figueiredo, founding partner of fund manager Mauá Investimentos, is cautious. Slower growth in the G-7 countries is likely to harm commodity prices and that could bring Brazilian growth skidding down to 3.5 per cent next year, he says. Overall, he thinks, there is more downside risk than upside potential in the equity markets.

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