Private equity roundup:Latin America
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Rising interest rates in the US and increased macroeconomic stability across Europe are precipitating a reversal of asset flows from the emerging markets back to the developed markets, which is likely to continue to create near-term volatility for many emerging economies. However, the underlying secular trends that have made Latin America increasingly attractive to PE firms over the last decade – notably, a rising middle class and favorable demographics – remain intact. They will continue to play out over the course of the next decade and will continue to provide PE firms with a wide range of compelling opportunities.

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Latin America remains a key destination for investors in private equity (PE). While 2013 was a challenging year across the emerging markets, PE investors in Latin America continued to raise, deploy and return capital to their limited partners. Perhaps most importantly, PE firms continued to work closely with family owners and entrepreneurs to professionalize and grow their businesses.

The year was defined by deceleration across many of the region’s economies. Accelerating economic recovery in the US and Europe led to a sell-off in the equity markets across many developing economies, including Latin America. The impending start of monetary tightening in the US prompted a reversal of asset flows, which strengthened the dollar at the expense of many Latin American currencies.

The result was a mixed operating environment for PE. A more challenging economic environment made growth more difficult, especially for companies heavily dependent on domestic demand. At the same time, lower equities prices in the public markets helped to bridge the valuation gap between private market buyers and sellers. While valuations remain high in certain industries and geographies, this could ultimately spur increased activity and help PE put to work the significant amount of dry powder it has raised over the last five years.

The investment thesis for Latin America remains intact. A decade of stable politics, prudent fiscal and monetary policies, and growth-oriented economic reforms has led to the rise of an increasingly powerful middle class. Increased regulatory openness and the evolution of Latin America’s capital markets have made these secular trends more investable for PE investors. Yet Latin America remains in the very early stages of its growth story. Firms with patience, resilience, robust networks, access to local resources and ability to add value in active partnership with entrepreneurs will continue to see a range of interesting opportunities.
After several years of strong economic activity throughout most of Latin America, economic growth remained flat in Latin America in 2013, the result of domestic supply-side constraints and a less favorable external environment. This in turn has given the region’s governments less room to maneuver in promoting measures to boost growth using higher government spending. GDP growth in the region is expected to close 2013 at 2.7%, in line with the prior year.

Among the key developments was when the US Federal Reserve signaled its intent to end its program of quantitative easing in May 2013. While the Fed ultimately deferred execution of the wind-down to sometime in 2014, global financial markets tightened on the news, triggering a sell-off of emerging market assets and impacting exchange rates, sovereign spreads and local bond yields. It also led to a strengthening of the dollar, which brought emerging market currencies more in line with fundamentals and benefited EM exports, although it impacted the cost of imports and thus local inflation.

The slowdown in China was another factor that affected growth rates in the region. China remains the primary destination for Latin America’s commodities, making the region highly sensitive to economic downturns in China. After several years of double-digit GDP growth, growth rates in China have moderated as pressure from slowing exports to Europe and the US, coupled with stagnating domestic demand, slowed the nation’s economy. Currently, China is expected to grow at 7.7% in 2013, in line with 2012, before rebounding over the course of the next year.
Economic overview

While region-wide growth remained flat in Latin America in 2013, there remain significant variations in economic growth patterns and their drivers across the region’s countries. Latin America’s largest economies, Brazil and Mexico, both experienced slower-than-expected growth, but for different reasons. In Brazil, real wage growth moderated while job creation slowed, causing private consumption to become a less important driver of economic activity. This was offset, however, by the depreciation of the Brazilian real, which benefited exports but affected the cost of imports and thus local inflation. Brazil is expected to post GDP growth of 2.5% in 2013, up from 0.9% in 2012. In Mexico, disappointing external demand, an unexpected slowdown in construction and lower public spending led to muted growth during the year – Mexico saw its growth decline to 1.3% in 2013, down from 3.9% in 2012.

However, growth is expected to accelerate in 2014. Commodities prices and demand from China should stabilize. The ongoing recovery of the US economy should positively impact the region, especially Mexico, and the inflow of foreign capital, in the form of FDI, should continue to help Latin American countries as well. In 2014, growth is expected to average 3.3% for the region. While this is below average growth rates for last decade, it would represent a marked improvement over the last two years.

Figure 2. Growth rates for key Latin American economies, 2012-14

Source: Global Insight
In 2013, global PE fund-raising saw its most active year since 2008. PE firms raised a collective US$401b, well above the US$341b they raised in 2012. Driving the trend was the return of larger funds to the market. Globally, average fund sizes hit their highest amount on record. The average fund closed with US$623b in commitments in 2013, up 38% from 2012.

Latin America, however, stood in marked contrast to the global trend. Macroeconomic deceleration and a current surfeit of dry powder led to a muted fund-raising environment for Latin America in 2013. After raising nearly US$18b in 2011, and an additional US$8.1b in 2012, PE firms raised just US$5.2b in 2013, a decline of nearly 36% from the prior 12 months.

Figure 3. PE fund-raising in Latin America, 2010–13 (US$b)

Source: Preqin
Among the most significant drivers for the decline was the lack of fund-raising by the large Brazilian funds. In 2011 and 2012, large funds were raised by a number of the region’s most venerated houses, including Gávea Investimentos, Victoria Capital Partners, Pátria Investimentos and Vinci Capital Partners, but relatively few were raised in 2013. Instead, the emphasis was on smaller funds, many focused on the emerging markets of Mexico, Central America and, in particular, the Andean region.

Peru saw a number of funds raised targeting opportunities in the country. NG Capital Partners II closed with US$600m in commitments, making it one of the largest funds to close in 2013, and the largest fund ever focused on the Peruvian market. Another Peru-focused fund, the Carlyle CrediCorp Peru Fund, closed with US$308m in commitments, and Altra Investments’ second fund, Altra Private Equity Fund II, closed with US$356m in investor commitments. All three funds will invest across a range of sectors poised to grow concurrent with the Andean region’s rapidly developing economies.

### Figure 4. Top funds raised, 2013

<table>
<thead>
<tr>
<th>Fund name</th>
<th>Type</th>
<th>Final size (US$m)</th>
<th>Country focus</th>
</tr>
</thead>
<tbody>
<tr>
<td>BTG Pactual Brazil Infrastructure Fund II</td>
<td>Infrastructure</td>
<td>1,380</td>
<td>Brazil, South America</td>
</tr>
<tr>
<td>NG Capital Partners II</td>
<td>Buyout</td>
<td>600</td>
<td>Colombia, Peru</td>
</tr>
<tr>
<td>Nexxus Capital Private Equity Fund VI</td>
<td>Growth</td>
<td>550</td>
<td>Mexico</td>
</tr>
<tr>
<td>Brasil Portos e Ativos Logísticos</td>
<td>Infrastructure</td>
<td>409</td>
<td>Brazil</td>
</tr>
<tr>
<td>Altra Private Equity Fund II</td>
<td>Buyout</td>
<td>356</td>
<td>Colombia, Peru</td>
</tr>
</tbody>
</table>

Source: Preqin

Clearly, Latin America is currently in a very different stage of the fund-raising cycle relative to the developed markets. While the last several years have been very active, the focus is now shifting toward putting those assets to work. However, interest in the region remains high, and funds with differentiated strategies and compelling value propositions should continue to be well-subscribed.
PE firms announced 93 deals valued at US$2.9b in 2013. While this represented a decrease from the US$4.5b announced in 2012, it was up nearly 45% from the US$2.1b announced in 2011. The fourth quarter of the year was the most active, with 27 announced deals and a combined value of US$1.1b.

Among the year’s largest deals was the Advent International’s US$595m investment in Oleoducto Central SA, which it acquired alongside Colombia-based pension funds Sociedad Administradora de Fondos de Pensiones y Cesantias Porvenir SA and Administradora de Fondos de Pensiones y Cesantias Proteccion SA. The investors acquired a minority stake in Colombia’s largest pipeline by volume from divestor Talisman Energy Inc. The 830km pipeline can carry nearly 600,000 barrels per day, accounting for 60% of Colombia’s total oil production. Advent intends to work with the majority owners and the company’s management team to expand capacity by 30%.

Figure 5. PE deal value in Latin America, 2010–13 (US$b)

<table>
<thead>
<tr>
<th>Year</th>
<th>Deal value (US$m)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td>$8.9</td>
</tr>
<tr>
<td>2011</td>
<td>$2.1</td>
</tr>
<tr>
<td>2012</td>
<td>$4.5</td>
</tr>
<tr>
<td>2013</td>
<td>$2.9</td>
</tr>
</tbody>
</table>

Source: Thomson One

Figure 6. Top deals announced, 2013

<table>
<thead>
<tr>
<th>Company</th>
<th>PE firm</th>
<th>Deal value (US$m)</th>
<th>Country</th>
<th>Sector</th>
</tr>
</thead>
<tbody>
<tr>
<td>Oleoducto Central SA</td>
<td>Advent International</td>
<td>595</td>
<td>Colombia</td>
<td>Oil and gas</td>
</tr>
<tr>
<td>GranBio Investimentos SA</td>
<td>Banco Nacional de Desenvolvimento Economico e Social (BNDES)</td>
<td>294</td>
<td>Brazil</td>
<td>Life sciences</td>
</tr>
<tr>
<td>Tanner Servicios Financieros SA</td>
<td>Capital International</td>
<td>200</td>
<td>Chile</td>
<td>Financials</td>
</tr>
<tr>
<td>Smiles S.A.</td>
<td>General Atlantic LLC</td>
<td>200</td>
<td>Brazil</td>
<td>Transportation</td>
</tr>
<tr>
<td>Atlantic Energias Renovaveis</td>
<td>Actis Brasil Energia FIP</td>
<td>169</td>
<td>Brazil</td>
<td>Energy and power</td>
</tr>
<tr>
<td>Nativ Industria Brasileira de Pescados Amazonicos SA</td>
<td>Global Equity Administradora de Recursos SA</td>
<td>101</td>
<td>Brazil</td>
<td>Agriculture</td>
</tr>
</tbody>
</table>

Source: Thomson One
The influx of capital into the region and the growth of the PE industry across Latin America, while largely a positive development, have led to elevated valuations in many industries over the last several years, especially for larger deals. Anecdotal evidence suggests that 2013 may have delivered some measure of relief, as falling stock prices across the region’s exchanges helped PE firms to narrow the valuation gap. In 2013, the MSCI Emerging Markets Latin America Index fell 13.2%.

Declining stock prices failed to dampen enthusiasm for Latin American IPOs. The region saw 20 companies raise US$13.5b, making it the most active year since 2007. Seven of the 20 companies were backed by PE firms, including CVC Brasil Operadora e Agencia de Viagens SA, which raised US$226m on the BM&F Bovespa exchange in a December offering. The company, which is Brazil’s largest travel agency, was acquired by the Carlyle Group in 2009. IPOs have been an important source of liquidity for PE investors in recent months. Globally, PE-backed deals raised US$58.5b in 2013, the highest amount on record.

Figure 7. IPO activity in Latin America by number of IPOs, 2004-13

Source: Dealogic
Chile and Peru are small, distinctive and dynamic markets for PE investment. While very different from one another in size, market maturity and income level, both are attractive markets for PE. They both share similar industrial profiles, with a large emphasis on mining and metals, energy, and agriculture, but with increasingly important consumer goods businesses in line with the rest of the region.

Chile has long been a model for economic management in Latin America, and the fiscal stability that the country has built gained it access as the OECD’s first South American member in 2010. The country has 22 active free trade agreements that cover 86% of the world’s GDP and an innovative taxation structure that facilitates foreign investment and rewards long-term capital commitments to the country. Peru, although starting from a lower base and a more turbulent political environment, has demonstrated a similar commitment to creating stable conditions for business.

Investors have noticed. Local funds such as Nexus Group and Enfoca Inversiones have completed multiple successful fund raisings from an investor set that includes both local and global investors. The Nexus Group’s most recent fund, which closed in May 2013, saw 26% of its assets come from local and regional investors, while the majority of its US$600m in commitments
came from investors scattered throughout North America, Europe and the Middle East. Global firms are also becoming increasingly active. In February 2013, the Carlyle Group closed on more than US$300m in commitments, to be deployed by a staff of four investment professionals based out of Lima.

While both countries have seen a deceleration in macroeconomic growth over the last 12 months, it could ultimately be a net positive for PE investors focused on the region. Valuations in both countries have been relatively high compared with some other markets, a result of the marked appreciation of the Chilean peso and the Peruvian nuevo sol. In particular, many of the most attractive sectors, including consumer products, consumer finance, and oil and gas, have tended to have elevated valuations given the relatively small size of the market as a proportion of the amount of investment capital that needs to be deployed.

Although global funds are becoming more actively involved in both countries, the majority of exits are to strategic players, highlighting the importance of local partners for global funds. The fact that funds are entering Chile and Peru in spite of these barriers demonstrates the vast amount of perceived value and potential in both markets.
Outlook
By most accounts, the operating environment has become increasingly challenging for PE firms seeking to invest in Latin America. Growth has slowed from the very high levels of just a few years ago. Private consumption in many countries and industries has decelerated, challenging companies to find new ways to grow their businesses.

The result is that PE firms must be increasingly selective in the companies in which they choose to invest. While opportunities exist, they are distributed unevenly across sectors, regions and individual companies. In this sense, PE firms continue to have a unique advantage – not only can they effectively deploy capital across companies with the potential for outsized growth amid a mixed economic environment, but they can take an active role in working with companies to identify the team and develop the strategy required for companies to grow. In partnering with family owners and entrepreneurs, PE firms bring access to wide networks of talent and resources, significant operational expertise, corporate governance, and financial discipline.

PE firms have the wind at their back. The industry is flush with capital after several years of successful fund-raising. Entrepreneurs and family owners are becoming increasingly familiar with PE and the benefits that it can provide. Regulators are growing increasingly comfortable with PE investment and cognizant of the important role it can play in the region’s economies. Perhaps most importantly, valuations could trend lower as equity prices fall. As 2014 unfolds, Latin America remains a region with substantial opportunity for PE firms and their investors.
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