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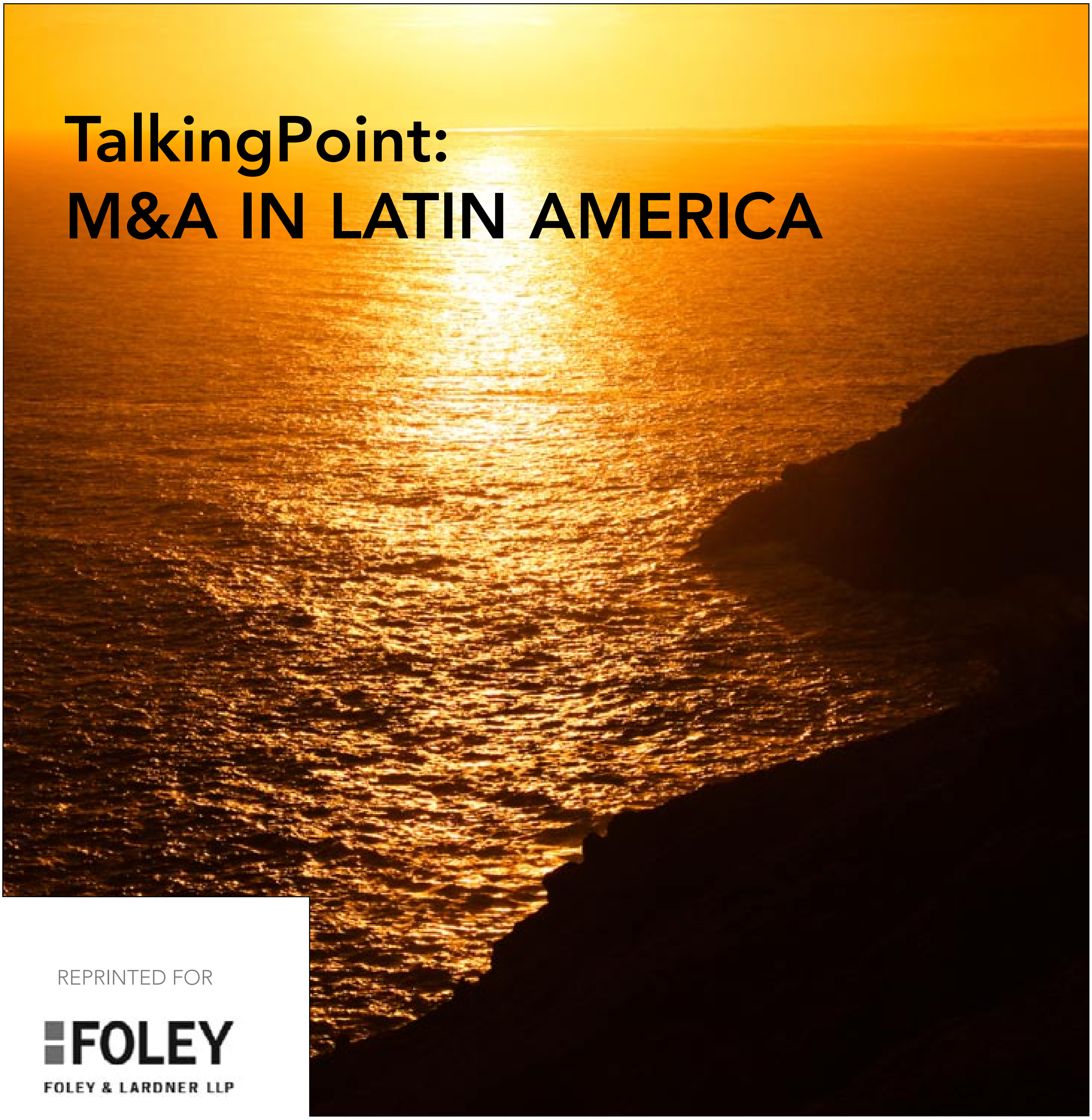

TalkingPoint:
M&A IN LATIN AMERICA

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FOLEY & LARDNER LLP

FW moderates a discussion focusing on M&A in Latin America between Francisco J. Cerezo at Foley & Lardner LLP, Ricardo Walter Beller at Marval, O'Farrell & Maira, and Sergio J. Galvis at Sullivan & Cromwell LLP.

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FW: What major trends have you seen in M&A activity across Latin America over the last 12 months? What factors are driving deals and which key sectors seem to be attracting buyers?

Cerezo: Over the last 12 months we have continued to see strong deal flow in the energy, natural resources and financial services sector, as well as notable transactions from Asian investors. Additionally, we are seeing increasing activity from Latin American private equity firms as well as from highly diversified and cash rich family controlled Latin American groups looking to expand beyond their national territories. These investors are seeking opportunities throughout the Americas, including the US, and in some notable examples one finds substantial Latin American investments throughout Europe, Africa and Asia. In short, a major deal driver has been the continued growth of Latin American groups as significant regional and global investors seeking opportunities beyond their home markets.

Beller: An increasing degree of multinational companies are recognising the importance and opportunities of growth in Latin America. This has led to acquisitions being made to ensure their presence in several countries in the region. There has been a greater involvement of players from emerging countries, such as China, India, Russia and also Brazil, which is consolidating itself as the leading country of the region. The sectors that attract most investors are commodities – such as energy, mining and agricultural products – financial institutions, and media and telecommunication companies.

Galvis: Latin America's vast natural resource reserves will continue to attract investors seeking to capitalise on the rise in commodity prices and continuing demand out of China and the rest of Asia. For example, demand for natural resources in Japan should remain stable as rebuilding efforts continue following the devastating earthquake earlier this year. This continued demand coupled with high commodity prices will continue to put pressure on infrastructure necessary to transport raw goods from remote regions to export centres, particularly in Brazil with respect to iron ore and other minerals, and Colombia with respect to oil. As a result, foreign and regional capital and expertise will inevitably drive business combinations in the coming years as efforts increase to close the infrastructure gap. A more recent and equally important development, however, has been the rise of a stable middle class in countries like Peru, Brazil and Colombia. As a result, investments in companies that service domestic markets also are becoming increasingly attractive as the domestic client base continues to mature.

FW: What general advice would you give to a foreign buyer on negotiating and closing deals in the region? For example, are there any cultural nuances they should take into consideration?

Beller: It is important to understand not only what the laws and regulations say, but more importantly how these are applied. Some rules apply which cannot be found in writing anywhere, and others which theoretically should be the applicable law do not apply in the exact terms in which they are written, or not at all. Hiring counsel with adequate knowledge and expertise in the local regulations is a key factor to successfully understanding these issues. Careful consideration should be given to the role that government and regulators will play in a given transaction. In several jurisdictions, transactions at a minimum require the approval of antitrust authorities. Approval may be complicated in sectors which are considered strategic or which for other reasons the local government considers sensible to its political interests. The particular situation of the sector in which the investment will be made and players involved should be analysed with local counsel. Investors should not only consider how they may realise the investment transaction, but also their ability to administer the company they purchase and eventually divest their interests. Certain sectors of the economy may be heavily regulated and supervised by local authorities, while others may be considerably unregulated.

Galvis: The thriving commodities market has incentivised many countries with lower levels of foreign direct investment in the region to undertake efforts to attract such investments as a way to boost economic and social growth. These are positive and welcome developments but, as with any nascent regime, investors must engage in early efforts to analyse applicable regulations in order to identify issues to be addressed internally or with regulatory authorities. In these types of situations, investors should be aware that, given the pace of investment and development in the region, regulations, and the governmental authorities responsible for interpreting and enforcing such regulations, are often slow to adapt to the increasingly complex nature of transactions in the region. As a result, complex cross-border transactions require constant coordination and cooperation among principals and their respective advisers. Companies that recognise this and engage in advanced planning with experienced local and international advisers will be rewarded through successful transactions and the development of useful relationships.

Cerezo: One key piece of advice is to realise that although Latin American countries share many common traits, they each have their idiosyncrasies and cultural nuances. Foreign investors need to realise that what works in Brazil will not necessarily work in the Dominican Republic or Costa Rica and vice versa. Moreover, even within a particular area of Latin America such as Central America, there are significant differences since, for example, what works in Costa Rica may not work in El Salvador or Guatemala. As such, foreign investors should develop a strategy specific to each country and such strategy should be developed in close consultation with local and international advisers – legal, accounting and otherwise – who are experienced in structuring and closing transactions in the particular country.

FW: How important is it to undertake a thorough due diligence process to manage the risk in a Latin American transaction? What key areas must be included in this process?

Galvis: As with investments in any part of the world, thorough diligence is key to investments in Latin American companies. Political risk has decreased in many Latin American countries, but investors should continue to monitor legal developments to ensure that they take full advantage of foreign investment protection regimes. In addition, as inbound and outbound M&A activity continues to increase, foreign and regional companies must seek to identify key deal drivers in attractive markets in advance of any potential transaction. For example, public disclosure requirements, litigation potential, regulatory approvals and corporate governance requirements all represent potential areas that could lead to unnecessary costs and delays if not considered in advance and are certainly becoming more and more important in recent large-scale transactions.

Cerezo: A thorough due diligence is of paramount importance. Due diligence is always important regardless of where the transaction takes place, yet in Latin America it is particularly important because there is less transparency and access to information than there may be in other markets, like the US and Western Europe. As such, those performing the due diligence investigation need to be ever more thorough and resourceful in order to complete a comprehensive review. Beyond the accounting and legal due diligence, it is also critically important to learn as much as possible about the local market, including potential partners and competitors. That is to say, the due diligence is critical and needs to go beyond simply what the books and records may show from a legal and accounting perspective.

Beller: The thoroughness of the due diligence process will depend significantly on the size of the transaction. In a huge transaction, the investment and consequent risk would be greater, which would justify a greater amount of due diligence. Additionally, there would probably be greater room to cover due diligence expenses. In smaller transactions, the buyer will invest less time and money in the due diligence, and will attempt to focus more on the matters which it considers to be the key to its investment. The buyer will generally focus its due diligence on checking the proper maintenance of the target company's books and records, including the ownership of the equity the seller is offering; confirming that the target company owns the assets and the business it claims it owns, such as key contracts, real estate assets and machinery; and determining liabilities of the target company and the parties involved in the transaction, including in particular existing judicial, administrative or other claims and potential tax, labour and/or environmental claims.

FW: To what extent can local market knowledge and advice make the difference between a successful deal and a failed deal?

Galvis: Familiarity with the region is certainly helpful but inexperience should not be an impediment to potential investments. For new investors, the effective use of experienced local and international advisers can easily overcome any lack of familiarity. More importantly, given the scale and complexity of recent M&A transactions in Latin America, local market knowledge coupled with international experience and expertise are becoming more essential than ever before. Regional firms are no longer expected to play the traditional role of 'local counsel' and are instead being called upon to serve as integrated partners in an effort to create value for clients. The recent LAN-TAM transaction is a perfect example. Lawyers from New York, Chile and Brazil all worked together to draft an agreement in English governed by New York law, something that was possible only as a result of a coordinated effort among counsel. M&A transactions in the region will continue to see more of this type of integration in the near- and long-term.

Beller: Hiring local counsel with adequate knowledge and expertise is a key factor to a successful deal. In particular, it is very important to find counsel with good communication skills who can help foreign investors to properly understand local regulations. Some deals are not successful simply because potential investors do not adequately understand the local environment, and in some cases this is due to poor communication skills or lack of experience of their counsel.

Cerezo: Being sensitive to local considerations, cultural and otherwise, and understanding the local market are crucial to the successful structuring, negotiation and closing of a transaction. Many deals fail to realise their potential after closing or never reach closing due to a lack of knowledge of the local market. As such, it is of utmost importance that foreign buyers and investors rely on the advice of seasoned advisers with deep knowledge of the local market. Beyond the advice leading up to a successful closing, foreign buyers are well served by having a clear management plan in place which also includes the participation of persons with deep knowledge of the local market. Oftentimes this can be achieved by retaining local management or other key local advisers. This will not only ensure a successful closing but, more importantly, will ensure that the venture thrives post closing.

FW: Are there any unique or challenging aspects of regional M&A regulations which buyers will need to understand when making an investment?

Beller: Investors need to understand not only the regulations that apply to making an investment but, even more importantly, those that will apply once the investment is made or in the event of a future divestment.

Galvis: The regulatory environment in Latin America can present varying levels of complexity to interested investors. While some countries may have established rules that have been tested over time, other countries may have only recently drafted regulations that are new to both investors and regulatory authorities. The challenge in the latter case is identifying the degree to which such regulations address financing, structural and operating needs. Alternatively, established regulations may nevertheless present certain complications in the context of unique, large-scale transactions. Ultimately, the reality in any potential transaction is that each country will present a unique regulatory environment that may be informed by any number of political, economic and social views and each investor should become familiar with such regulations as early as possible.

Cerezo: Depending on the particular country, there can be a wide array of regulations which are fundamental to determining the viability of an investment. In some jurisdictions there may be absolutely no restrictions on foreign ownership while in others there may be outright prohibitions on foreign ownership of certain assets and yet in others there may be no prohibitions per se but enough restrictions to affect the economic viability of a given investment. It is important not to assume that the regulations applicable in one jurisdiction will be the same throughout the region. Therefore, at the beginning of a transaction special attention should be given to applicable regulations so that the viability and attractiveness of a given transaction can be evaluated in light of applicable regulations.

FW: What scope is there for acquirers to take advantage of local tax regulations to plan their deals efficiently? Are any benefits or incentives available under the tax framework covering M&A?

Cerezo: Proper structuring from a tax perspective is a fundamental part of any M&A transaction. Such planning and structuring, however, needs to be done in close collaboration with local counsel who can highlight local and national tax regulations as well as the benefits or incentives which may affect the transaction. Throughout Latin America one finds numerous examples of tax incentives ranging from tax holidays and credits to reduced tax rates aimed at attracting foreign investment. These incentives vary dramatically based on regional and industry considerations. Tax regulations and possible incentives can affect the economics of a transaction significantly, so it is vitally important that competent tax advisers, both local and international, carefully structure the transaction to ensure maximum efficiencies post-closing.

Beller: Tax planning is a key feature in an M&A transaction. There are several treaties which allow tax efficient investments. Careful consideration should be given to the jurisdiction from which the investment will be made and the corporate vehicle chosen to such effect.

FW: In your experience, where do foreign buyers tend to fall short from a post-deal integration perspective? What steps should they take to realise the full benefits of a deal in Latin America?

Beller: Most buyers we have worked for have been very efficient administering the company they purchased. In some exceptional cases, after closing the transaction foreign buyers have not adequately supervise local managers and the running of the business. Some clients have been able to enhance their supervision by maintaining a working relationship with a local firm and requesting its support for the post-deal administration of the company they purchased. An old saying in Argentina is 'the eye of the owner fattens the cow'. Local counsel can act as the foreign investor's eyes.

Cerezo: After a deal successfully closes, the challenge remains to ensure the success of the investment. First and foremost, successful post-deal integration requires that the foreign investor be sensitive to local practices and procedures. Wholesale application of practices and procedures that may work in the investor's home country is usually a recipe for failure. Foreign investors should avoid trying to force a square peg in a round hole and, in consultation with counsel experienced in the region, should instead be mindful of the best local practices and reconcile those with the investor's best practices. In addition to this, at the pre-closing stage investors often fail to reflect on other key post-closing considerations. Among the issues that need to be carefully considered are the post-closing role of local management, political risks and even possible exit strategies should the venture not yield the desired results. By keeping the above in mind from the first stage of negotiations and deal structuring, foreign investors will have a much higher level of successful post-deal integration. ■