

"DISTRESSED ASSETS" OFFER GOOD OPPORTUNITIES

José Luis de Salles Freire
Partner of TozziniFreire Advogados
jfreire@tozzinifreire.com.br

Marta Viegas
Partner in the Corporate Law Practice Group of
TozziniFreire Advogados
mviegas@tozzinifreire.com.br

Brazilian law has advanced significantly by bringing safer and newer restructuring procedures inspired by the US "Chapter 11"

The term "distressed assets" designates assets that have depreciated greatly, but strictly for issuer-related reasons, as opposed to market's conditions. Lately, they have been attracting investors' interest because recessions usually offer good business opportunities. Although the worst of the world financial crisis initiated at the end of 2008 has already passed, many believe there are still lucrative opportunities in companies that suffered with the financial earthquake.

Some private equity funds specialize in "distressed assets". With experience in company restructuring, most of these long-term funds apply several investment strategies. They can either buy securities for speculation or snap up significant chunks of companies' debt obligations or share capital, in order to influence or directly control a restructuring process.

The purpose of any of these investment strategies is to acquire assets at low prices and sell them when their value increases. To assess an asset's appreciation potential, a fund must perform a thorough due diligence, meet with managers, shareholders and creditors, and analyze financial information, business plans, and the company's ability to generate cash and pay off its debts.

In many cases, asset appreciation stems from a restructuring process. It is therefore essential that the fund be well aware of the applicable laws and discuss the company's situation with its major creditors. The laws on restructuring may vary depending on the country, and some successful cases may not be repeatable in other places.

In Brazil, the law has advanced significantly by bringing safer, newer and more complete restructuring procedures, inspired by "Chapter 11" of the U.S. bankruptcy code. The available restructuring mechanisms include a spin-off, merger, transfer of company control, management replacement, permission for creditors to appoint managers or modifications in management bodies, property leasing, employee pay reduction, partial sale of assets, usufruct, shared management, issuance of security, and the organization of specific purpose entities to receive the debtor's assets as a means of debt payment.

The chosen measures must be part of a restructuring plan approved by the majority of creditors, establishing how they will be paid, with or without reduction of indebtedness.

Regarding the partial sale of assets comprising an operating unit, the restructuring law provides that the purchaser will not succeed the company under restructuring in relation to its debts, provided that the applicable requirements for such sale are observed. In this scenario, the investors are mainly interested in acquiring an operating unit, maintaining and developing its economic activity, paying a price that will create value for the assets and generate higher earnings for creditor payment and equalization.

Financing a company under court restructuring procedures is also an option. DIP Financing, extensively used outside Brazil, has been afforded enhanced safety in its Brazilian version since whoever lends to a company under restructuring will have the "super priority" of not being subject to the bankruptcy payment order should the debtor fail to get back on its feet. Therefore, loans made during court-supervised restructurings must be paid before any other credits in the event of forced liquidation of the company

As we can see, newer and safer "distressed assets" investment options are available to investors in Brazil.

- This article was first published at *Capital Aberto* Website.