Private Equity 2014 - Introduction

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In terms of development, overall Latin American economic growth remained relatively flat in 2013, belying an underlying trend of heterogeneous growth that is expected to continue in the near term. Countries such as Brazil, Argentina and Uruguay experienced moderate or decreased growth, while other countries in the region, such as Peru, Colombia and Chile, experienced more robust growth that they are expected to sustain in the coming years. 2013 also saw a return of volatility to Latin American markets, underscoring the importance of macroeconomic fundamentals as important factors for foreign investors. Though domestic demand grew more moderately in 2013 than in past years, economic performance in the region continues to benefit from increased local and regional consumption and investment, and to rely less on oil and gas or other commodities sectors that have historically attracted the majority of foreign investment. Overall, sound macroeconomic and fiscal fundamentals, a continuously growing middle class and the increased sophistication of market participants in the region mean these countries are becoming less dependent on global appetite for hydrocarbons and other natural resources.

Nonetheless, the exit environment remains a challenge for private equity investors, while Latin American economies continue to develop deeper capital markets. Many relevant local and regional market players don’t find the risk-reward calculation to be in favour of going public. The breadth and size of financial institutions also limits the scale and type of ventures that local entrepreneurs can target, as corresponding borrowing costs have usually been comparatively high. Therefore, the strength of these local players lies in their local knowledge and their ability to capitalise on available financing opportunities, allowing them to optimise their current and potential capital structures.

While global private equity fundraising efforts in 2013 exceeded those of previous years, fundraising in Latin America declined significantly in 2013. Decreased fundraising by large Brazilian funds, which had a surfeit of unallocated funds raised in prior years, was a key contributor to the overall decline. While being unable to offset the decline in fundraising in larger economies such as Brazil, fundraising efforts by smaller funds and in other countries, such as Peru, lessened the decline in overall fundraising. Furthermore, private equity funds are now looking to invest the surplus funds raised over the past years.

Despite the challenging economic environment, private equity funds remain committed to investing in Latin America, with many limited partners indicating in late 2013 that they would be increasing their investment in funds in the region. While Brazil has been the most important market for private equity investments in the past, limited partners active in the region are increasingly focusing on Mexico, Peru and Colombia. A private equity fund’s ability to seek out key investments in specific countries, including outside of the traditional markets for private equity investment in the region, will be an important determinant of its success.

The fact that private equity activity remained strong during 2013, in spite of flat overall GDP growth in the region, suggests that the sophistication and commitment of private equity players is allowing them to better identify and realise these investment opportunities. This degree of sophistication and better understanding of local conditions is also demonstrated by the type of transactions and industries in which private equity investments are being made. Middle market investments are continuing to increase, amounting to around one third of the total private equity investment in the region. In addition, investments are increasingly being made in sectors that have been historically underdeveloped and that are less dependent on the economic performance of the respective country’s trade partners, including consumer/retail products, financial services and education, among others.

Throughout all these trends, international legal services providers will continue to play a key value-adding role by contributing their expertise in transaction structuring, implementing innovative solutions, and analysing overall industry trends. Their experience in cross-border debt financing and leveraged buyouts is also essential, as private equity investments are increasingly relying on these types of financing. Effective partnerships with local counsel in the region remain critical to help navigate the regulatory environment and develop tailored solutions to country-specific legal issues. Legal counsel are uniquely positioned to help pierce the fog that stands in the way of private equity investors hoping to make the most out of the region's investment opportunities and local entrepreneurial talent and potential.