

Private equity roundup – Latin America

Private equity roundup – Latin America is published quarterly by Ernst & Young to provide insight and analysis on this important emerging market.

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With fresh capital in hand, private equity (PE) in Latin America expanded across the region in 2012

In 2009 and 2010, Latin America emerged from the global downturn in a far better position than many of the world's more advanced economies. Years of fiscal restraint, pro-growth reforms and political stability had yielded economies that were robust and resilient. Now, as volatility continues throughout the global economy, Latin America has seen a deceleration in growth. Exports have dropped and commodity prices have declined as key trading partners have curbed spending. However, the structural underpinnings of Latin America's emergence remain intact and continue to provide good opportunities for PE investors.

According to a recent World Bank report, more than 50 million people joined the middle class in Latin America over the last 10 years, increasing its ranks by half. The increase in domestic spending as a result of their emergence has yielded a rich set of opportunities for PE firms – retail, consumer products, financial services, health care and education are all sectors that have seen significant PE investment over the last two years.

In 2012, PE investors appeared to shift their focus from fund-raising. Firms raised just US\$4.9b through the end of December 2012. This compared with the US\$15.2b PE firms raised in 2011. Many of the region's largest PE players raised funds during that time, including Gávea Investimentos, Vinci Partners, Pátria Investimentos and The Carlyle Group. This has added to the significant amount of capital available to fund new transactions, and it could be two years or more before many funds need to return to the market for fresh capital.

Deal activity in the region increased as firms focused on sourcing and executing new transactions. In 2012, PE firms announced US\$4.1b in new acquisitions, up markedly from the US\$2.1b announced during the entirety of 2011. Many of these investments are poised to benefit directly from the growth of Latin America's middle class. As the new year begins, PE firms will continue to opportunistically pursue interesting investments throughout Latin America. Given the region's positive economic and demographic trends, they should have little issue putting investors' assets to work.

Economic overview

Growth rates to moderate after 2012 deceleration

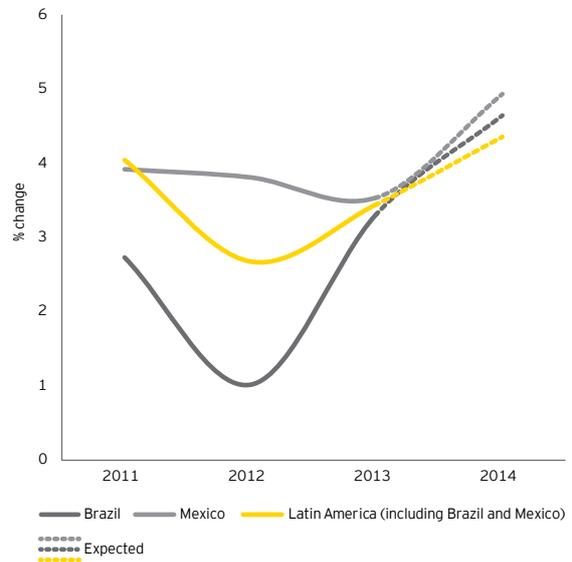
A significant deceleration in the once white-hot economies of Latin America happened in 2012 as the sovereign crisis in Europe, an economic slowdown among key trading partners including the United States and China, and reduced capital inflows took their toll on economies throughout the region. Brazil, Latin America's largest economy, took the brunt of the economic hit and saw the steepest decline in growth. Brazil's GDP growth fell from 7.5% in 2010 to 2.7% in 2011 to an expected 1% in 2012.

However, other key economies in the region also saw declines. In Chile, growth fell from 6% in 2011 to an expected 5.3% in 2012; similarly, in Colombia, GDP growth fell from 5.9% in 2011 to an expected 4.6% in 2012. Overall in Latin America, economists expect growth to hit 2.7% for 2012, down from 4.0% the year prior.

Policymakers in Brazil have been among the most aggressive in taking economic countermeasures to stem the downturn. In October, the Brazil Central Bank voted to cut the country's benchmark SELIC rate by 25 basis points to 7.25%, the lowest on record. The cut was the most recent in a series of cuts that have seen interest rates reduced from a peak of 12.5% in August 2011. Additionally, authorities have sent a clear message that additional cuts will be considered and enacted as needed. Moreover, government policies to support increased domestic spending, including a 14% hike in Brazil's minimum wage, should help bridge some of the gap from reduced demand for exports and weakened commodities prices.

As a result, GDP growth in Brazil is expected to resume an upward trajectory in 2013. According to IHS Global Insight, 2013 growth for Brazil should reach 3.3%. Across the broader region, growth forecasts are considerably more muted. However, many of these countries saw far less of a decline than Brazil, and declining growth rates represent more of a "glide path" from unsustainably high rates to more moderate but sustainable growth.

Figure 1. Quarterly actual and expected GDP growth for China versus major world economies, 2011-2014



Source: IHS Global Insight as of 15 December 2012

Economic overview (continued)

The continuing rise of the consumer

Over the last 10 years, Brazil and the rest of Latin America have made remarkable economic gains. While cyclical factors, including strong demand for the region's commodities and exports account for a significant portion of the region's growth, what has excited economists and attracted a range of investors to Latin America is the continued rise of the consumer.

According to a recently released report by the World Bank, nearly 50 million people joined the ranks of the middle class in Latin America in the last 10 years. The middle class now accounts for roughly 30% of the population, up 50% from a decade ago. Most importantly, these newly emerged consumers are driving demand for a widening range of goods and services, including automobiles, technology and telecom, financial services, education, real estate and health care. Private consumption is expected to grow at an average rate of 4.2% over the next decade in Latin America, compared with 2.2% in the US and 1.1% in the eurozone. One of the enablers of increased consumption by the middle class is an

increase in the availability of credit. Where most industries once operated on a cash basis, credit has become more available and widely used for an array of consumer products including home loans, auto loans and consumer goods.

Funding challenges still remain for many entrepreneurs and small and medium enterprises (SMEs) in Brazil and the rest of Latin America. A recent Ernst & Young study of the entrepreneurship environment in G20 countries found that 72% of Brazilian entrepreneurs cited difficulties in accessing funding. Most importantly however, was that nearly all felt that PE could play a significant role in closing the funding gap – 98% of respondents believed that PE would have a medium to high impact in the future to improve their long-term growth. Clearly, word of the benefits companies can obtain by working with PE investors is spreading. Where many entrepreneurs were once wary of losing control, there is a growing awareness and comfort level among the Latin American business community, which is likely to translate into increased opportunities for financial sponsors.

50 million

Number of people who joined the middle class in Latin America in the last 10 years.

Fund-raising

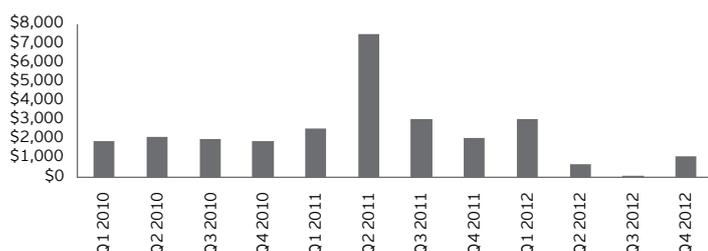
While fund-raising declines, PE firms have significant dry powder for new deals

Despite continued strong interest in the region by general partners (GPs) and limited partner (LPs) alike, fund-raising declined markedly in 2012 as PE firms turned their attention to sourcing and executing deals. Many of the larger local and global managers, including Gávea Investimentos, Vinci Partners, Pátria Investimentos and The Carlyle Group, completed significant fund-raisings during the 2011 calendar year. As a result, fund-raising declined from US\$15.2b in 2011 to US\$4.9b through the end of 2012. This has added to the significant stores of available capital, also known as dry powder available to fund new transactions, meaning it could be two years or more before many funds need to return to the market for fresh capital.

A recent survey from the Latin America Venture Capital Association (LAVCA) and Collier Capital found that 85% of LP respondents intend to keep their allocations to Latin America at current levels or higher, which clearly bodes well for future fund-raisings. As PE continues to expand and mature in Latin America, strategies and asset classes will increasingly vary. Many LPs hold different views on this. Some prefer managers that can deliver exposure to multiple asset classes so they can limit the number of firms with whom they have relationships; others are looking for specialists in a particular strategy. However, nearly all can agree that Latin America is a rich environment where multiple strategies are viable – what matters most is execution.

US\$4.9b Funds raised for Latin America in 2012.

Figure 2. Quarterly Latin America fund-raising, 2010-2012 (US\$m)



Source: Preqin

Figure 3. Closed funds 2012 YTD

Fund name	Manager	Type	Commitments (US\$m)	Closed	Geographic focus
Victoria South American Partners II	Victoria Capital Partners	Buyout	850	30 March 12	Argentina, Brazil, Chile, Colombia, Peru, South America
GTIS Brazil Real Estate Fund II	GTIS Partners	Real estate	810	1 March 12	Brazil
Arias Resource Capital Fund II	Arias Resource Capital Management	Growth	504	15 February 12	South America, Global
Kinea II Private Equity	Kinea Investimentos	Growth	488	15 October 12	Brazil
Macquarie Mexican Infrastructure Fund	Macquarie Infrastructure and Real Assets (MIRA)	Infrastructure	411	31 December 12	Mexico
Brasil Petroleo I	Mantiq Investimentos	Infrastructure	339	1 February 12	Brazil
FIP Sondas	Artha Capital	Infrastructure	312	13 February 12	Mexico
Rio Bravo Energia I	Rio Bravo	Infrastructure	235	4 May 12	Brazil
Multinational Industrial Fund II	WAMEX	Expansion/late stage	160	30 March 12	Mexico
FINTRA	Darby Overseas Investments	Infrastructure	150	1 June 12	Colombia

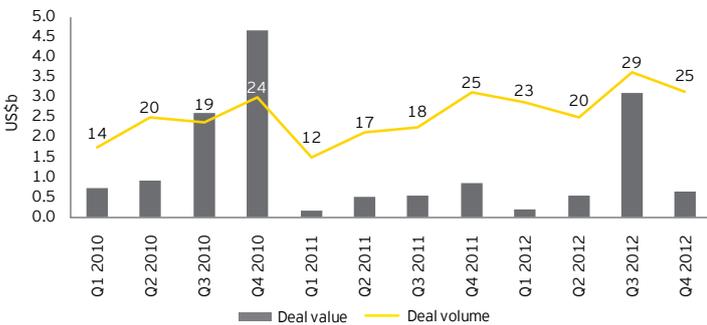
Source: Preqin

Transactions and exits

Transaction activity picks up in third quarter as firms focus on deal-making

In 2012, PE firms announced US\$4.5b in new transactions across 97 deals. There was a significant uptick in both value and volume in the third quarter, driven in part by Brookfield's investment in the Obrascón Huarte toll road.

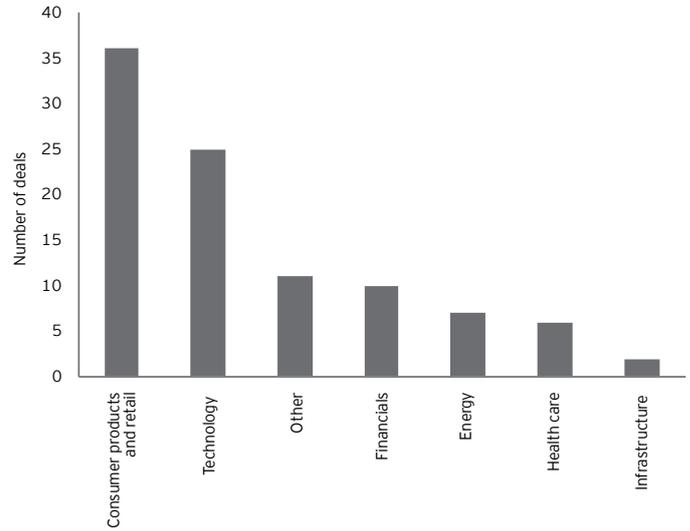
Figure 4. Latin America deals, Q1 2010–November 2012



Source: Thomson One

At US\$1.7b, Brookfield's investment was the largest deal announced in 2012. The investment was a joint venture with Abertis Infraestructuras in August. Obrascón Huarte Lain Brasil SA is the largest operator of toll roads in Brazil and manages more than 3,200km of roads in states that account for 65% of Brazil's GDP and two-thirds of the country's 70 million vehicles. Toll roads in Brazil and other emerging markets represent an interesting opportunity for PE. Infrastructure is one of the region's bottlenecks to more aggressive growth, and toll roads are uniquely positioned to benefit from the need to expand as rising wealth and economic activity drive increasing levels of traffic.

Figure 5. PE acquisitions in 2012 by sector



Source: Thomson One

Consumer products, retail and technology continue to be the most active sectors for deals in Latin America, accounting for 63% of the deals in 2012. Among the largest was The Carlyle Group's acquisition of an 80% stake in Tok&Stok, Brazil's largest specialty furniture retailer. It was the second acquisition that Carlyle made in the consumer space in 2012. In March, the firm announced an investment in Ri Happy Brinquedos, Brazil's largest toy retailer. Ri Happy subsequently made an add-on acquisition of another company in the space, PBKIDS Brinquedos, in June. Carlyle has been among the more active of the global firms in Brazil, along with Advent International Corporation, Actis Capital LLP and General Atlantic Partners.

As PE firms work to deploy the significant amount of funds raised over the last two years, consumer-oriented plays will continue to be among the most active industries. The ability to consolidate fragmented retail chains, improve sales channels and leverage the region's increase in credit availability are all factors in favor of continued growth.

Transactions and exits (continued)

Figure 6. Announced deals 2012

Company	PE firm	Deal value (US\$m)	Date	Sector
Obrascón Huarte Lain Brasil SA	Brookfield Asset Management	1,700.0	6 August 2012	Infrastructure
Repsol Butano Chile	Larrain Vial SA	529.5	24 July 2012	Oil and gas
Estok Comércio e Representações Ltda	The Carlyle Group	346.4	13 September 2012	Retail and wholesale
Leader Participacoes SA	Banco BTG Pactual SA	335.4	28 May 2012	Retail and wholesale
Sociedad Concesionaria Vespucio Norte Express SA	Brookfield Asset Management	289.5	2 July 2012	Real estate
SBF Comércio de Produtos Esportivos Ltda	GP Investments, Partners Group AG	220.6	8 November 2012	Retail and wholesale
XP Investimentos CCTVM S.A.	General Atlantic LLC	201.2	5 December 2012	Banking & Capital Markets
Grupo Cruzeiro do Sul Educacional	Actis Capital LLP	103.0	20 January 2012	Education
Total Artefactos SA	Linzor Capital Partners	99.7	21 December 2012	Retail & Wholesale
Despegar.com, Inc.	Tiger Global Management LLC	92.5	2 April 2012	Professional firms and services

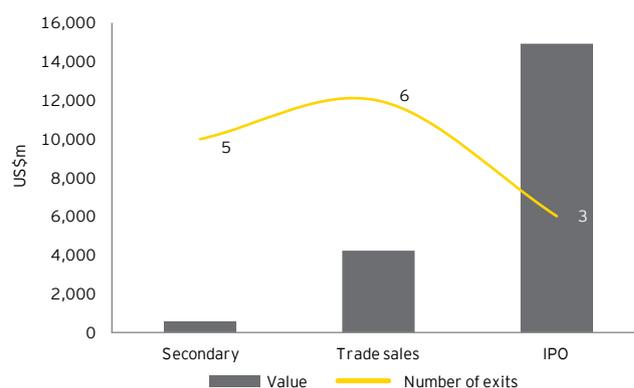
Source: Thomson One

14 exits by PE firms in 2012

There were 14 exits by PE firms in 2012 – 6 by trade sales, 3 by IPOs and 5 companies that were sold in secondary transactions to other PE investors. From a value perspective, IPOs dominated, largely on the strength of one new offering – the US\$1.7b IPO of Banco BTG Pactual. It was the largest IPO in Brazil since the Banco Santander offering in 2007. BTG was backed by a consortium of investors that put US\$1.8b into the bank in 2010, including JC Flowers and multiple sovereign wealth funds. In November 2012, BTG acquired Chile's Celfin Capital. In doing so, BTG became the largest investment bank in Latin America. The Celfin acquisition gives the bank a platform for expansion outside of Brazil at a time when countries such as Chile, Colombia and Peru are becoming a more important part of the overall Latin American market.

Overall, IPOs have made for difficult exit routes globally. The value of global new issuance was down 22% from 2011. In Brazil, overall IPO volume was down significantly from 2011. Through the end of December, just four IPOs had priced on the BM&FBOVESPA exchange. These raised US\$2.6b, down from 11 IPOs in 2011 that raised US\$4.4b in total.

Figure 7. PE exits in 2012 by type



Source: Dealogic, EMPEA

The year was also notable for a number of secondary sales. Among them was GP Investments' sale of Fogo de Chao Churrascaria, a Brazil-based restaurant chain, for US\$400m to US-based Thomas H. Lee Partners. The sale was one of two secondary exits that GP completed during the year. In April, the firm sold its stake in Sascar Tecnologia e Seguranca Automotiva to Empreendedor Brasil and JCR for an undisclosed amount. As the PE industry in Brazil matures, secondary sales such as these could play an increasingly important role. Many industry participants see the advent of a two-stage model as critical to the industry's continued growth in the region. Growth capital investments sourced and managed by middle-market firms with an emphasis on organic growth and establishing good governance practices could be sold to larger firms better positioned to execute on the next phase, including inter-regional expansion, inorganic growth and new product lines.



Outlook for 2013 and beyond

Latin America's resilient and dynamic market will continue to provide interesting opportunities

Latin America's dynamic macroeconomic environment will continue to be a key driver of PE activity for the foreseeable future. As millions of people in the region continue to enter the middle class and favorable demographics drive increased domestic consumption, PE firms will continue to see a wide range of interesting opportunities. As they do, they will help to develop not only a handful of portfolio companies, but the economies of Latin America as a whole.

Even more so than in the developed markets, PE investors in Latin America rely on operational improvements to drive returns. Working closely with entrepreneurs and family owners to instill financial discipline, capital structure flexibility and drive organic revenue growth, PE firms are helping Latin America's businesses to grow and expand in new directions – entering new geographies and bringing new products to market.

Of course, challenges remain. There was a substantial deceleration among several of Latin America's key economies, and while most appeared to have turned the corner, significant uncertainty remains. Chief among these is the potential for a hard landing in China and continuing economic contraction throughout the eurozone. However, it was the resiliency of Latin America that attracted this new wave of interest from PE investors, and that resiliency should see the region through the current demanding environment.

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