Privcap/

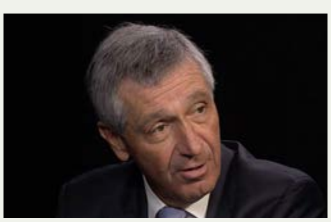
Q4 2015

VIDEO SERIES

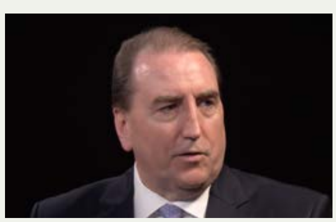
Briefing

Finding Value in Latin America

An executive summary of the Privcap video series
“Investing in Latin America in 2015”



Carlos Garcia
Victoria Capital



Michael Rogers
EY

Scott Voss
Harbourvest Partners

Finding Value in Latin America

Key Findings

1. A slump in commodity prices and currencies is driving the LatAm downturn
2. Some countries in the region are better able to weather the headwinds
3. Depreciating currencies create opportunity for investors
4. For investors in today's Brazilian PE market, strategy is the key
5. Latin America has strengths that other emerging markets do not

The Panelists

Carlos Garcia
Co-managing Partner, Chairman,
Victoria Capital

Michael Rogers
Global Deputy Private Equity Leader,
EY

Scott Voss
Managing Director,
Harbourvest Partners

➜ CONTINUES ON NEXT PAGE

1 A SLUMP IN COMMODITY PRICES AND CURRENCIES IS DRIVING THE LATAM DOWNTURN.

Sinking commodity prices, weakening currencies, and sagging stock markets have hit emerging markets around the world—and Latin America has felt the impact especially hard. Brazil's economy is in recession, its debt has been downgraded to junk status, and the turbulence in the country—LatAm's largest economy—is magnifying the effect of negative global trends throughout the region.

"We've seen a change in the macroeconomic landscape," says Carlos Garcia, co-managing partner and chairman of Victoria Capital. "Latin America is still likely to grow, but at a slower pace, and inevitably this is going to have an impact on consumers. It's going to mean fewer job opportunities, fewer increases in compensation, and it's going to be more difficult for consumers to increase their purchasing power."

This would normally make consumer-facing companies less attractive to investors. But Michael Rogers, global deputy private equity leader at EY, points out that even greater weakness in LatAm heavy industries—caused by anemic local currencies and consequently more expensive imports—has actually bolstered consumer companies.

"The challenges that are going to come forward are going to be more in heavy equipment, cars, electronics, things of that nature that depend on imports," Rogers says. "We're seeing a bit more migration back into consumer products, which can in many cases be produced locally. That opportunity will be there for private equity, because the purchasing power of consumers for products brought in from around the world is going to be less and less."

2 SOME COUNTRIES IN THE REGION ARE BETTER ABLE TO WEATHER THE HEADWINDS.

Countries that depend heavily on commodities are suffering more in the current downturn, along with those that do not have strong economic policies. The countries faring best are those along the Pacific Coast.

"We see the fastest recovery in the Pacific area," Garcia says. "Countries like Peru, Chile, and Colombia are likely to

Hope Dims for Aspiration

Carlos Garcia
Victoria Capital

Consumer-facing businesses have been a focus of private equity investors in Latin America. But these deals will be more challenging as consumer spending slumps amid the economic downturn in the region.

"I would be very careful with things that are correlated to international brands, such as luxury goods, cars, and electronics," says Garcia. "But basic consumer staples, I believe, are going to remain solid in the region." He recommends moving away from deals that involve high-end, aspirational brands. Instead he likes value brands that everyone can afford, such as quick-service restaurants.

Garcia adds that his firm will continue to be an opportunistic investor in consumer-related deals and that consumer spending is a fundamental part of Victoria's investment strategy. "We've invested in a lot of consumer services like education and healthcare over the last few years," he says. "We believe those deals are the most defensible."

➜ CONTINUES ON NEXT PAGE

navigate this slowdown in better shape than countries in the Atlantic region."

These are simply better-managed economies, he explains. They have fiscal discipline, a high level of internal savings, and the capacity to finance growth. Colombia and Peru have ongoing infrastructure initiatives that will propel some degree of growth, even as consumer spending slows.

Wherever investors go, they will need patience—and that patience will be rewarded. "Secular change versus cyclical is an important distinction," says Scott Voss, a managing director at Harbourvest Partners. "I think we all feel the long-term secular change is positive, and in 10 or 20 years all of these economies are going to be much better off than they are today. But there are going to be cycles, and that's where the private equity opportunity is. If you have long-term capital that can fill a funding gap when capital is scarce, you can actually find very good value in these markets."

3 DEPRECIATING CURRENCIES CREATE OPPORTUNITY FOR INVESTORS.

A depreciating local currency obviously has an impact on the holding value of assets on the ground, especially if the investments were done three or four years ago. But a sinking currency creates opportunity for dollar investors—even in Brazil.

"It's hard to make a bullish case for Brazil today, given that almost every economic indicator is going in the wrong direction," EY's Rogers says. "But with a currency that's 30 or 40 percent down relative to the dollar, at some point valuations will be attractive and capital will flow back in there. We're already seeing pretty strong flows into Brazil."

4 FOR INVESTORS IN TODAY'S BRAZILIAN PE MARKET, STRATEGY IS THE KEY.

Brazil's difficulties extend beyond economics. The country is going through a political crisis, and it's not clear what the outcome will be—or when it will be. Nevertheless, investors are piling back into the country. Deals closed in

A Family Affair

Mike Rogers
EY

Latin America is a region dominated by family-owned businesses. Many of these companies are a primary target for PE investors, especially now that these family-run businesses are approaching the third and fourth generation of ownership.

"Some of these heirs just don't have an interest in running the business," Rogers says. "That's a perfect window for private equity to come in and add operational improvement. Maybe families that historically were not interested in selling might find themselves interested in selling. And that's an opportunity for PE that's not yet [been] fully exploited."

Another emerging opportunity is corporate spinouts that traditionally have been few and far between in Latin America. "Companies evolve and change, so we're beginning to see some larger entities disentangle themselves a little bit more," says Rogers. "That's freeing up some new options for private equity."

➜ CONTINUES ON NEXT PAGE

the first half of the year totaled around $3.6B in all of Latin America, and about $2.2B of that was in Brazil.

"Over 50 percent of the investment in Latin America was directed toward Brazil, despite all the challenges we've described," Rogers says. "It's just too big to ignore, and the opportunities are the largest there, quite honestly." For those with a medium-to-long-term strategy, like sovereign funds and family offices, Brazilian assets look especially attractive.

"The question is, when do you step in and do the deal?" Harbourvest's Voss notes. "Are asset prices going to fall further, or is this a good point to enter, based on sentiment and currency? There are different strategies. For value-oriented managers, who tend to hold investments longer, the entry is critical, and our value managers are deploying money in Brazil right now."

5 LATIN AMERICA HAS STRENGTHS THAT OTHER EMERGING MARKETS DO NOT.

In a lot of emerging markets, investor interest is receding. Latin America offers advantages to investors that other markets do not. As a region, it's more diverse, with a better balance between consumers and commodities than, say, Turkey, where 75 percent of the economy is driven by consumption, or Russia, which is commodity-dependent.

"I'd put a vote in for Latin America for a couple of reasons," Rogers says. "One is more political stability than some other countries right now. Latin America has also developed pro-growth policies and reduced barriers for trade."

In the most recent Emerging Markets Private Equity Association study rating attractiveness around the world, Latin America, excluding Brazil, was ranked most attractive by readers and investors for the second year in a row.

"Long-term, people view it's there," Rogers says, "even though it's obviously a much slower-growing opportunity right now." ■

Bench Strength

Scott Voss
Harbourvest Partners

Financial engineering is no longer the name of the game in private equity. You need a strong operating team to move the needle. And this is especially true in Latin America, where PE firms must demonstrate that they have the local knowledge and operating chops necessary to deliver returns.

Success in the LatAm market "is really about management and operational improvement," Voss says. "It's about creating better companies and better governance structures that become more attractive for the ultimate exit, whether it's an IPO or an acquirer. We've seen around the world that private equity can win using that playbook, regardless of what's going on in the macro-economic environment."

It's more important than ever to involve operating partners in Latin American deals, because they're the ones who know the businesses inside and out.

"More and more we see teams building out an operational bench or capability," says Voss. "You have the corporate finance guy who does the deal, and then they bring in their operational executives to help grow the company. And that's important, because the biggest challenge in doing a private equity deal in Latin America is finding the middle-level executives to actually run and grow these companies. It's hard to find talent, so if you can pull that talent off your bench, it gives you an advantage."

Expert Q&A

With Michael Rogers, Global Deputy Private Equity Leader, EY

What is the case for investments in Latin America, particularly in Brazil, today?

It's hard to make a bullish case for Brazil today, given that almost every economic indicator is going in the wrong direction. But with a currency that's down 30 or 40 percent relative to the dollar, at some point valuations will be attractive and capital will continue to flow back. In fact, we've actually seen pretty strong flows into Brazil despite the recent currency drop.

Private equity is really only about 35 years old as an industry. But if you look through the cycles that we've experienced, oftentimes some of the best deals for private equity have been done in periods of downdraft. So if you have a long-term view and have an investment platform there, you may not be able to catch the exact bottom, but you're probably getting close to it.

Should investors avoid countries that rely heavily on exporting commodities for economic growth and stability?

The commodities cycle is one where you can go down the list and see who has more exposure. That's always a challenge, but I would put a vote in for Latin America for a couple of reasons. One [reason] is more political stability than some other countries right now. [Don't think you need that bracketed "reason."] They've also developed some pro-growth policies and reduced some of the barriers for trade. And so if you look at the EMPEA study for attractiveness around the world, Latin America, ex-Brazil, was rated the number one most attractive [region] by their readers

What we're seeing more and more is we're getting into businesses that are third- and fourth-generation owned. And some of the children or the heirs don't have an interest in running the business. That seems like a perfect window for private equity, where you could come in, [where] maybe a family that historically was not interested in selling might be, [and you] add the operational improvement. And that's also a window for PE that's not yet fully exploited in Latin America.

What can Latin American countries do to combat falling currency valuations?

What will happen is, because of the currency challenges, [with] some of the luxury goods that were being imported into some of these markets, people might say, "Let's focus back on our own region." And so there might be more capital and investment made in-country, which might provide opportunity for private equity in those locally owned businesses, as opposed to the model that had been used for a while, to get a position in one of these businesses and think about international expansion. There are probably going to be some nice opportunities to find assets in-country where they're focused on consumers locally—things like food and retail and restaurants. ■

Contact: Michael Rogers at mrogers@ey.com

Privcap/

About Privcap Media

Privcap is a digital media company that produces events and thought-leadership content for the global private capital markets. Privcap Media offers communications services to market participants.

Contacts

Editorial
David Snow / dsnow@privcap.com
Mike Straka / mstraka@privcap.com
Andrea Heisinger / aheisinger@privcap.com
Rachel Lapidos / rlapidos@privcap.com

Sponsorships & Sales
Gill Torren / gtorren@privcap.com
Neil Golub / ngolub@privcap.com

Series/ **Finding Value in Latin America**

Watch the series in its entirety
at **www.privcap.com**

Click to follow link

- **Staying Optimistic About LatAm Opportunities**
- **How PE Firms Can Adapt in LatAm Downturn**
- **Unique Qualities of LatAm Countries**
- **Expert Q&A: With Michael Rogers of EY**