Insights Conversations: Latin America M&A

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Contributing Partners

Paola Lozano
New York

Paul T. Schnell
New York

Four Times Square
New York, NY 10036
212.735.3000

skadden.com

Political stability, investor-friendly (or unfriendly) policies, commodity pricing, corruption scandals, and new legal regimes in areas such as tax and antitrust all factor into the M&A market in Latin America. Skadden partners Paola Lozano and Paul T. Schnell discuss the current state and 2015 outlook for activity in the region.[1]

How do you view the general outlook for corporate/M&A legal business in Latin America for 2015?

Paul: We are expecting a moderate level of M&A activity in the coming year. Although conditions are variable, they are much less volatile than in the past, as the markets have continued to stabilize. The exuberance of several years ago is gone — when there was talk about Latin America having decoupled from the rest of the world, rising above the global financial crisis in 2009 — and the region faces plenty of political, economic and social challenges, but there seems to be more confidence in the ability to weather these challenges without slipping into a crisis. This increase in confidence, even if tempered, will embolden companies and private equity firms to continue to do deals.

Economic conditions and M&A activity in the region also will continue to be impacted by developments in other parts of the world. In the first several years after the financial crisis, Latin America was considered more attractive for investment than other regions, offering a combination of economic growth and increasing stability that could not be found elsewhere. It was only a few years ago that investors in global private equity firms saw Brazil as the single most attractive market for PE deals. More recently, however, as growth has slowed in Latin America and economic conditions and investment opportunities have become more appealing in other regions, including the U.S., Asia and even Europe, it's no longer clear that Latin America retains an edge as a place in which corporate, private equity and institutional investors will want to participate.

For a region where natural resources and commodities are such a major part of the economy, global pricing and demand for oil and other basics will have a significant local impact. Additionally, an increase in interest rates rise in the U.S. and elsewhere could negatively impact economic conditions in Latin America, which would in turn adversely impact the level of investment and M&A activity.

In 2015, we expect to see more Latin American and international companies looking to build businesses across the region rather than in just a single country. We think inbound investment will continue from all major sources — the U.S., Europe and Asia, and strategic and private equity buyers. While there may be several high-profile outbound deals — Latin American companies making acquisitions outside the region — we think there may be fewer of these deals in 2015.

When it comes to Latin America, you can't just talk about the region as a whole. What are some of the differences that exist when you examine the M&A market on a country-by-country basis?

Paul: Colombia and Peru remain the strongest M&A markets in the region, with acquirers attracted by high economic growth, decent political stability and reasonable pricing for assets. By contrast, activity has cooled in Chile, which is a striking change, as Chile was long the strongest, most developed market in the region. Brazil continues to be buffeted by uncertainty; other countries that continue to be pockets of volatility, such as Argentina and Venezuela, still do not show signs of becoming meaningful markets for M&A in the near term. Mexico has not met expectations for increased M&A activity due to macroeconomic worries, although it remains a major market for sophisticated transactions.

Let's talk about Mexico. What are the issues and what can we expect in 2015?

Paola: Mexico saw a healthy volume of M&A deals throughout 2014, but the volume of inbound deals did not reach the levels some had hoped for. Investors' perception on difficult macro questions, including gross domestic product growth, increased violence in certain regions, high-profile corruption scandals, and the uncertainty that comes with evolving legal and enforcement regimes in important areas — Foreign Corrupt Practices Act, antitrust, and oil and energy, among others — will need to be overcome for the volume of cross-border M&A activity to dramatically increase during 2015.

However, large sophisticated cross-border players, as well as private equity funds, appear ready to increase their investment in Mexico. We also continue to see new entrants into the Mexican markets either because they are close to outgrowing the possibilities in their home jurisdiction and are looking for sizeable new markets with growth potential, or because of the promise that with some increased stability in the U.S., Mexico can deliver on its unrealized potential. It is important to note the growing reach of large and mid-market Mexican companies actively pursuing outbound transactions into a wider variety of regions — not only into other Latin American countries, but also into the U.S. and Europe. We expect those trends to continue through the first half of 2015, providing enough transactional opportunities to make for a healthy year in Mexican M&A. Also, improvements in the market driven by the structural reforms recently undertaken will likely start having a more tangible impact, enhancing the opportunities for transformational transactions. Finally, domestic M&A activity, with increased levels of sophistication, should remain at a steady pace.

Will Brazil fare any better in 2015 than it did last year?

Paul: We expect Brazil to remain a challenging market in 2015, very similar to 2014. There are too many question marks affecting the country: low growth, lower prices for commodities, increasing inflation, concerns about the government's anti-business sentiment and interference with the economy, excessive regulation, and pressure on its currency and its credit rating. The corruption investigations affecting Petrobras and other entities have been cited as an additional factor negatively impacting the market, and that is likely to continue to be the case in the near term. In the longer term, if Brazil can show that it can deal with corruption in a transparent and effective way — a big "if," perhaps — confidence in the country could increase. Even with the corruption headlines, Brazil compares very favorably, in terms of rule of law, with other emerging markets.

Despite its troubles, Brazil is such a large market that a steady flow of transactions will continue. Lower prices for assets, reflected in a significant drop in the stock market, and a weaker currency may make investment more attractive for international acquirers. There should be interest across many industries, including infrastructure and commodities, health care, consumer products and financial services. With the continuing increase in purchasing power among more and more of its population, Brazil will remain one of the more attractive markets for consumer product companies.

What should we expect from the rest of Latin America in 2015?

Paola: Colombia continues to attract growth-focused investors, resulting in significant inbound M&A activity. Experts expect GDP growth to be robust in 2015-19 (at an average of 4.4 percent), citing a positive business environment, a track record of investor-friendly policies and a perception of sound macroeconomic management as additional drivers of the sustained interest of foreign investors. We believe this will hold true through 2015. However, negative pressure on global oil and mineral prices, the uncertainty of the peace process and the concerns arising from the evolving tax regime could have a negative impact on overall activity.

Our outlook on outbound M&A activity by Colombian conglomerates is very positive; we have started to see middle-market players expanding into other Latin American countries, increasing our confidence that the volume of outbound M&A from Colombia will grow in 2015.

Peru's growth has slowed down significantly, mainly due to downward pressure on prices of commodities. The mining sector also had been a driver of M&A activity. Therefore, the overall inbound M&A volume and aggregate dollar value will depend largely on the evolution of the trends of the global commodities market and the growth and policies of Peru's large trading partners in Asia. However, we believe infrastructure and consumer-based opportunities will help maintain the interest of foreign investors in Peru.

Chile suffered a significant slowdown in 2014, and with an economy largely dependent on copper and a perception of uncertainty based on the implementation of tax reforms, we expect a slow start for cross-border inbound M&A activity in Chile as compared to previous years. However, energy and infrastructure needs and policy priorities likely will help reduce the gap and create significant opportunities for cross-border activity, as will some seasoned investors with a continued willingness to expand their investments in Chile in strategic areas of their businesses.

Bolivia and Ecuador are expected to pick up additional interest from foreign investors, mostly from other Latin American countries, seeking growth markets.

We expect some inbound action focusing on Central America in the near future. Strategic investors capable of managing the region as one — despite the varying levels of sophistication and market development among the countries that comprise it — will likely maintain a healthy appetite for inbound M&A, as the potential for growth is very significant, even in sectors in which the larger economies in Latin America seem to have matured already.

While some significant transactions are likely to occur in Argentina, and Venezuela may be motivated to promote some high-profile transactions as it seeks much-needed liquidity, we expect activity in those jurisdictions to be measured by only a handful of significant matters rather than any consistent growth in the cross-border M&A market. This is likely to be the norm unless and until there is a significant shift toward sustainable foreign investment policies and legal certainty.

[1] Portions of this commentary were published by *Latinvex* on January 14, 2015.