Machado Meyer

PRESS

THE LAND OF OPPORTUNITY

12 MARCH 2012

Tuesday, 13th March 2012 by Rosie CresswellIs the private equity industry finally convinced of the returns to be had in Latin America? The glowing reports from leading bankers and legal practitioners at Latin Lawyer's private equity conference suggest the region's moment has now arrived. Rosie Cresswell reportsPrivate equity in Latin America has been a long time coming, in the eyes of Todd Crider, partner of Simpson Thacher & Bartlett and chair of Latin Lawyer's recent private equity conference. After the fledgling efforts of the 1990s and the beginnings of growth in the 2000s, he thinks this could be the decade in which the industry really comes of age. The figures are certainly compelling. Nicolas Aguzin, JP Morgan's CEO for Latin America, predicts that the eventual value of private equity funds raised for Latin America in 2010 and 2011 alone could amount to as much as anything between US$40 billion and US$50 billion. The best estimates suggest US$15 billion of new funds allocated to or investable in Latin America were raised in 2011, while in 2010 the figure was closer to US$8 billion. And that's just the beginning; those funds have to be invested and then you have the exits. As Aguzin notes, "this phenomenon of private equity in Latin America across debt, equity and M&A is very significant."Private equity interest in the region has surged. "Latin America is the best place in the world to be doing private equity today," says Paul Schnell, partner of Skadden, Arps, Slate, Meagher & Flom. "It has more stable governments and societies, a stronger rule of law, better and more transparent regulation – in many ways it is the envy of the world."It's an opinion that much of the industry shares if the comments from speakers at Latin Lawyer's second annual private equity conference, held in New York last September, are anything to go by. Capturing the view from the outside, Wilson Neely of Simpson Thacher says, "They're looking at the region with lust in their hearts." Meanwhile in Latin America, Luis González of Solórzano, Carvajal, González, Pérez & Correa notes how the industry has evolved in Mexico over the last 15 years. What was initially dominated by US players flying down for a board meeting here and there has led to more committed investors who have established offices in the country alongside a growing contingent of Mexican funds. Mattos Filho, Veiga Filho, Marrey Jr e Quiroga Advogados' Daniel Miranda says even though the private equity industry is not proportionate in size to the economy in Brazil, it's clearly a booming industry, with over 300 FIPs (a regulated investment fund commonly used in private equity) currently registered with the securities regulator, the vast majority of which have significant amounts under management.There are many good reasons for this enthusiasm. Neely says funds in the US appreciate the "tremendous job" done in a number of countries in Latin America in terms of getting their "domestic houses in order". The region's population has greater disposable income and energy needs – fuelling the sectors of most interest to private equity firms at the moment. Citi Venture Capital International, for example, has put money into a Mexican hotel developer while fishmeal has proved a lucrative option given the protein demand from Asia. As Juan Carlos Garcia of Quadrant Capital says, "You also have the gap we all experience first hand in terms of infrastructure – toll roads, ports – there's clearly space for deployment of private equity returns on those spaces." Apax Partners invested in Brazilian IT and business services outsourcer Tivet because technology is one of its five prioritised sectors for the world as a whole. (Others are retail, healthcare, business services, and media.)Struggling economies elsewhere reconfirm Latin America's position as a land of opportunity. For example, Apax has an investment in Travelex, the foreign exchange broker. Apax's Ashish Karandikar notes that the developed markets do not offer opportunities for growth in that sector because disposable incomes are not growing, whereas in Brazil there is a lot of outbound travel given the economic boom and a strong currency. So Apax helped Travelex buy Grupo Confidence, the largest forex broker in Brazil. Aguzin says funds that used to invest elsewhere in the world are making that percentage of their portfolio smaller; "That was their safe investment, now it's their risk investment."Beyond BrazilBrazil has been the biggest draw to date. "Activity for private equity in Brazil is booming – whoever isn't there is coming to town," says Daniel Wainstein, head of investment banking for Goldman Sachs in the country. "Brazil has a middle >Flavio Meyer of Machado, Meyer, Sendacz e Opice Advogados. But there is also huge potential in the rest of Latin America. Aguzin says around 75 per cent of deals have been in Brazil to date, but he expects that to drop to 50 per cent as investors get more comfortable with the region overall and the Brazilian market starts to feel saturated. Citi has already passed the 50-50 mark. Enrique Bascur, Citi Venture Capital's Latin American head, says its five main countries of interest are Brazil, Mexico, Chile, Peru and Colombia.Advent International and Essex Ventures made their first foray into Colombia in November, hot on the heels of Equity International's entry into the country's real estate market. Aureos has made two investments in Peru – last year and in 2008, with the most recent prompting the country's first ever management buyout operation. Compass Group closed a US$100 million investment fund there in 2010 – Peru's largest to date. Solórzano Carvajal's González is optimistic about opportunities in Mexico, although Luis Nicolau of Ritch Mueller SC notes that in the short-term investment activity has been "lukewarm" because a new administration is coming and because the existing government has not promoted the successful results of investment in infrastructure projects as well as it could. Meanwhile in Chile, Carey y Cía's Francisco Ugarte says the industry is still comparatively small, especially next to Brazil.The conference took place as the Eurozone crisis unfolded. While the prospects for private equity in Latin America are undoubtedly good, the region cannot be separated completely from the rest of the world and Europe's financial troubles are showing no signs of abating, which puts considerable pressure on international finance. Roger Altman, chairman of Evercore Partners and the keynote speaker at the conference, made no bones

about the severity of the dangerous economic and financial conditions in the US and Europe, and said recovery would be slow and painful. It's hard to know exactly how big the impact will be on the private equity industry in Latin America, but it would be foolish to overlook it."We are very careful about the future and what to expect, and in that context you will see a slowdown especially as it relates to international funds investing in the region," says Aguzin. But there are more positive ramifications. Bascur makes a comparison to the 2008 financial crisis, which forced divestments and presented new opportunities. "Crisis brings increased M&A activity in the sense there is a number of assets that need to change hands because this is when people retrench and review strategies and decide whether they want to be in one place or not. There are usually a few places that fall off... It's provided opportunities historically."How to spend itSo the private equity industry is looking at Latin America with lust in its heart, but how does the technical scenario in the region compare with the rest of the world? Several panels at the conference were dedicated to the nuts and bolts of the industry in the region, and it was agreed that while the playing field is increasingly sophisticated, Latin America has its own peculiarities like anywhere in the world.Firstly, foreign private equity funds should be aware of the cyclical nature of Latin America's economies. While timelines for investment may not differ hugely to other parts of the world, emerging markets in general do see more volatility, and that could delay exits. "Cycles are more pronounced in Latin America," says Quadrant's Garcia. "You need to have the willingness to ride the cycle so as not to sell the wrong asset at the wrong time for the wrong reason, which is what volatility causes you to do." For Garcia, there is a strong argument for using lower leverage and having more sustainable capital structures; "to weather the unknowns out there that will continue to impact the region." It also requires sticking to your strategy. "You probably need to be more active, more rigorous and more disciplined, but generally speaking it is the concept that you put in place when the deal was made that will take you through these cycles," says Garcia.The starting point is fundraising. Glenn Sarno of Simpson Thacher describes Latin America as having a very robust fundraising market and expects to see further growth and commitments to funds, not least via offshore investors partnering up with local private equity firms. As previously mentioned, more than US$8 billion was raised for Latin America in 2010 (up from US$5 billion four or five years ago), including Advent closing its fifth Latin American fund at US$1.65 billion, while Southern Cross Group raised US$1.68 billion of committed capital in its fourth fund focused on the region. Some 50 private equity funds were seeking up to US$16 billion in 2011, making for intense competition. Mattos Filho's Miranda says fundraising in Brazil has skyrocketed from the early days of 2005. "There's a steep curve going on. Even in the second half of this year [2011] when there might have been an expectation of a downward trend we've seen fundraising continue apace," he says.Preqin, an intelligence service for the alternative assets industry, tracks 400 limited partnerships (LPs) that have invested in Latin America through investments in funds targeting the region. In March last year 56 per cent of these investors were based in the US and one-quarter were US pension funds. According to Preqin, more public pension funds are thought to have gained exposure to Latin America than any other investor >Local pension funds also have the power to drive the private equity industry in Latin America. For example, thanks to recent regulation Mexican pension funds can now invest up to 15 per cent of their assets in private equity and have US$3 billion to play with, while Brazilian funds can also allocate more capital to the industry. But pension funds have a particular view as to how governance should work in a private equity fund. Ritch Mueller's Nicolau says Mexican pension funds require each fund manager remain in office for the duration of the fund's life, while in Brazil, "they like to have rights, even veto rights over investment," Miranda says. That said, he also notes that US institutional investors have never been that concerned about them having an active role. While the framework may be there, there are still hurdles to overcome. Nicolau says pension fund investments in private equity in Mexico came to a sudden stop in February last year because participants decided the existing structure didn't quite work as it required pension funds to disburse all the money up front. The situation is now being addressed. Meanwhile Guillermo Morales of Morales & Besa says Chile has huge scope for fundraising through pension funds, but it is hindered by "regulatory mismatches and tax issues" that lead to scepticism on the part of Chilean pension funds, which are far more interested in investing abroad. A new bill has been announced to address these regulatory hurdles and tax disincentives. Overall it seems the learning curve of how to integrate international investors with local pension fund investors is leading to a more streamlined process, but the various obstacles suggest the evolution of fundraising is likely to be slow.A common component of private equity investment is leverage – Garcia describes it as "part of the alchemy of private equity". But leverage is not as readily available in Latin America as it has traditionally been elsewhere (at least in the absence of a financial crisis). In some Latin American countries it makes no sense because of the costs, whereas in others it can be used reasonably. The crisis will determine the role of leverage to some extent as it opens up the market for new players; as US and European banks retreat, local lenders will come to the fore. "Forced divestitures of European companies, both in the banking and non-banking sectors where they have to retrench back to the local markets, contract their balance sheets," says Garcia.For now private equity firms are sticking to the old fashioned way of making money – by running a company better. "That's what's been validating private equity in Latin America," says Citi's Bascur. "You take companies, you change management, you improve the performance of the company, you make it more efficient, you expand its markets and take it to the next step of growth and then divest it or make a strategic sale, but the emphasis is really on the management and operations side with a very prudent use of leverage."Private equity firms are known to bring in co-investors, although that's not a universal trend. Bascur says it would be unusual for a fund the size of Citi's, unless it's in more of a passive role, for reasons of control. "You need to have control of your exit certainly, and sufficient control on management side to make an impact on the company," he explains. But Garcia says Quadrant Capital works a lot with other financial sponsors. "We like it because it enables us to diversify our portfolio by writing smaller cheques in the transactions we like. As long as you have control to make changes and control the exit you can still do very well." What's critical is the credibility and experience of all those involved, he says.Simpson Thacher's Neely says US firms should have a local firm as a partner or their own team on the ground; "Tourist investing is not a good thing." He expects to see more US-local partnerships. Carey y Cía's Ugarte says that in Chile, US firms are partnering up with local investment banks or dealers and setting up investment funds to capture some of the liquidity in the market and invest either in Chile or other countries in region. But while the pairing of local and foreign investors may be the perfect scenario, the needs of both must be accounted for.Doing the dealWhen it comes to actually investing in the target, Sullivan & Cromwell LLP's Sergio Galvis notes the "extraordinary evolution" of deal technology in the region. Investors need to realise issues such as confidentiality are treated differently from country to country. Disclosure obligations get triggered earlier under some Latin American securities law regimes than in the US, which can present a dilemma

for preliminary conversations. Jean Michel Enríquez of Creel, García-Cuéllar, Aiza y Enríquez, SC says Mexican companies must disclose relevant events to the public quickly, while Alejandro Linares of Gómez-Pinzón Zuleta Abogados SA says there is an interesting discussion in Colombia as to whether the opening of a data room constitutes relevant information under local securities law. There is another conversation over whether a target company is protected from unsolicited offers through the negotiation of a non-disclosure agreement. While Mexico is not yet prone to hostile transactions, Enríquez says there is a discussion nevertheless in the deal community. Another factor feeding into deal structure is whether the party is subject to mandatory tender offer rules – a big issue in Brazil according to José Luis Homem de Mello of Pinheiro Neto Advogados. "We have provisions in the law dealing with the matter, in the listing segments of Bovespa, in the by-laws of the company – it can become quite complicated."While funds being raised may be on the up, a report by the Latin American Venture Capital Association (LAVCA) shows that capital committed to new deals in Latin America has actually fallen. LAVCA's findings show that the figure for the first half of 2011 was down by 30 per cent from 2010, with US$2.7 billion committed in 56 transactions, and a further nine deals announced without financials reported. This could be down to decision-makers resisting overpaying for assets while valuations are high and currencies overvalued, choosing to focus on exiting from existing assets in the meantime.Nevertheless the long-term view is that Latin America is home to plenty of target companies offering attractive returns. Garcia notes that certain industries in the region haven't evolved at the same pace as the economy where companies run their businesses without internal corporate structures – fertile ground for private equity. "In Latin America we have top line growth, increased per capita consumption, markets are growing and you have companies that have not necessarily evolved as quickly so you can extract costs from the system, you can integrate them, you can divest the non-core businesses and develop new industries." He argues that this makes the proposition for private equity in Latin America even stronger; "you can therefore run it with much lower leverage and still get your 20 to 30 per cent returns".Target companies are wising up to how private equity works and growing savvier at the negotiating table as a result. "There are really a lot of very good companies down there, many of which are still closely held family owned businesses," says Neely. "But what's changing is that these families realise that in order to take it to the next level they're going to need outside capital, and will benefit from partnership with more globally based investors to help them accomplish that goal."Goldman Sachs' Wainstein believes the local perspective has gone one step further, arguing that family-owned companies realise they are capable of hiring the growing pool of talented executive teams in Brazil on their own. "Private equity doesn't have that magic touch in being the only one able to attract a professional management team," he says. The balance of power has undoubtedly shifted; family businesses have more experience and power while private equity firms are keener on minority stakes. As a result the issue of control has to be managed very carefully.This is important to bear in mind when it comes to the exit stage. Pablo Guerrero of Barros & Errázuriz Abogados in Chile lists the three basic exit strategies available to private equity firms – sell to the controller (the easiest), sell to a strategic investor or float the company. Those considering selling the company are in a good position given the huge interest from strategic players looking to enter Latin America via the acquisition of a suitable target. Floating a company is an equally viable option, in Brazil at least. Even with the equity markets boom pre-2008, Wainstein says the IPO market in Brazil is still nascent and estimates there will be 200 IPOs there in the next few years. By comparison, Carey y Cía's Ugarte notes that traditionally the exit strategy of an IPO for private equity investment has not been so much of a choice in Chile given the capital markets are small, but he thinks that could increase.Souza, Cescon, Barrieu & Flesch Advogados' Joaquim Oliveira says discussions over the mechanics for exit strategies in Brazil have grown more sophisticated. Conversations that once centred on the right of first refusal and tag along rights have evolved to include capital markets. Negotiations have moved from including a clause to tie management into doing its best to see the company listed, to a detailed discussion about how to bring the level of corporate governance up to the standards BM&F Bovespa's Novo Mercado. Then it has to be decided who has the priority in selling shares – the family or the private equity firm?The private equity investor increasingly needs to consider the desires of the controlling shareholders, who may take a different view or change their minds when it gets to the exit stage. Every scenario needs to be considered prior to signing because companies are that much more informed. They recognise the benefits of private equity investment, the value it adds and how it can help the company grow and gain credibility with the management expertise they bring. In today's world families are less likely to sell 100 per cent – they will sell a minority, watch the company grow and then consider an IPO or a merger.Exits had reached historic levels by the end of the first half of 2011 according to LAVCA, which found US$8.9 billion was raised by the 20 divestments whose financials were disclosed, while another 13 exits were reported.If private equity continues to develop as it does, the industry stands to have a significant impact in Latin America. As Simpson Thacher's Crider says, it will make for a more efficient use of capital and spur the development of the region's capital markets, public tender offers and acquisition finance. "The big picture of what this means to economies in the region, to its legal systems and for the development of sophisticated technologies is something we all need to be aware of," he says. When closing the conference, Crider referred to the Gabriel García Márquez novel entitled Crónica de una muerte anunciada, or Chronicle of a Death Foretold. He said that if García Márquez had happened to be writing about private equity in Latin America, the title would be Chronicle of an Announced Arrival.(Latin Lawyer 13.03.2012)(Notícia na Íntegra)

Tuesday, 13th March 2012 by Rosie Cresswell

Is the private equity industry finally convinced of the returns to be had in Latin America? The glowing reports from leading bankers and legal practitioners at Latin Lawyer's private equity conference suggest the region's moment has now arrived. Rosie Cresswell reports

Private equity in Latin America has been a long time coming, in the eyes of Todd Crider, partner of Simpson Thacher & Bartlett and chair of Latin Lawyer's recent private equity conference. After the fledgling efforts of the 1990s and the beginnings of growth in the 2000s, he thinks this could be the decade in which the industry really comes of age. The figures are certainly compelling. Nicolas Aguzin, JP Morgan's CEO for Latin America, predicts that the eventual value of private equity funds raised for Latin America in 2010 and 2011 alone could amount to as much as anything between US$40 billion and US$50 billion. The best estimates suggest US$15 billion of new funds allocated to or investable in Latin America were raised in 2011, while in 2010 the figure was closer to US$8 billion. And that's just the beginning; those funds have to be invested and then you have the exits. As Aguzin notes, "this phenomenon of private equity in Latin America across debt, equity and M&A is very significant."

Private equity interest in the region has surged. "Latin America is the best place in the world to be doing private equity today," says Paul Schnell, partner of Skadden, Arps, Slate, Meagher & Flom. "It has more stable governments and societies, a stronger rule of law, better and more transparent regulation – in many ways it is the envy of the world."

It's an opinion that much of the industry shares if the comments from speakers at Latin Lawyer's second annual private equity conference, held in New York last September, are anything to go by. Capturing the view from the outside, Wilson Neely of Simpson Thacher says, "They're looking at the region with lust in their hearts." Meanwhile in Latin America, Luis González of Solórzano, Carvajal, González, Pérez & Correa notes how the industry has evolved in Mexico over the last 15 years. What was initially dominated by US players flying down for a board meeting here and there has led to more committed investors who have established offices in the country alongside a growing contingent of Mexican funds. Mattos Filho, Veiga Filho, Marrey Jr e Quiroga Advogados' Daniel Miranda says even though the private equity industry is not proportionate in size to the economy in Brazil, it's clearly a booming industry, with over 300 FIPs (a regulated investment fund commonly used in private equity) currently registered with the securities regulator, the vast majority of which have significant amounts under management.

There are many good reasons for this enthusiasm. Neely says funds in the US appreciate the "tremendous job" done in a number of countries in Latin America in terms of getting their "domestic houses in order". The region's population has greater disposable income and energy needs – fuelling the sectors of most interest to private equity firms at the moment. Citi Venture Capital International, for example, has put money into a Mexican hotel developer while fishmeal has proved a lucrative option given the protein demand from Asia. As Juan Carlos Garcia of Quadrant Capital says, "You also have the gap we all experience first hand in terms of infrastructure – toll roads, ports – there's clearly space for deployment of private equity returns on those spaces." Apax Partners invested in Brazilian IT and business services outsourcer Tivet because technology is one of its five prioritised sectors for the world as a whole. (Others are retail, healthcare, business services, and media.)

Struggling economies elsewhere reconfirm Latin America's position as a land of opportunity. For example, Apax has an investment in Travelex, the foreign exchange broker. Apax's Ashish Karandikar notes that the developed markets do not offer opportunities for growth in that sector because disposable incomes are not growing, whereas in Brazil there is a lot of outbound travel given the economic boom and a strong currency. So Apax helped Travelex buy Grupo Confidence, the largest forex broker in Brazil. Aguzin says funds that used to invest elsewhere in the world are making that percentage of their portfolio smaller; "That was their safe investment, now it's their risk investment."

Beyond Brazil

Brazil has been the biggest draw to date. "Activity for private equity in Brazil is booming – whoever isn't there is coming to town," says Daniel Wainstein, head of investment banking for Goldman Sachs in the country. "Brazil has a middle >Flavio Meyer of Machado, Meyer, Sendacz e Opice Advogados. But there is also huge potential in the rest of Latin America. Aguzin says around 75 per cent of deals have been in Brazil to date, but he expects that to drop to 50 per cent as investors get more comfortable with the region overall and the Brazilian market starts to feel saturated. Citi has already passed the 50-50 mark. Enrique Bascur, Citi Venture Capital's Latin American head, says its five main countries of interest are Brazil, Mexico, Chile, Peru and Colombia.

Advent International and Essex Ventures made their first foray into Colombia in November, hot on the heels of Equity International's entry into the country's real estate market. Aureos has made two investments in Peru – last year and in 2008, with the most recent prompting the country's first ever management buyout operation. Compass Group closed a US$100 million investment fund there in 2010 – Peru's largest to date. Solórzano Carvajal's González is optimistic about opportunities in Mexico, although Luis Nicolau of Ritch Mueller SC notes that in the short-term investment activity has been "lukewarm" because a new administration is coming and because the existing government has not promoted the successful results of investment in infrastructure projects as well as it could. Meanwhile in Chile, Carey y Cía's Francisco Ugarte says the industry is still comparatively small, especially next to Brazil.

The conference took place as the Eurozone crisis unfolded. While the prospects for private equity in Latin America are undoubtedly good, the region cannot be separated completely from the rest of the world and Europe's financial troubles are showing no signs of abating, which puts considerable pressure on international finance. Roger Altman, chairman of Evercore Partners and the keynote speaker at the conference, made no bones about the severity of the dangerous economic and financial conditions in the US and Europe, and said recovery would be slow and painful. It's hard to know exactly how big the impact will be on the private equity industry in Latin America, but it would be foolish to overlook it.

"We are very careful about the future and what to expect, and in that context you will see a slowdown especially as it relates to international funds investing in the region," says Aguzin. But there are more positive ramifications. Bascur makes a comparison to the 2008 financial crisis, which forced divestments and presented new opportunities. "Crisis brings increased M&A activity in the sense there is a number of assets that need to change hands because this is when people retrench and review strategies and decide whether they want to be in one place or not. There are usually a few places that fall off... It's provided opportunities historically."

How to spend it

So the private equity industry is looking at Latin America with lust in its heart, but how does the technical scenario in the region compare with the rest of the world? Several panels at the conference were dedicated to the nuts and bolts of the industry in the region, and it was agreed that while the playing field is increasingly sophisticated, Latin America has its own peculiarities like anywhere in the world.

Firstly, foreign private equity funds should be aware of the cyclical nature of Latin America's economies. While timelines for investment may not differ hugely to other parts of the world, emerging markets in general do see

more volatility, and that could delay exits. "Cycles are more pronounced in Latin America," says Quadrant's Garcia. "You need to have the willingness to ride the cycle so as not to sell the wrong asset at the wrong time for the wrong reason, which is what volatility causes you to do." For Garcia, there is a strong argument for using lower leverage and having more sustainable capital structures; "to weather the unknowns out there that will continue to impact the region." It also requires sticking to your strategy. "You probably need to be more active, more rigorous and more disciplined, but generally speaking it is the concept that you put in place when the deal was made that will take you through these cycles," says Garcia.

The starting point is fundraising. Glenn Sarno of Simpson Thacher describes Latin America as having a very robust fundraising market and expects to see further growth and commitments to funds, not least via offshore investors partnering up with local private equity firms. As previously mentioned, more than US$8 billion was raised for Latin America in 2010 (up from US$5 billion four or five years ago), including Advent closing its fifth Latin American fund at US$1.65 billion, while Southern Cross Group raised US$1.68 billion of committed capital in its fourth fund focused on the region. Some 50 private equity funds were seeking up to US$16 billion in 2011, making for intense competition. Mattos Filho's Miranda says fundraising in Brazil has skyrocketed from the early days of 2005. "There's a steep curve going on. Even in the second half of this year [2011] when there might have been an expectation of a downward trend we've seen fundraising continue apace," he says.

Preqin, an intelligence service for the alternative assets industry, tracks 400 limited partnerships (LPs) that have invested in Latin America through investments in funds targeting the region. In March last year 56 per cent of these investors were based in the US and one-quarter were US pension funds. According to Preqin, more public pension funds are thought to have gained exposure to Latin America than any other investor >
Local pension funds also have the power to drive the private equity industry in Latin America. For example, thanks to recent regulation Mexican pension funds can now invest up to 15 per cent of their assets in private equity and have US$3 billion to play with, while Brazilian funds can also allocate more capital to the industry. But pension funds have a particular view as to how governance should work in a private equity fund. Ritch Mueller's Nicolau says Mexican pension funds require each fund manager remain in office for the duration of the fund's life, while in Brazil, "they like to have rights, even veto rights over investment," Miranda says. That said, he also notes that US institutional investors have never been that concerned about them having an active role. While the framework may be there, there are still hurdles to overcome. Nicolau says pension fund investments in private equity in Mexico came to a sudden stop in February last year because participants decided the existing structure didn't quite work as it required pension funds to disburse all the money up front. The situation is now being addressed. Meanwhile Guillermo Morales of Morales & Besa says Chile has huge scope for fundraising through pension funds, but it is hindered by "regulatory mismatches and tax issues" that lead to scepticism on the part of Chilean pension funds, which are far more interested in investing abroad. A new bill has been announced to address these regulatory hurdles and tax disincentives. Overall it seems the learning curve of how to integrate international investors with local pension fund investors is leading to a more streamlined process, but the various obstacles suggest the evolution of fundraising is likely to be slow.

A common component of private equity investment is leverage – Garcia describes it as "part of the alchemy of private equity". But leverage is not as readily available in Latin America as it has traditionally been elsewhere (at least in the absence of a financial crisis). In some Latin American countries it makes no sense because of the costs, whereas in others it can be used reasonably. The crisis will determine the role of leverage to some extent as it opens up the market for new players; as US and European banks retreat, local lenders will come to the fore. "Forced divestitures of European companies, both in the banking and non-banking sectors where they have to retrench back to the local markets, contract their balance sheets," says Garcia.

For now private equity firms are sticking to the old fashioned way of making money – by running a company better. "That's what's been validating private equity in Latin America," says Citi's Bascur. "You take companies, you change management, you improve the performance of the company, you make it more efficient, you expand its markets and take it to the next step of growth and then divest it or make a strategic sale, but the emphasis is really on the management and operations side with a very prudent use of leverage."

Private equity firms are known to bring in co-investors, although that's not a universal trend. Bascur says it would be unusual for a fund the size of Citi's, unless it's in more of a passive role, for reasons of control. "You need to have control of your exit certainly, and sufficient control on management side to make an impact on the company," he explains. But Garcia says Quadrant Capital works a lot with other financial sponsors. "We like it because it enables us to diversify our portfolio by writing smaller cheques in the transactions we like. As long as you have control to make changes and control the exit you can still do very well." What's critical is the credibility and experience of all those involved, he says.

Simpson Thacher's Neely says US firms should have a local firm as a partner or their own team on the ground; "Tourist investing is not a good thing." He expects to see more US-local partnerships. Carey y Cía's Ugarte says that in Chile, US firms are partnering up with local investment banks or dealers and setting up investment funds to capture some of the liquidity in the market and invest either in Chile or other countries in region. But while the pairing of local and foreign investors may be the perfect scenario, the needs of both must be accounted for.

Doing the deal

When it comes to actually investing in the target,Sullivan & Cromwell LLP's Sergio Galvis notes the "extraordinary evolution" of deal technology in the region. Investors need to realise issues such as confidentiality are treated differently from country to country. Disclosure obligations get triggered earlier under some Latin American securities law regimes than in the US, which can present a dilemma for preliminary conversations. Jean Michel Enríquez of Creel, García-Cuéllar, Aiza y Enríquez, SC says Mexican companies must disclose relevant events to the public quickly, while Alejandro Linares of Gómez-Pinzón Zuleta Abogados SA says there is an interesting discussion in Colombia as to whether the opening of a data room constitutes relevant information under local securities law. There is another conversation over whether a target company is protected from unsolicited offers through the negotiation of a non-disclosure agreement. While Mexico is not yet prone to hostile transactions, Enríquez says

there is a discussion nevertheless in the deal community. Another factor feeding into deal structure is whether the party is subject to mandatory tender offer rules – a big issue in Brazil according to José Luis Homem de Mello of Pinheiro Neto Advogados. "We have provisions in the law dealing with the matter, in the listing segments of Bovespa, in the by-laws of the company – it can become quite complicated."

While funds being raised may be on the up, a report by the Latin American Venture Capital Association (LAVCA) shows that capital committed to new deals in Latin America has actually fallen. LAVCA's findings show that the figure for the first half of 2011 was down by 30 per cent from 2010, with US$2.7 billion committed in 56 transactions, and a further nine deals announced without financials reported. This could be down to decision-makers resisting overpaying for assets while valuations are high and currencies overvalued, choosing to focus on exiting from existing assets in the meantime.

Nevertheless the long-term view is that Latin America is home to plenty of target companies offering attractive returns. Garcia notes that certain industries in the region haven't evolved at the same pace as the economy where companies run their businesses without internal corporate structures – fertile ground for private equity. "In Latin America we have top line growth, increased per capita consumption, markets are growing and you have companies that have not necessarily evolved as quickly so you can extract costs from the system, you can integrate them, you can divest the non-core businesses and develop new industries." He argues that this makes the proposition for private equity in Latin America even stronger; "you can therefore run it with much lower leverage and still get your 20 to 30 per cent returns".

Target companies are wising up to how private equity works and growing savvier at the negotiating table as a result. "There are really a lot of very good companies down there, many of which are still closely held family owned businesses," says Neely. "But what's changing is that these families realise that in order to take it to the next level they're going to need outside capital, and will benefit from partnership with more globally based investors to help them accomplish that goal."

Goldman Sachs' Wainstein believes the local perspective has gone one step further, arguing that family-owned companies realise they are capable of hiring the growing pool of talented executive teams in Brazil on their own. "Private equity doesn't have that magic touch in being the only one able to attract a professional management team," he says. The balance of power has undoubtedly shifted; family businesses have more experience and power while private equity firms are keener on minority stakes. As a result the issue of control has to be managed very carefully.

This is important to bear in mind when it comes to the exit stage. Pablo Guerrero oBarros & Errázuriz Abogados in Chile lists the three basic exit strategies available to private equity firms – sell to the controller (the easiest), sell to a strategic investor or float the company. Those considering selling the company are in a good position given the huge interest from strategic players looking to enter Latin America via the acquisition of a suitable target. Floating a company is an equally viable option, in Brazil at least. Even with the equity markets boom pre-2008, Wainstein says the IPO market in Brazil is still nascent and estimates there will be 200 IPOs there in the next few years. By comparison, Carey y Cía's Ugarte notes that traditionally the exit strategy of an IPO for private equity investment has not been so much of a choice in Chile given the capital markets are small, but he thinks that could increase.

Souza, Cescon, Barrieu & Flesch Advogados' Joaquim Oliveira says discussions over the mechanics for exit strategies in Brazil have grown more sophisticated. Conversations that once centred on the right of first refusal and tag along rights have evolved to include capital markets. Negotiations have moved from including a clause to tie management into doing its best to see the company listed, to a detailed discussion about how to bring the level of corporate governance up to the standards BM&F Bovespa's Novo Mercado. Then it has to be decided who has the priority in selling shares – the family or the private equity firm?

The private equity investor increasingly needs to consider the desires of the controlling shareholders, who may take a different view or change their minds when it gets to the exit stage. Every scenario needs to be considered prior to signing because companies are that much more informed. They recognise the benefits of private equity investment, the value it adds and how it can help the company grow and gain credibility with the management expertise they bring. In today's world families are less likely to sell 100 per cent – they will sell a minority, watch the company grow and then consider an IPO or a merger.

Exits had reached historic levels by the end of the first half of 2011 according to LAVCA, which found US$8.9 billion was raised by the 20 divestments whose financials were disclosed, while another 13 exits were reported.

If private equity continues to develop as it does, the industry stands to have a significant impact in Latin America. As Simpson Thacher's Crider says, it will make for a more efficient use of capital and spur the development of the region's capital markets, public tender offers and acquisition finance. "The big picture of what this means to economies in the region, to its legal systems and for the development of sophisticated technologies is something we all need to be aware of," he says. When closing the conference, Crider referred to the Gabriel García Márquez novel entitled Crónica de una muerte anunciada, or Chronicle of a Death Foretold. He said that if García Márquez had happened to be writing about private equity in Latin America, the title would be Chronicle of an Announced Arrival.

(Latin Lawyer 13.03.2012)

(Notícia na Íntegra)