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Company insolvencies in Brazil: what to expect in the near future?

Restructuring and bankruptcy remain increasingly used procedures

Activity in Brazil remains lacklustre, inflation above targets and interest rates are amongst the highest in the world. Various indexes show that confidence in Brazil remains down, while the low investment ratio continues to deteriorate.

Within this context, it is not surprising that the number of companies that filed for court-supervised restructuring procedures (Chapter XI¹ established in 2005 under the new Bankruptcies Law) has grown significantly in recent years. In 2012, when the industry contracted by 0.8%, there was a growth of 49.5% in the number of companies that filed for this mechanism. During 2013 this increased by a further 17.2%, while the data for the 12-months accumulated up to April 2014 shows a decrease of 11.5%. It is still too early to consider a rebound and the weak economic indicators lead Coface to forecast a continued weak scenario for companies.

In addition to the Chapter XI procedure, bankruptcy (Chapter VII) also began to increase again and closed 2013 with a high of 5%. A high of 3.1% was observed in the 12 months accumulated until April 2014, compared to the period immediately before. The recurrent growth since 2012 is also influenced by the number of cases of companies that remained in Chapter XI for years and failed to recover.

Several industries particularly affected by insolvencies

The recent marginal improvement in the total number of companies that filed for Chapter XI does not reflect the situation in all sectors. In some sectors the trend is not expected to be maintained: Paper/Wood (-3%), Minerals (-15%) and Distribution (-9%²). In several other sectors the insolvency situation remains worrying, due to the country's low level of activity and the difficulties faced by industry to remain competitive.

- The food industry is the most affected, with an increase of 46%. The main reason for this growth in insolvency is the fact that companies are using this mechanism as an alternative to financial imbalances.
- The textiles and clothing industry, which has been facing difficulties due to increasing pressure from imported products, observed a high of +7%.

¹**Chapter XI** was established in Brazil in 2005, under the New Law of Bankruptcies (number 11.101). It is a measure for trying to avoid Chapter VII. Chapter XI protection can be requested either by the company in difficulty, or by one of its creditors. This procedure implicates an intent to restructure the company, under the control of a court and allows the debtor to retain all of its assets, to oppose the demands of its creditors, to postpone the deadline for its payments and to unilaterally reduce its debt.

On the other hand the company is obliged to give detailed information on the progress of transactions on its creditors to the judge. This is the biggest difference between Chapter XI and **Chapter VII** of the same Law, which involves the end of business activity. In Chapter VII, a judicial trustee is then appointed to sell the assets and organize the distribution of sums recovered partially in order of priority.

²Between May 2013 and April 2014, in comparison to the previous period.

- The service sector, responsible for 59% of Brazilian activity, recorded a slight high of +2% and insolvency is not expected to decline in the short term.

A weak scenario for companies in 2014 and 2015

Unfortunately, the figures for the first half of 2014 do not indicate any sign of recovery, as GDP fell into negative territory. Activity is not gaining momentum and is expected to increase by only 0.4% in 2014. Admittedly a slight pickup in growth is expected in 2015, but its level will remain well below its long-term average.

“Independently of who wins the presidential elections, next year will probably be marked by a series of adjustments to the economy’s relative prices. Interest rates may be raised again to compensate for a higher pressure over prices, arising from the repositioning of oil prices and energy tariffs. The country’s infrastructure needs to rebound in 2015, in order to increase activity in the medium term, while the economy is likely to remain in slow mode”, concludes Patricia Krause, Coface Economist for the Latin America region.

In accordance with this scenario, Coface does not expect the number of insolvency cases to relinquish in the near future.

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