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Latin America M&A 2009 Mid-Year Report

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EDITOR'S NOTE: Transaction data was obtained from publicly available news sources on reported deals.]

Market Conditions

While 2008 was a record year for merger and acquisition (M&A) transactions in Latin America (LATAM), 2009 has seen a marked decrease in M&A activity and investment. On a macroeconomic level though, Latin America appears to have held up better than many other regions during the worldwide economic recession - certainly better than the US and Europe. With less corporate and per-capita household debt, Latin American companies and individuals aren't as overleveraged and appear to have dealt better with the global financial crisis - - and may see a recovery arriving sooner. Worldwide equity markets are up year to date, usually a leading indicator of economic performance, with an economic turnaround percolating around Q-4 2009 or early 2010 (at least according to US Fed Chief Bernanke). Worldwide credit markets also appear to be thawing. So with resilient markets, improving economies and availability of financing, we may see an increase in M&A activity in Latin America for the remainder of this year.

Market Leaders

Mexico and Brazil, historically the largest markets in the region, will likely continue as the market leaders for M&A and investment. Other active markets with modernized legal and financial systems and political stability include Colombia, Peru and Chile. While not all countries have been equally hard hit during the worldwide recession, Brazil has generally fared much better – actually decoupling from the rest of the region as a beacon for investment. Some of the most active market sectors include telecom, banking, infrastructure and renewable energy.

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Foreign Investment

Latin American investment will likely continue from U.S. sector-focused strategic and financial investors, with Spanish firms following closely on their heels. Spanish companies, struggling with recession and high unemployment in their home country, have been looking to LATAM to bolster lagging returns. Recent Spanish investment in the region has focused on banking, infrastructure and energy. Other investment trends appear to be the growing local Latin American companies and financial institutions emerging as regional and even worldwide acquisition players. Though foreign financial buyers may face some difficulty arranging deals and obtaining financing, local strategic buyers with available financing appear well-poised to acquire market share.

Country Analysis

Mexico

They say that when the US sneezes, Mexico catches a cold – and this spring Mexico actually caught the flu. Already hard hit by the US recession, Mexico faced the triple whammies of falling oil prices (now recovering), drug violence in the north and the swine flu pandemic. Although the swine flu emanated from the inland areas around Mexico City, the bad press surrounding the pandemic badly affected Mexico's coastal tourist areas, as foreign visitors generally stayed away from Cancun and Acapulco. When the travel advisories were finally lifted, the damage had already been done to tourism and trade. Mexico's first quarter GDP was down almost 6% from 2008, and last month, the Mexican Finance minister admitted that Mexico was in recession, with a negative GDP of more than 5% projected for 2009.

Certain Mexican investment sectors remain active, such as banking and telecom. Spanish bank Caja de Ahorros Mediterráneo announced in April 2009 that it would acquire Mexican lender Crédito Inmobiliario for EUR145mn (US$196mn).

With a recent injection of $1.5 billion in debt financing, Mexican billionaire, Carlos Slim continues the acquisition spree of his regional telecom conglomerate America Móvil (AM). Last month, AM announced an investment in Columbus Communications, a major undersea cable company in the Caribbean. Earlier this year Mr. Slim, who already owns 6.9 percent of the New York Times, announced an additional $250 million debt investment in the company's six-year notes.

In January, Mexican based Coca-Cola bottler Embotelladoras Arca announced the completion of the acquisition of the Coca-Cola bottling franchise for northwestern Argentina.

Brazil

Brazil is often referred to as the "Japan" of Latin American, i.e. the largest economic engine of the region. Among the most resilient worldwide economies during this economic downturn, Brazil accounts for at least one-half of the M&A deal volume and value in the LATAM region. With lots of natural resources, energy development and a vibrant economy, the long-term prospects for investment in Brazil remain promising. President Lula is among the region's most popular presidents (although there are elections late next year).

In the banking sector, Spain's largest bank, Santander, continues its acquisition spree with the completion of its acquisition of Brazilian insurer Real Tokio Marine Vida e Previdencia BRL678mn (US$284mn) in March. Santander had acquired Banco Real from ABN Amro last year, which doubled its presence in Brazil. Banco Itau, which merged with Unibanco last year, continues acquiring mid-market Brazilian banks on its way to becoming a regional powerhouse.

In the energy sector, the state-controlled utility CEMIG, acquired a majority stake in Terna Participações, from the Brazilian subsidiary of Italy's Terna SpA, for BRL608mn (US$278mn) in April of 2009. In the telecom sector, Brazilian mobile operator TIM Participacoes agreed to purchase long-distance operator Intelig in a stock deal valued at US$300mn (subject to regulatory approval).

In May, 2009, Advent International, the global private equity firm entered the Brazilian credit markets with the biggest private equity deal of the year - the US$170M purchase of a 30% stake in CETIP, S.A., the largest central depository for private fixed income securities and over-the-counter derivatives in Latin America. Other notable deals include the US-based Bristow Group's acquisition of a 42.5 percent stake in Brazil's Lider Aviacao Holding for $174 million in May 2009.

In June 2009, the Brazilian supermarket chain Pão de Açúcar announced that it had entered into an agreement to purchase 70% of the equity in Ponto Frio, the Brazilian chain of home-appliance and electronics stores for BRL824.5mm (US$ 421mm) from Globex Utilidades (according to Bloomberg). This transaction will create the largest Brazilian retailer with more than 1,200 stores.

Colombia

Under the helm of President Álvaro Uribe, the country's economy and security situation have improved significantly. The country has launched a $22 billion infrastructure initiative. The state-owned oil company, Empresa Colombiana de Petroloeos SA (Ecopetrol), continues its aggressive acquisition foray. In May 2009, it acquired the remaining 51% interest in Refineria de Cartagena SA (RC), a crude oil mining company, from its former partner, Glencore International AG, for 1.397 trillion Colombian pesos (US $549 million). In March 2009, Ecopetrol closed on the acquisition of Hocol Petroleum – the Colombian hydrocarbon exploration and production company - for US$580 million (plus US$162 million working capital).

Central America

In April 2009, Luxembourg-based telecom provider Millicom International Cellular closed on the US$90 million purchase of the balance of Guatemalan-based Navega.com from its joint venture partners. This follows its acquisition in 2008 of Central American cable and telephony provider Amnet for US$512 million.

LATAM M&A Challenges

M&A transactions face certain legal and regulatory challenges particular to Latin American.

Stringent Regulations

The bureaucratic and stringent regulatory environment can be challenging to LATAM dealmaking. For example, there has been a lot of deal activity in the automotive industry, which continues to do well in LATAM and was one of the gems in GM's portfolio. Yet local dealer protection laws may hamper the consolidation of dealerships by imposing big penalties on the cancellation of dealer franchises (sometimes calling for payment of several years of profits to the terminated dealer).

Antitrust Clearance

Approval by antitrust or competition authorities can be complicated and unpredictable in LATAM, adding layers of uncertainty to deal clearance. There can be a multiplicity of regulatory and enforcement authorities. Often there is a lack of clarity in filing requirements and waiting periods. These varying requirements and the lack of predictability require that local antitrust counsel be engaged early in the M&A planning process.

Labor Matters

Pro-labor employment laws in LATAM pose challenges to consolidation. Shedding personnel may require significant "indemnity payments", sometime totaling several years of salary to terminated employees. Also, some companies in the region are prone to treat personnel as unregistered independent contractors to avoid paying employment taxes and benefits. Significant retroactive labor payments may be triggered by an M&A transaction or result in successor liability to the buyer for labor claims and taxes.

Off-Shore Capital

In many LATAM companies, the private equity is often held in trusts or holding companies offshore or in tax havens to avoid taxation - posing a barrier to inbound deal structuring.

Financing

Financing, perfection and enforcement of security interests can be difficult in LATAM. The difficult financing climate in various Latin American countries is beginning to recover and bank financing may be becoming more readily available (though not emerging market debt). Different sources of financing may also be available in LATAM, e.g. vendor financing.

Private Equity

Private equity in LATAM defies generalization given the diversity of the markets in the region. Generally, private equity penetration is low in Latin America, representing only a small fraction of deal volume. Many businesses in the region have been family-owned for generations and can be resistant to foreign ownership and the transparency that comes with it. By the same token, closely held companies may not reach their full potential without the backing of a financial partner. So there appears to be a good opportunity for private equity in Latin America. However, financing for leveraged buyouts (LBO's) can be difficult to come by. In many countries such as Mexico and Argentina, pension funds are not even authorized to invest in private equity funds (although Mexico is in the process of liberalizing its investment laws).

Private equity activity in LATAM has historically come from US sector-targeted funds. US private equity fundraising targeted for LATAM (particularly Brazil) has been active in the past few years. The Carlyle Group has raised a Brazil fund and a Mexican real estate fund. Blackstone Group raised a Brazilian investment fund. So has GP Investimentos. Darby International has raised a Brazilian infrastructure fund. Other funds such as KKR have expressed an interest in the region. All this private equity "dry powder" remaining to be deployed should result in increased M&A and investment activity in the region.

IPO's

Latin American markets will generally follow the world markets, which are generally up and in the black for the year (after some precipitous drops in the early part of the year). Public market valuations still remain somewhat low, making it a good environment for some investment funds to engage in "going private" transactions of some lesser-capitalized public companies (although leverage may still be difficult to come by).

The Brazilian Bovespa has been the leading LATAM equity market. In May 2009, Brazil's VisaNet, which services half of the country's credit card market, filed for an IPO for up to $R5 billion ($US 2.4 billion). It had postponed its filing last September as credit markets dried up. While no date for the offering has been set, it clearly indicates more favorable equity market conditions now (mid-2009) than was the case last fall (perhaps the low point of this past recessionary period).

Distressed M&A

The rising volume of global corporate defaults and bankruptcy filings has created a bullish outlook for distressed M&A globally. With valuations down, the markets appear to be presenting distressed investment opportunities. Bankruptcy can be a great opportunity to pick over the carcasses of bankrupt companies, buy assets on the cheap and avoid legacy liabilities (just take a look at GM and Chrysler). In the U.S., bankruptcy filings and sales are up sharply with billions of available capital in distressed investment funds.

What does the situation look like in Latin America? Surprisingly, distressed M&A is not as popular as in the U.S. Bankruptcy, always a complicated and visible court process, can be especially difficult in Latam. Due diligence is complicated and it can be difficult to bid on assets entangled in the courts. Bankruptcy laws and procedures are still developing in the LATAM region. Mexico, Brazil and Argentina have modernized their laws with modern US-style features, such as US Chapter 11 style reorganization (not just liquidation), pre-packaged bankruptcy plans, private party management of the process (instead of by government-appointed officials), creditor protections such as reorganization plan approval – all serving to reduce the bureaucracy and cost of the procedures. Some smaller countries too, such as Chile and Peru have adopted bankruptcy reforms. Overall, prospects look good for distressed investing in LATAM, particularly in Mexico.

Summary

Many Latin American economies have held up better during the worldwide economic recession and seem well-positioned for a robust recovery, particularly Brazil. Given the resilient economies, modernized legal systems, improving markets and availability of financing, M&A activity should continue in LATAM. Strategic investors from the US, Spain and emerging Latin America players will likely lead the charge in the banking, telecom, energy and infrastructure sectors. Private Equity funds, flush with cash from recent fundraising, will likely look to LATAM, especially Brazil for investment opportunities. Prospects also look favorable for distressed investing under LATAM's modernized bankruptcy legal regimes, particularly in Mexico. Overall, prospects look favorable for M&A in Latin America.

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