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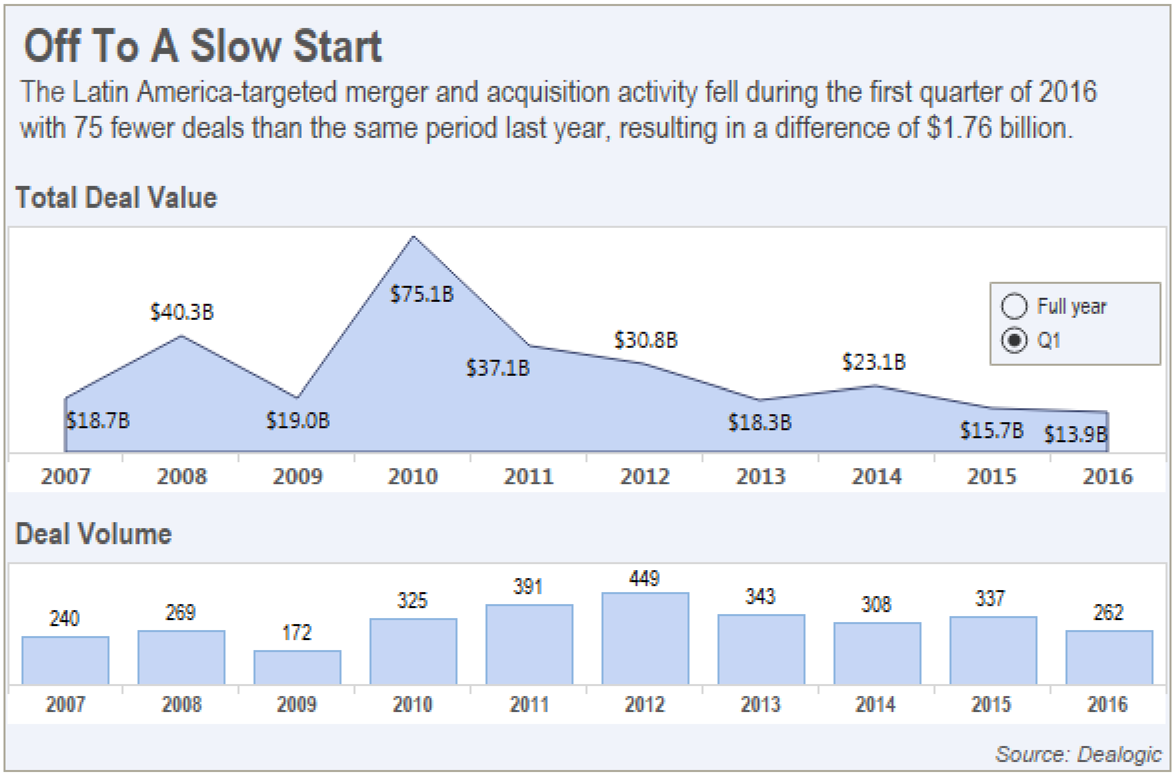
A Closer Look At The Latin America M&A Market

By **Chelsea Naso**

Law360, New York (April 25, 2016, 7:07 PM ET) -- Latin America-targeted merger and acquisition activity fell during the first quarter as deal-making continued to be weighed down by regional political and economic challenges, but the region is ripe for investment going forward, experts say.

During the first quarter of 2016, there were 262 Latin America-targeted deals worth $13.93 billion, compared to the 337 deals worth $15.69 billion seen in the first quarter of 2015 and the 308 deals worth $23.08 billion seen in the first quarter of 2014, according to data tracked by Dealogic.

In fact, 2016's year-to-date deal volume and value as of Friday — 317 deals worth $15.56 billion — has yet to surpass the activity in the first quarter of 2015, a year that went on to be the slowest in terms of deal value since 2009, according to Dealogic.



Certain areas are faced with more challenges than others — Brazil, for example, is in the midst of some serious political turmoil — but the M&A market is not as doomed as some deal makers may think, noted Daniel Ganitsky, a Proskauer Rose LLP partner in the firm's M&A and Latin America practice groups.

"There are people that are extremely pessimistic about the short-term outlook for Latin America," Ganitsky said. "That pessimism may be a little too strong."

Recession, Corruption and Low Oil Prices

M&A may be depressed compared to a few years ago, but it has managed to persist at a relatively steady pace across the region because of countercyclical factors that have slowed deal-making in some countries but fueled it in others. It's difficult to paint such a large region with a single brush, but recession, the related slide in currency valuations, political turmoil and low oil and gas prices have had a hand in changing the face of M&A in Latin America.

Recessions tend to put the brakes on deal-making, and with currencies hitting extreme lows in 2015, strategic buyers were hesitant to ink deals in such uncertain circumstances. Certain countries saw even more uncertainty as corruption came to light and political turmoil took hold.

For example, Petroleo Brasileiro SA, known as Petrobras, is embroiled in allegations of concealing a multibillion-dollar kickback and bribery scheme. And political turmoil in Brazil is reaching a boiling point, with the country's lawmakers currently weighing whether to impeach President Dilma Rousseff.

"The private equity investors are in the business of making investments," said Mayer Brown LLP corporate partner Christian Fabian. "But I think the strategics are going to be more cautious in that environment."

However, some of those factors also breed opportunity for divestitures and distressed M&A at a price long-term investors are likely to see as favorable. Low currency valuations, while a sign of the economic trouble, also make assets more affordable.

"Invariably, currencies in the region are significantly lower than where they were two years ago. And that has actually helped to bridge valuation gaps," said Baker & McKenzie LLP partner Jaime Trujillo, who heads the firm's Latin America M&A practice. "Many people believed that Latin America in general was too expensive."

So while M&A may not be robust, it's still holding relatively stable as companies look to weather tough economic and political challenges. During the first quarter, the oil and gas sector ranked as the sixth most active by deal value, with 15 deals worth $876 million, while the utility and energy sector ranked as the most active, with 11 deals worth $4.75 billion, according to Dealogic.

"Two, three, four years ago, we were seeing a lot of Latin American companies doing acquisitions outside their home countries, and now you are seeing a lot more of defensive moves — selling noncore assets, selling distressed assets," Ganitsky said.

That trend is poised to continue. Just last week, Pacific Exploration & Production said that it plans to initiate cross-border bankruptcy proceedings in the U.S., Canada and Colombia to execute a restructuring deal with private equity firm The Catalyst Group that is designed to reduce the oil and gas company's debt by $5 billion.

Distressed M&A is not the only factor driving deals in the region. A portion of deal-making also continues to be driven by wealthy Latin American families that started building their business empires 20 to 30 years ago, noted Francisco Cerezo, a DLA Piper partner and head of the firm's Latin America corporate practice. Those wealthy business magnates, like Mexico's Carlos Slim, have begun inking more international deals over the past year.

"The rise of the family group acting almost as if they were very significant private equity players, but on their own account of their portfolio companies, growing significantly in their own territories, then expanding regionally and globally, is a really interesting trend," Cerezo said.

More M&A on the Horizon

Investors from the U.S. and Europe snapped up a significant number of Latin American assets in 2015 and the first quarter of 2016, a trend that is expected to only increase as the year goes on despite headwinds.

With oil prices beginning to stabilize and the exchange rates still favorable to the dollar and the euro, foreign direct investment in struggling or distressed energy assets, especially from U.S. and European buyers willing to bet on the long-term viability of energy companies and projects, will likely be strong by the end of the near, according to Ganitsky.

"I think you are going to see a lot of U.S. and European funds — private equity, not just strategics — going into the region," he said.

The infrastructure industry is also poised for consolidation, a factor that will draw foreign, regional and local investment, according to Trujillo. Many Latin American countries have been pushing to improve their infrastructure to be more competitive — particularly in the wake of free trade agreements in the region — with the government and public-private partnerships helping to fund those initiatives.

But as time goes on, the smaller contractors are likely to join forces with larger ones to create the critical mass needed to carry out ambitious infrastructure programs, and foreign investors interested in infrastructure investment will buy into firms to establish a local presence, Trujillo said.

"We don't rule out that 'financially weak' concessionaires may want to join forces with those players that have more financial muscle. There is an interest in doing infrastructure-related M&A and of course a lot of M&A buying into domestic infrastructure firms because in many cases, having a local partner or presence is essential," Trujillo added.

It's not all doom and gloom spurring M&A in the region, however, as cross-border and local deal-making is also likely to be fueled by the growing middle class in the region, Trujillo said. The commodities boom allowed many Latin American countries — particularly Brazil, Chile, Peru, Colombia and Mexico — to invest more money in their citizens, helping more to join the middle class and opening more industries up for growth.

"The middle class is demanding all sorts of products and services from consumer services and electronics to financial services and tourism services. There are a lot of investors both regional and global that are seeing that and are buying into those markets," he said.

--Editing by Christine Chun and Mark Lebetkin.