New Financial Frontiers

Indices
Derivatives
Private Equity
Securitization
Remittances

INTERVIEW
Merrill Lynch’s
James B. Quigley
attracting external resources to finance sustainable development

- **US$ 250 million**
  - YANKEE BOND
  - May 2005

- **JPY 20,000 million**
  - SAMURAI BOND
  - July 2005

- **US$ 150 million**
  - CONDOR BOND
  - July 2005

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December 2005

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Five Hard Lessons

Latin America is living a golden age of financial innovation and deregulation. Derivatives, floating currencies, hedge funds, robot traders and other financial fauna are all relatively new arrivals but they are changing the region’s markets beyond recognition.

The benefits of modern financial products are clear. Derivatives, day traders, hedge funds – once considered bêtes noires – have all gone mainstream. They enable risk to be shared and priced appropriately, helping markets to operate more transparently and consequently allocate capital efficiently.

Of course, Latin American markets are still a long, long way from providing deep pools of capital available to companies looking for long-term local currency financing. But a start has been made.

How can the region build on the advances of the past few years to further develop its markets?

First, governments must maintain economic stability, with special emphasis on fiscal prudence and debt reduction. Nearly all governments continue to run large budget deficits even as the region is expanding at a healthy clip. Tighter fiscal policy will deliver lower interest rates and reduce crowding out of the private sector in local capital markets. Public credit officers across the region should concentrate their efforts on building out a domestic yield curve beyond the customary five years, opening up space for private companies and banks to issue long-term bonds.

Second, governments have to aggressively pursue deregulation. This does not mean officials have to chuck out their rulebooks. In consultation with the markets, officials need to decide to eliminate useless bureaucracy and red tape that hinders the functioning of efficient markets. They should then focus their energies on enforcing regulations, with special emphasis on defending investor and creditor rights.

Third, Latin America’s businesses should fully embrace the capital markets. Companies still rely heavily on bank loans, denying themselves the benefits of accessing the public debt and equity markets, although reliance on bank finance is understandable in small countries with shallow capital markets. Family-owned companies still avoid ceding control to public equity investors, often preferring to sellout to foreign multinationals.

Fourth, the investment community needs to wake up. Analysts and investment officers are still content to concentrate on government and public sector assets even as yields collapse across the region. Issuers complain – with considerable justification – that they cannot gain the attention of fund managers. Explaining sophisticated structures that mitigate risk and give investors exposure to sound long-term assets is an uphill battle.

Fifth, the region’s stock market authorities could learn from the example of the São Paulo Stock Exchange (Bovespa) and the Mexico City Derivatives Exchange (MexDer). The Bovespa has pioneered new markets and indices that are the most advanced in the developing world. MexDer has in a few years built one of the region’s most successful derivatives market, an essential part of any country’s financial system.
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Debt Tango in Buenos Aires
The Province of Buenos Aires has offered to exchange $3.1 billion in debt, or about 30% of its total $9 billion in debt. The exchange, to take place over the course of six weeks early in the new year, will allow creditors to swap their existing holdings for three new bonds: a 30-year par bond, a 15-year par bond and a 12-year discount bond. The new bonds will be available in dollars or euros. The exchange is expected to give the provincial government a principal reduction of about 50 cents on the dollar in net present value terms. This is less of a cut than the 75% reduction the federal government imposed on its bondholders earlier this year. Citigroup is global coordinator for the debt exchange deal.

Pemex Issues Big
Mexican state oil monopoly Pemex issued $920 million in peso-denominated bonds in October. It raised $414 million with a 10-year bond and a further $506 million in a second six-year floating rate tranche. The 10-year bond pays a 9.91% coupon for a yield of 9.31%, or 45 basis points above the comparable sovereign bond. The six-year bond pays 35 basis points over three-month Cetes Mexican treasury bills. The issue was three times oversubscribed. Santander Serfin, Banamex, and ING were bookrunners on the deal.

Argentina’s Friends Lend a Hand
After suffering a humiliating setback in the markets in September, the government of Argentina sold $613.6 million of its 10-year Bodens – or local currency bonds – to public sector agencies and the government of Venezuela in late October. The Argentine government had refused to pay the 8.8% yield investors demanded in September. It then returned to the markets in October, asking investors to put in orders for the Bodens they wanted to buy at an 8.75% fixed yield. Only government-affiliated groups, such as federally controlled Banco de la Nación Argentina and the Province of Santa Cruz, President Néstor Kirchner’s home province, took the bonds. The government of Venezuela also bought $336.8 million of the bonds. This brings Venezuela’s purchases of Argentine bonds to $930 million so far this year. Venezuelan Finance Minister Nelson Merentes says his government plans to buy $1 billion in Argentine debt this year.

BBVA Buys Granahorrar
Spain’s second largest bank BBVA has bought Granahorrar, Colombia’s 10th-largest bank, for $423.6 million. The sale was Colombia’s largest bank privatization to date. BBVA’s local bank was already Colombia’s third-largest bank but the acquisition does not change its ranking. The deal also increases BBVA’s stake in Colombian pension fund Horizonte to 99.67% from 80%. The government had set a minimum price of $187 million in the auction. BBVA outbid other Colombian financial groups such as Davivienda, Banco Colpatria and Grupo Aval. Santiago-based IB Partners advised the government’s bank restructuring agency, Fogafin, on the sale.

Brazil Basks in Outlook Upgrade
An upgrade in Brazil’s outlook to positive by Standard & Poor’s allowed Brazil to return to the international debt markets for the fourth time this year with a tightly priced offering. The government raised $500 million through a third reopening of its 2015 issue. The bond carries a 7.875% coupon but was priced above par at 100.702 to yield 312 basis points over 10-year US Treasuries. Brazil currently has a sub-investment grade rating of BB- from S&P. The latest bond sale brings the government’s global market issuance this year to $7.5 billion. Citigroup and HSBC were bookrunners on the deal.

Colombia Issues Floating-Rate Bond
Colombia raised $400 million with 10-year floating-rate bonds sold Nov. 9. The bonds were issued at par with a spread of 180 basis points over Libor. JP Morgan was bookrunner on the deal.

Votorantim Goes Liquid
Brazil’s Grupo Votorantim industrial group in November closed a $300 million liquidity facility in a deal underwritten by BankBoston, Société Générale and WestLB. Votorantim can access the facility any time over the next three years, paying a fee of 35 basis points of the committed amount and a two-year drawn tenor priced at 65-75 basis points of the outstanding amount. This is the first vanilla liquidity facility for a Brazilian issuer that exceeds a two-year availability period. The deal received $335 million in commitments, allowing Votorantim to achieve record low pricing.
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CVRD Goes Long Again
Brazilian mining group Cia. Vale do Rio Doce (CVRD) reopened its 30-year bond first issued in January 2004 to raise a further $300 million. The bond carries a coupon of 8.25% and the reopening was priced at 106.881 for a 7.65% yield-to-maturity, giving investors a spread of 286 basis points over comparable US Treasuries. The issue was priced 50 basis points below the original $500 million issue. CVRD reopened the bond to lengthen the average maturity of its debt. The issue was twice oversubscribed. ABN Amro and HSBC were the bookrunners on the deal.

Uruguay Returns to the Market
Backed by rapid economic growth, Uruguay launched a $200 million, 17-year bond priced at 98.237 to yield 8.194%, or 364 basis points over US Treasuries. The bond pays an 8% coupon. Moody’s rates Uruguay B3 and Standard & Poor’s rates it B. The amortizing bonds will repay principal in three equal annual tranches beginning in 2020. This was Uruguay’s longest maturity bond since its 30-year issue in 1997, and its first international issue since the country canceled a perpetual bond issue in 2001. The offer was arranged by UBS.

Mabe Brings the Money Home
Mexican household manufacturer Controladora Mabe sold $200 million in privately placed notes with a 10-year maturity. The notes carry a 6.5% coupon and are due in December 2015. They were priced below par at 99.082, for a yield of 6.625%. Registered as Rule 144A securities with the US Securities and Exchange Commission, the notes will be used to repay existing debt. S&P and Fitch both rated the issue BBB-. Citigroup Global Markets and ABN Amro were joint lead managers.

Scoring Another Goal
The holding company controlling Chilean soccer club Colo Colo has issued more stock. Blanco y Negro, which in June became the first Latin American soccer team to go public, issued an additional $14 million in shares on the Santiago Stock Exchange. The company used the June IPO to pay down debt and is using proceeds from the October follow-on offering to cover salaries and administrative costs. Another Chilean soccer club, Unión Española, was expected to launch 80% of its equity in an IPO at the end of November.

Madeco Issues More Equity
Chilean copper cable manufacturer Madeco sold 1.1 billion shares in a secondary offer that raised $140 million from investors. The deal represented a 25% increase in the company’s pre-sale equity. Madeco is part of Chile’s Quíñenco Group, the financial and industrial conglomerate run by Guillermo Lukšic, scion of Chile’s richest family.

Unibanco Banks on Payment Flows
A syndicate of international banks led by Japan’s Sumitomo Mitsui Bank has set up an innovative $200 million standby facility for Unibanco, Brazil’s fifth-largest bank. Unibanco has access to the structured facility for two years, beginning in October. Should it draw on the line, Unibanco will have five years to repay the funds used, with a grace period of two years. Interest is an average of 25 basis points over Libor. Once Unibanco taps the facility, a Unibanco special purpose company automatically issues securitized notes backed by its hard currency payment flows. Sumitomo Mitsui will then sell the notes to institutional investors. US-based Financial Guaranty Insurance will guarantee the securitized notes, which carry a AAA investment grade rating from Moody’s and Standard & Poor’s.

Hipotecario Issues Bonds
Argentina’s Banco Hipotecario mortgage bank returned to the global markets in November, issuing $150 million in five-year 9.75% notes. The bonds were priced at 99.035 to yield 10%. Hipotecario will use the proceeds to pay down debt and finance increased lending. This was Hipotecario’s first global issue since its 2004 debt restructuring. Deutsche Bank was the bookrunner on the deal with Citigroup.

Industrial Activity in Chile
Chilean industrial conglomerate Sigdo Koppers raised $156 million in an IPO of 25% of the firm’s equity through an offering on the Santiago Stock Exchange. The company had hoped to raise $220 million from the issue to finance a three-year, $500 million expansion plan. A week later Enaex, a previously listed subsidiary, issued $108 million in inflation-linked local currency bonds.

Wasting No Time to Market
Promotora Ambiental (PASA), a Mexican waste management company, also held an IPO in November. PASA listed newly created shares that represent about 20% of the company’s outstanding capital following the offering, raising $57 million. Majority owners, including the founding Garza family as well as the Darby Latin American Mezzanine Fund, sold another 20% for an additional $57 million at the time of the issue. The funds raised by the company will be used to expand current operations, which include trash pick-up and landfill services, as well as sewage treatment for Mexico’s oil company Pemex. Funds may also go towards expansion through acquisitions. BBVA Bancomer was the global coordinator, as well as joint placement leader with Banamex.
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## Top Latin American and Caribbean M&A transactions - October 1 to October 31, 2005

<table>
<thead>
<tr>
<th>Rank</th>
<th>Date</th>
<th>Target Description</th>
<th>Bidder</th>
<th>Value (US$ million)</th>
<th>Target Adviser</th>
<th>Bidder Adviser</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>31-Oct</td>
<td>Banco Granahorrar</td>
<td>BBVA</td>
<td>423.21</td>
<td></td>
<td>IB Partners</td>
</tr>
<tr>
<td>2</td>
<td>18-Oct</td>
<td>Biosintetica</td>
<td>Ache</td>
<td>268.44</td>
<td></td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>31-Oct</td>
<td>Gas Participacoes</td>
<td>Mitsui &amp; Co</td>
<td>250.00</td>
<td></td>
<td>JP Morgan</td>
</tr>
<tr>
<td>4</td>
<td>14-Oct</td>
<td>Coteminas (sheet and towel businesses)</td>
<td>Springs Industries</td>
<td>200.00</td>
<td></td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>24-Oct</td>
<td>Banco Salvadoreno (60%)</td>
<td>Banistmo</td>
<td>145.50</td>
<td></td>
<td></td>
</tr>
<tr>
<td>6</td>
<td>13-Oct</td>
<td>Cia. de Seguros Generales Cruz del Sur, La Republica Cia. Argentina de Seguros Generales</td>
<td>Royal &amp; Sun Alliance Insurance Group</td>
<td>119.00</td>
<td></td>
<td></td>
</tr>
<tr>
<td>7</td>
<td>3-Oct</td>
<td>Nine hydroelectric plants (Brazil)</td>
<td>Grupo Arbeit</td>
<td>80.77</td>
<td></td>
<td></td>
</tr>
<tr>
<td>8</td>
<td>27-Oct</td>
<td>Acesita (4%)</td>
<td>Arcelor</td>
<td>59.13</td>
<td></td>
<td></td>
</tr>
<tr>
<td>9</td>
<td>7-Oct</td>
<td>Carbones Colombianos Del Cerrejon</td>
<td>Adobe Ventures</td>
<td>42.63</td>
<td>BNP Paribas</td>
<td></td>
</tr>
<tr>
<td>10</td>
<td>27-Oct</td>
<td>Forestal Tornagaleones (34.45%)</td>
<td>Masisa</td>
<td>29.90</td>
<td></td>
<td></td>
</tr>
<tr>
<td>11</td>
<td>17-Oct</td>
<td>Alvi Supermercados Mayoristas (35%)</td>
<td>Distribucion y Servicio D&amp;S</td>
<td>20.94</td>
<td></td>
<td></td>
</tr>
<tr>
<td>12</td>
<td>27-Oct</td>
<td>Forestal Argentina (29.15%)</td>
<td>Masisa</td>
<td>14.50</td>
<td></td>
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<tr>
<td>13</td>
<td>18-Oct</td>
<td>Image Memorial</td>
<td>Diagnosticos da America</td>
<td>14.45</td>
<td></td>
<td></td>
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<tr>
<td>14</td>
<td>31-Oct</td>
<td>Reposo</td>
<td>United Phosphorus</td>
<td>11.00</td>
<td></td>
<td></td>
</tr>
<tr>
<td>15</td>
<td>10-Oct</td>
<td>CAS Productos Medicos</td>
<td>Phonak Holding</td>
<td>10.16</td>
<td></td>
<td></td>
</tr>
<tr>
<td>16</td>
<td>25-Oct</td>
<td>RNC (Colombia)</td>
<td>Colombia Goldfields</td>
<td>6.13</td>
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<tr>
<td>17</td>
<td>17-Oct</td>
<td>Stanley Entertainment</td>
<td>Leisure &amp; Gaming</td>
<td>3.79</td>
<td></td>
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<td>18</td>
<td>1-Oct</td>
<td>Virgin Gorda Airport</td>
<td>British Virgin Islands</td>
<td>2.90</td>
<td></td>
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<tr>
<td>19</td>
<td>11-Oct</td>
<td>Papeles Nacionales (10.15%)</td>
<td>Kruger</td>
<td>1.34</td>
<td></td>
<td></td>
</tr>
<tr>
<td>20</td>
<td>7-Oct</td>
<td>Mantos Grandes copper/gold projects</td>
<td>Sundance Resources</td>
<td>1.20</td>
<td></td>
<td></td>
</tr>
<tr>
<td>21</td>
<td>3-Oct</td>
<td>Fiber plant (Mexico)</td>
<td>Invista</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>22</td>
<td>6-Oct</td>
<td>Prodesal</td>
<td>Quimica del Pacifico</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>23</td>
<td>5-Oct</td>
<td>Energetica Campos de Cima da Serra</td>
<td>Brascan Energetica</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>24</td>
<td>5-Oct</td>
<td>Quetzal (majority stake)</td>
<td>Cemex</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>25</td>
<td>12-Oct</td>
<td>ING Bank (Argentina)</td>
<td>Standard Bank Group</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>26</td>
<td>18-Oct</td>
<td>Hipotecaria Casa Mexicana (majority stake)</td>
<td>Advent International (IBO)</td>
<td></td>
<td>Pablo Rion y Asociados</td>
<td></td>
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<tr>
<td>27</td>
<td>13-Oct</td>
<td>Bank of America (Mexican management business assets)</td>
<td>Grupo Financiero Serfin</td>
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<td></td>
<td></td>
</tr>
<tr>
<td>28</td>
<td>20-Oct</td>
<td>Giovanni Comunicacoes (60%)</td>
<td>Foote Cone &amp; Belding</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>29</td>
<td>19-Oct</td>
<td>Edenor (14%)</td>
<td>New Equity Ventures</td>
<td></td>
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</tr>
</tbody>
</table>

Source: Dealogic

## Top Latin American and Caribbean bond issues - October 1 to October 31, 2005

<table>
<thead>
<tr>
<th>Rank</th>
<th>Date</th>
<th>Issuer Description</th>
<th>Bookrunner</th>
<th>Value (US$ million)</th>
<th>Original Currency</th>
<th>Amount (million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>19-Oct</td>
<td>PMXCB</td>
<td>ING, Citigroup, BSCH</td>
<td>503.20</td>
<td>Mexican Peso</td>
<td>5,500.00</td>
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<tr>
<td>2</td>
<td>19-Oct</td>
<td>PMXCB</td>
<td>ING, Citigroup, BSCH</td>
<td>411.71</td>
<td>Mexican Peso</td>
<td>4,500.00</td>
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<tr>
<td>3</td>
<td>26-Oct</td>
<td>Vale Overseas</td>
<td>ABN Amro, HSBC</td>
<td>300.00</td>
<td>US Dollar</td>
<td>300.00</td>
</tr>
<tr>
<td>4</td>
<td>11-Oct</td>
<td>Jamaica</td>
<td>Morgan Stanley</td>
<td>250.00</td>
<td>US Dollar</td>
<td>250.00</td>
</tr>
<tr>
<td>5</td>
<td>4-Oct</td>
<td>Telefonia del Peru</td>
<td>Citigroup</td>
<td>227.06</td>
<td>Peruvian Sol</td>
<td>754.05</td>
</tr>
<tr>
<td>6</td>
<td>3-Oct</td>
<td>Banco Votorantim</td>
<td>Deutsche Bank</td>
<td>200.00</td>
<td>US Dollar</td>
<td>200.00</td>
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<tr>
<td>7</td>
<td>18-Oct</td>
<td>CIE</td>
<td>Citigroup</td>
<td>128.09</td>
<td>Mexican Peso</td>
<td>1,400.00</td>
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<td>8</td>
<td>5-Oct</td>
<td>CEDEVIS 05-2U</td>
<td>BBVA, Banco Inbursa</td>
<td>98.00</td>
<td>Mexican UDI*</td>
<td>294.44</td>
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<td>9</td>
<td>4-Oct</td>
<td>TENANC 05</td>
<td>Interacciones Global</td>
<td>64.90</td>
<td>Mexican UDI*</td>
<td>194.98</td>
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<td>10</td>
<td>18-Oct</td>
<td>MMMACCB 05-2U</td>
<td>Credit Suisse First Boston</td>
<td>61.46</td>
<td>Mexican UDI*</td>
<td>186.80</td>
</tr>
</tbody>
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*Inflation-protected currency
Source: Dealogic
### Top Latin American and Caribbean bond issues - October 1 to October 31, 2005 (continued)

<table>
<thead>
<tr>
<th>Rank</th>
<th>Date</th>
<th>Issuer</th>
<th>Bookrunner</th>
<th>Value (US$ million)</th>
<th>Original Currency</th>
<th>Amount (million)</th>
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<tbody>
<tr>
<td>11</td>
<td>27-Oct</td>
<td>Hipotecaria Su Casita</td>
<td>Vector Casa de Bolsa</td>
<td>56.42</td>
<td>Mexican Peso</td>
<td>600.00</td>
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<td>12</td>
<td>27-Oct</td>
<td>Banco Mercantil do Brasil</td>
<td>Banco Finantia, Standard Bank</td>
<td>50.00</td>
<td>US Dollar</td>
<td>50.00</td>
</tr>
<tr>
<td>13</td>
<td>3-Oct</td>
<td>Financiera Compartamos</td>
<td>Citigroup</td>
<td>28.87</td>
<td>Mexican Peso</td>
<td>310.00</td>
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<td>14</td>
<td>11-Oct</td>
<td>Bladex</td>
<td>Mizuho</td>
<td>5.00</td>
<td>US Dollar</td>
<td>5.00</td>
</tr>
<tr>
<td>15</td>
<td>20-Oct</td>
<td>Corp. Metropolitana de Arrendamientos</td>
<td>Invex Casa de Bolsa</td>
<td>3.66</td>
<td>Mexican Peso</td>
<td>40.00</td>
</tr>
</tbody>
</table>

Source: Dealogic

### Latin American syndicated loans - October 1 to October 31, 2005

<table>
<thead>
<tr>
<th>Rank</th>
<th>Date</th>
<th>Borrower</th>
<th>Mandated Arrangers</th>
<th>Value (US$ million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>27-Oct</td>
<td>Telmex</td>
<td>HSBC, BBVA, Citigroup, ABN AMRO</td>
<td>2,500.00</td>
</tr>
<tr>
<td>2</td>
<td>20-Oct</td>
<td>Telefonica CTC Chile</td>
<td>Bank of America, Rabobank, RBS, BBVA, Citigroup</td>
<td>150.00</td>
</tr>
</tbody>
</table>

Source: Dealogic
### Top corporate bond issuers – Jan 2005 to Sept 2005

<table>
<thead>
<tr>
<th>Rank</th>
<th>Issuer</th>
<th>Value (US$ million)</th>
<th>Deals</th>
<th>% Share</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Pemex</td>
<td>5,737.60</td>
<td>8</td>
<td>18.0</td>
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<tr>
<td>2</td>
<td>Banco Bradesco</td>
<td>3,187.97</td>
<td>5</td>
<td>10.0</td>
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<tr>
<td>3</td>
<td>Telefonos de Mexico</td>
<td>1,747.71</td>
<td>2</td>
<td>5.5</td>
</tr>
<tr>
<td>4</td>
<td>Eli Lilly</td>
<td>1,500.00</td>
<td>1</td>
<td>4.7</td>
</tr>
<tr>
<td>5</td>
<td>America Movil</td>
<td>1,458.29</td>
<td>2</td>
<td>4.6</td>
</tr>
<tr>
<td>6</td>
<td>Unibanco Holdings</td>
<td>1,357.66</td>
<td>3</td>
<td>4.3</td>
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<tr>
<td>7</td>
<td>Companhia Siderurgica Nacional</td>
<td>1,210.25</td>
<td>3</td>
<td>3.8</td>
</tr>
<tr>
<td>8</td>
<td>Hegoasou Administracao</td>
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<td>3.3</td>
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<td>9</td>
<td>BSCH</td>
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<td>708.72</td>
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<tr>
<td></td>
<td><strong>Total</strong></td>
<td>31,927.13</td>
<td>120</td>
<td>100.0</td>
</tr>
</tbody>
</table>

### Top corporate bond bookrunners – Jan 2005 to Sept 2005

<table>
<thead>
<tr>
<th>Rank</th>
<th>Bookrunner</th>
<th>Value (US$ million)</th>
<th>Deals</th>
<th>% Share</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Credit Suisse First Boston</td>
<td>5,844.67</td>
<td>17</td>
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<tr>
<td>2</td>
<td>JP Morgan</td>
<td>2,942.97</td>
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<td>9.2</td>
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<tr>
<td>3</td>
<td>Banco Bradesco</td>
<td>2,894.94</td>
<td>7</td>
<td>9.1</td>
</tr>
<tr>
<td>4</td>
<td>Citigroup</td>
<td>2,269.69</td>
<td>16</td>
<td>7.1</td>
</tr>
<tr>
<td>5</td>
<td>BBVA</td>
<td>2,016.17</td>
<td>14</td>
<td>6.3</td>
</tr>
<tr>
<td>6</td>
<td>Deutsche Bank</td>
<td>1,681.24</td>
<td>6</td>
<td>5.3</td>
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<tr>
<td>7</td>
<td>Banco Itau</td>
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<td>11</td>
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<tr>
<td>8</td>
<td>Merrill Lynch</td>
<td>1,478.37</td>
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<td>4.6</td>
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<tr>
<td>9</td>
<td>ING</td>
<td>1,358.16</td>
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<tr>
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<td>Unibanco</td>
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<tr>
<td></td>
<td><strong>Total</strong></td>
<td>31,927.13</td>
<td>120</td>
<td>100.0</td>
</tr>
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### Top sovereign bond issuers – Jan 2005 to Sept 2005

<table>
<thead>
<tr>
<th>Rank</th>
<th>Issuer</th>
<th>Value (US$ million)</th>
<th>Deals</th>
<th>% Share</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Brazil</td>
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<td>8</td>
<td>41.2</td>
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<tr>
<td>2</td>
<td>Venezuela</td>
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<td>2</td>
<td>17.3</td>
</tr>
<tr>
<td>3</td>
<td>Mexico</td>
<td>2,193.01</td>
<td>3</td>
<td>13.0</td>
</tr>
<tr>
<td>4</td>
<td>Colombia</td>
<td>1,836.79</td>
<td>5</td>
<td>10.9</td>
</tr>
<tr>
<td>5</td>
<td>Peru</td>
<td>1,177.00</td>
<td>2</td>
<td>7.0</td>
</tr>
<tr>
<td>6</td>
<td>Uruguay</td>
<td>861.27</td>
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<tr>
<td>7</td>
<td>El Salvador</td>
<td>373.03</td>
<td>1</td>
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<tr>
<td>8</td>
<td>Jamaica</td>
<td>297.57</td>
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<td>9</td>
<td>Panama</td>
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<tr>
<td></td>
<td><strong>Total</strong></td>
<td>16,891.20</td>
<td>26</td>
<td>100.0</td>
</tr>
</tbody>
</table>

### Top sovereign bond bookrunners – Jan 2005 to Sept 2005

<table>
<thead>
<tr>
<th>Rank</th>
<th>Bookrunner</th>
<th>Value (US$ million)</th>
<th>Deals</th>
<th>% Share</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>JP Morgan</td>
<td>2,943.22</td>
<td>5</td>
<td>17.4</td>
</tr>
<tr>
<td>2</td>
<td>Deutsche Bank</td>
<td>2,887.87</td>
<td>8</td>
<td>17.1</td>
</tr>
<tr>
<td>3</td>
<td>Citigroup</td>
<td>2,700.11</td>
<td>7</td>
<td>16.0</td>
</tr>
<tr>
<td>4</td>
<td>UBS</td>
<td>2,287.53</td>
<td>5</td>
<td>13.5</td>
</tr>
<tr>
<td>5</td>
<td>Goldman Sachs</td>
<td>1,508.37</td>
<td>4</td>
<td>8.9</td>
</tr>
<tr>
<td>6</td>
<td>Bear Stearns</td>
<td>1,043.51</td>
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<td>6.2</td>
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<tr>
<td>7</td>
<td>Morgan Stanley</td>
<td>824.13</td>
<td>3</td>
<td>4.9</td>
</tr>
<tr>
<td>8</td>
<td>Merrill Lynch</td>
<td>776.88</td>
<td>3</td>
<td>4.6</td>
</tr>
<tr>
<td>9</td>
<td>Credit Suisse First Boston</td>
<td>541.10</td>
<td>2</td>
<td>3.2</td>
</tr>
<tr>
<td>10</td>
<td>Barclays Capital</td>
<td>457.96</td>
<td>1</td>
<td>2.7</td>
</tr>
<tr>
<td></td>
<td><strong>Total</strong></td>
<td>16,891.20</td>
<td>26</td>
<td>100.0</td>
</tr>
</tbody>
</table>

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New Financial Frontiers

by Maria O’Brien

With Latin America stabilizing and global markets in upheaval, the region has an opportunity to totally transform its capital markets.

On a bright Tuesday in late October, Roger Agnelli, chief executive officer of Brazil’s Cia. Vale do Rio Doce (CVRD), the third largest mining company in the world by market capitalization, visited the New York Stock Exchange. Agnelli, flanked by his finance and investor relations team, was there to celebrate CVRD’s five years as an NYSE listed company. Agnelli was justifiably proud that CVRD’s market capitalization had nearly quintupled to $50 billion and that the liquidity of its shares had increased tenfold.

But Fábio Barbosa, CVRD’s executive director of finance, was less proud of the company’s ill-fated recent attempt to issue a 40-year global bond. The issue was meant to highlight the company’s investment grade status and underscore its prowess as an issuer. Standard & Poor’s awarded the company a rating that pierced the sovereign ceiling in October, allowing it to be rated above the sovereign’s junk rating. Unfortunately though, there wasn’t enough demand for the underwriters, ABN Amro and HSBC Securities (USA), to price the bond competitively. That forced CVRD to scale back its ambitions and reopen its $500 million 2034 bond sold in January, which carried an 8.25% coupon.

“We have to make every effort to educate [investors] on the value of the company, because our bonds don’t reflect the value of the company,” Agnelli says. “Other mining companies are financing themselves 100 basis points cheaper than us with the same ratings. We have to work to show that we deserve a higher rating.”

The good news is that governments and corporates can make the most of an unusually positive economic outlook and growing financial sophistication in Latin America to rethink their approach to the markets and even reshape the way these markets operate. Investment banks are responding with increasingly sophisticated structures and opening up new sources of finance in regions such as Asia. Investors are reacting to the collapse in yields by searching out more complex, but also riskier, new structures and markets. Many are positioning themselves to make the most of the day – perhaps not so distant – when key Latin American issuers such as Brazil or Peru rid themselves of their junk status.

If Latin America continues growing, sustained by Asian demand for its commodities and natural resources, it is possible that Brazil, Peru and even Colombia could join Mexico and Chile as investment grade countries in as little as
five years. If this happens, the resulting stability would create a breeding ground for even stronger growth and innovation that would transform Latin America’s capital markets. This coincides with upheaval in the world economic system. Globalization, financial deregulation and fantastically powerful technology are transforming the world’s capital markets. Against this backdrop, freebooting hedge funds are constantly pushing forward the frontiers of finance in Latin America.

**Engines of Innovation**

Hedge funds have become important sources of finance in the domestic bond, equity, syndicated loan and private equity markets. Dirk Donath, managing director at New York hedge fund Eton Park Capital Management, which was launched in 2004, can invest up to 30% of the firm’s capital in long-term private equity transactions and illiquid deals, with particular interest in emerging market companies – the Cinderellas of Latin American finance. “There is enormous liquidity in the global financial markets and that is giving a false sense that it will be easy going forward,” says Nina Shapiro, vice president of finance and treasurer at the International Finance Corp. (IFC), the private sector arm of the World Bank. “It is important to note that the top-tier credits in the emerging markets are overbanked, spreads are very tight but the second-tier and other companies are really having trouble gaining access to long-term capital.”

Donath says he is often the first call bankers make when looking for strategic investors. “Traditional private equity firms can take six to nine months to make a decision. We can turn it around in a matter of weeks.” He says hedge funds are flexible about the stake they take in the company and the financing they provide. “If a company won’t sell a 51% stake, we can talk about taking a subordinated stake and providing mezzanine finance, a convertible bond, or a bond with warrants, which could earn us control over time.” Peter Getsinger, a former Deutsche Bank investment banker, set up hedge fund Nexstar Capital Partners in March 2004 to lend to and invest in mid-sized Latin American companies. Although his fund
Cover Story

LatinFinance December 2005

has invested mostly in distressed debt, he sees the most potential in financing second-tier companies neglected by Wall Street investment banks. “Hedge funds are much less constrained in their decision-making and therefore can act more quickly than the pension funds and insurance companies,” says Richard McNeill, head of global liability management and Latin American debt capital markets at Goldman Sachs.

Debt Strategy for the Future

At the same time, Latin American corporate issuers must devise sophisticated fixed-income issuing strategies to appeal to the much deeper but less worldly pool of investment-grade institutional investors in the US. Until now, many Latin American companies that have tapped the high-yield and high-grade markets in the US, have typically done so by placing their bonds privately with qualified institutional buyers using Rule 144a/ Regulation S bonds, which exempt them from registration under the US Securities Act for offerings and sales of securities outside the US. This has enabled them to raise capital overseas quickly and inexpensively. But the pool of investment-grade institutional investors that can support Latin American corporate bonds dwarfs that of qualified institutional buyers willing to buy emerging market corporate bonds in the 144a market.

As for investment grade issuers, it is logical for them to cultivate high-grade investors. AJ Medirratta, head of emerging-market debt capital markets at Bear Stearns, says that is why he would expect to see more Latin American companies filing shelf registrations to do full-blown plain vanilla bonds. Michael Lucente, head of Latin America at Merrill Lynch, says that once companies gain an investment grade rating, the pricing and the execution of their bonds becomes even more critical. “They will gravitate to the most experienced underwriters because they have to maintain and monitor every single basis point,” he says. Investors will be most interested in buying bonds from companies that have the most liquid issues and will therefore be important supporters of future bonds those issuers might sell. That means managing relations with fixed-income investors will become as important as relations with equity investors are for listed companies. “Meeting with the market consistently, educating investors on the credit as they do with the equity story, will be as important in the credit markets,” says Lucente. But improved creditworthiness alone will not open up new funding sources. Flexible, efficient and liquid markets also matter. Raising money in the global capital markets is a relatively straightforward proposition for big companies. For smaller issuers with access to capital limited to domestic sources of funding, developing efficient and liquid domestic markets in Latin America matters a lot. Fortunately, domestic markets are innovating rapidly.

Imagination and Deregulation

The São Paulo Stock Exchange, better known as the Bovespa, had the foresight and perseverance to establish the Novo Mercado as a market segment for companies adhering to the most stringent corporate governance practices. The Novo Mercado has emerged as a new source of capital for young companies. Mexican regulators are trying to do the same. A new capital markets law introduced by the government of Vicente Fox has already passed the Senate and is under discussion in the House of Representatives. It creates a new corporate model, a Sociedad Anónima Promotora de Inversión (SAPI). A SAPI company could list on Mexico’s stock market and have three years’ grace period to fully comply with the listing requirements of publicly traded companies.

The Bovespa has emerged as a hotbed of other innovations in recent years. It is launching a sustainability index of socially responsible companies in addition to its existing Ibovespa benchmark index and its IGC index for companies meeting high corporate governance standards. (See “Taking The Temperature,” p.40). The rest of Latin America will be watching it very closely,” says Rachel Kyte, director at the IFC’s environment and social development department. “The fact that the Bovespa thinks this makes business sense sends a powerful message to other centers of finance. It will be critically important in sending a signal that this is about good business in a developing country.” She adds: “Within a year I hope to see the first publicly listed sustainable private equity fund for emerging markets. Pension funds in Europe need to invest a large...
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proportion in sustainable ways and they are looking for fund managers who will subscribe to their values.”

Chile, which created the world’s first private pension funds in 1981, has been quietly innovating for years. Its pension funds fought and won battles to improve the treatment of minority shareholders. The Santiago Stock Exchange created a market for emerging companies in 2001 and won capital-gains tax exemptions for investors. Earlier this year, Latin America’s first hostile takeover took place in Chile. Chilean retailer Cencosud and conglomerate Quiñenco launched competing tender offers for control of Chilean retailer Almacenes Paris. Cencosud won, paying $602 million in stock for the company. And the Chileans continue to break new ground in infrastructure finance, crafting their own public-private partnership model that has raised $2 billion for toll roads through nine local market bond issues, secured on toll road receipts.

Managing Risk
Securitization has also transformed finance in Latin America in the last five years. Blue chips repackaged trade, mortgage and financial receivables and sold them to special-purpose companies that issued bonds, giving companies access to cheaper long-term financing because the bonds are backed by assets. Merrill’s Lucente now expects securitization to revolutionize access to finance for second-tier corporates. “Our experience around the world tells us that once [securitization] takes hold in the local markets, it will stay and grow, because if those assets are structured properly, they will perform well in a down macroeconomic environment.” Latin American companies also need to use more derivatives to manage risk. “Companies are at a disadvantage if they don’t have access to longer-term finance in local currency and to modern financial techniques such as hedging instruments. This lack of access makes it more difficult to compete,” says the IFC’s Shapiro. Local derivatives markets in Mexico and Brazil are liquid and deep in short-dated instruments such as currency and interest rate swaps, and Shapiro says developing long-dated derivatives in the local markets will be the next step. She says the IFC is working in 20 developing countries, including Russia and India, to help develop their derivatives markets. The IFC made a ruble-linked dollar loan to Russian Standard Bank and hedged it offshore in the derivatives market.

According to the Futures Industry Annual Survey for 2004, the Mexican and Brazilian derivatives exchanges rank in the world’s top 10 futures-only exchanges. The Mexican Derivatives Exchange, which has only been operating since 1998, traded 210 million contracts in 2004, a 21% increase on the year before, making it the world’s fifth largest exchange. Its leading contract, the TIIE 28-day interest rate futures, was the fourth most actively traded derivatives contract in the world last year. The Brazilian Mercantile and Futures Exchange, grew volume 52% to 183 million contracts last year and the Bovespa traded 235 million equity options contracts in 2004.

Arturo Cifuentes, managing director of structured products at fixed-income trading firm RW Pressprich, says collateralized debt obligations (CDOs), which include bonds and loans, enable financial institutions to pass on balance sheet risk to willing investors. He expects

Developing Liquidity

Liquid secondary markets are an essential feature of healthy local capital markets. But liquidity is a chicken-and-egg problem. Illiquid corporate debt is less attractive to investors when it is hard to price, which makes it less liquid and therefore harder to price. Market makers, or firms that commit to buy or sell a security in order to assure that the security can always be traded, do operate in Mexico and Brazil, but investors still complain that price discovery is difficult. Mexico’s Decimales, a proprietary inquiry-based electronic trading platform, allows dealers and institutional investors to trade fixed income and foreign exchange. In Brazil, several major banks provide single dealer quotes on local corporate bonds. MarketAxess, a leading electronic trading platform for US and European high-grade corporate and emerging markets bonds, is trying to bring more clarity to these markets by providing real time bid and offer prices from a broader number of market participants. The NASD Trace platform tracks corporate bonds for 160 emerging-market corporate issuers. MarketAxess tracks pricing on emerging market corporate bonds from 17 dealers. Richard McVey, MarketAxess chairman and CEO, says the company may cover local currency emerging market corporate bonds as well.
the new Basel II risk-based capital adequacy framework for banks will drive interest in CDOs. “CDOs could provide financial institutions in Latin America with an additional tool to manage their risk,” says Cifuentes. He thinks CDOs could revolutionize the consumer finance market by enabling banks to originate loans and then offload the risk to other investors, which frees them up for more lending. But interest rates in most countries would have to fall dramatically for this to be possible. Even in investment-grade rated Mexico, the overnight lending rate was as high as 9.25% at the end of October. Brazil’s overnight or Selic interest rate is a punishing 19%.

Rethinking Risk
Securitization could also be used to rid Latin American banks of bad debt. In 2004, Titularizadora Colombiana, Colombia’s first secondary mortgage company, pioneered Latin America’s first securitization of non-performing housing loans and the company wants to securitize fixed-rate loans, newly disbursed loans and mortgage products for consumers in the informal economy.

Evolving Sovereigns
Latin America’s aspiring investment-grade countries, Brazil, Peru and Colombia, are working hard to improve their attractiveness as a place to do business, stabilize their economies and pay down debt. They are working towards funding themselves more in local currency and less in the international markets “Through a series of liability management exercises, we have reduced our foreign debt to as low as 32% of total sovereign debt, from 50% in 2001,” says Ingrid Marlene Rodriguez, deputy director of public credit at the Ministry of Finance in Colombia. She adds: “The continuous reduction of exchange rate vulnerabilities will continue to be a key part of the government’s debt management strategy.” The Brazilian government took an important first step in September when it issued its first real-denominated global bond, raising R$3.4 billion ($1.5 billion) with a 10-year issue yielding 12.75%. JP Morgan and Goldman Sachs led the deal.

Richard McNeill, head of global liability management and Latin American debt capital markets at Goldman Sachs, says sovereigns could replace the book-building process for international issues with simple auctions, just as most Latin American governments already use in their domestic debt markets. Mexico, one of the emerging markets’ most sophisticated sovereign issuers, would be the best candidate to pioneer such a practice by using an auction format when it sells 30-year peso-denominated bonds this year or next.

The explosion of structured finance in Latin America and the success these structures have had withstanding crises have prompted rating agencies to rethink their ratings methodology. Vincent Truglia, head of sovereign ratings at Moody’s, says the agency is blending more structured finance criteria into its fundamental credit analysis. In February, Moody’s incorporated joint-default analysis into its ratings methodology to reflect government support for certain entities. This applies in particular to the ratings for stated-owned entities, which are based on the likelihood of government support if the issuer defaults. Moody’s also found that governments often went to great lengths to support local banks. With the exception of Argentina, defaults on bank local currency deposits are very rare. Moody’s applied its joint default analysis to 300 government corporations around the world earlier this year, many of which it then upgraded. “We are going to be extending that analysis to financial institutions, banks and eventually to local governments,” Truglia says.

Even regional development banks could learn from what other multilaterals and rating agencies are doing and start thinking more radically about how they finance their clients. “We have access to concessional finance that enables us to experiment, innovate and demonstrate and then we move on to the next innovation,” the IFC’s Kyte says. The IFC, which describes itself as a catalyst, is probably the most innovative multilateral, but regional multilaterals such as Corporación Andina de Fomento (CAF) and the Central American Bank for Economic Integration (Cabei) are following in its footsteps, deploying tools such as partial guarantees and capital market structures. A partial credit guarantee promises full and timely debt service payment up to a predetermined amount.

However, sophisticated markets require sophisticated investors. Educating regulators and domestic investors should be an important mission for multilaterals and development banks. “Latin America still lacks a full credit culture to allow for the evaluation of lesser credits,” the IFC’s Shapiro says.

A real measure of Latin America’s financial innovation will be the availability of credit in the international and local capital markets. Once credit is widely available to mid-sized companies, low-income consumers and even to workers in the informal market, an age of innovation truly will have arrived in Latin America. LF
Investment banking is a cut-throat business. As the forces of globalization advance inexorably, the industry consolidates and a league of corporate powerhouses concentrate their investment banking relationships in a diminishing group of elite firms that can offer the full range of financial services.

That means that bankers have to sweat harder than ever to meet their increasingly large – and demanding – clients. Investment banking has always been about the art of the deal, but as the banks themselves grow larger and more complex, senior bankers must stretch both to meet client expectations and to wring the most out of their own sprawling organizations.

James B. Quigley, president of Merrill Lynch International, clocked up 175 business days traveling to 27 countries between January and October. He has already packed his agenda for the first four months of 2006. Quigley says an important part of his job is making sure his teams work closely together “so that everybody is connected to real time decision making.” Communicating across regions, businesses and time zones requires, above all, a high degree of balance. “I think we do a good job of maintaining the integrity of the regional operating structure without compromising global agility,” he says.

New Products
Quigley says one of his challenges is to identify opportunities for product innovation. He points to Merrill Lynch’s $450 million securitization of workers’ remittances for government-owned Banco do Brasil as an example. It became the first Brazilian bank to securitize flows of international electronic money transfers, or MT-100 flows, in December 2001.

Merrill Lynch’s top international executive is positioning the firm for global competition – and explains where Latin America fits in.

Merrill Lynch rolled out similar MT-100 securitizations for clients in other parts of the world. “We were able to export that technology to other countries and replicate it for banks in Egypt, Turkey and elsewhere,” says Quigley. A year ago, Merrill Lynch drew on its deep roots in Asia, where it has built up a strong Japanese and Asia-Pacific retail franchise, to make a market for Latin American corporate perpetual bonds. In November 2004, the bank lead-arranged a $1.75 billion perpetual bond for Mexico’s national oil company Pemex with Citigroup and HSBC. The deal raked in $7 billion in orders and marked the first perpetual bond launched by an emerging-market issuer. Since then, Latin American companies have sold nine perpetual bonds in Asia, and Merrill Lynch has lead-managed six of them.

Latin American bond issuers have found ready buyers in Asia, giving them a new source of competitively-priced funding, while providing attractive yields to investors. Asia is also growing in importance as a vast new export market for Latin America’s commodity exports, with demand coming mainly from China. Says Quigley: “The Chinese government is focused on delivering economic growth and keeping the equilibrium growth rate of GDP at or above that 7.5% level.” This does not mean that Latin America should be complacent about its relationship with China. “The reality is that China will do what’s best for China,” he says.

China is also becoming an acquirer of Latin American companies, not simply purchasers of raw materials. In September, Canada’s EnCana, North America’s biggest independent oil explorer, sold its assets in Ecuador to a consortium of Chinese companies that included CNPC, the parent of PetroChina, the world’s fifth-largest listed oil firm, for $1.4 billion. The consortium fought off a rival bid for EnCana from India’s Oil and Natural Gas.

Asian companies are expanding at a furious pace as they build out global franchises, and Latin America needs to respond. “Latin American companies have got to be thinking about being global,” Quigley says. “It is very clear to me that once all the IPO business in China is completed in a couple of years’...
time, Chinese CEOs across every industry will be harboring the aspiration to develop global brands.” (See “Branching Out,” p. 30) This is no idle threat. Chinese companies are moving rapidly up the value chain. In May, Chinese PC computer company Lenovo Group completed the acquisition of IBM’s PC and laptop business for $1.75 billion. Merrill Lynch advised IBM, and Goldman Sachs Asia and Cazenove advised Lenovo in the deal.

Building Brands
Asian brands are becoming globally recognized, but Latin America lags far behind in terms of brand value. According to the fifth annual global brand ranking produced by brand strategist Interbrand with BusinessWeek Magazine, eight of the top 100 brands were Asian, with two of the three South Korean companies breaking into the top 100 for the first time. Not one Latin American company ranked in the top 100.

Quigley argues that creating a regional capital market would solve one of corporate Latin America’s biggest problems – finding low-cost, long-term local currency financing. Quigley points to the success of European capital markets in funding small- and mid-cap companies as an inspiration for Latin America. “Europe has one currency and one market, which is becoming increasingly sophisticated in the high-yield, small-cap and mid-cap sectors with hybrid capital available for family-owned companies that are not rated. There are all types of capital there for companies,” he says.

Latin American companies should also be thinking offensively. Companies with strong export flows to the US Hispanic market should think about acquisitions in the US market, which could serve as a springboard for global expansion.

Companies also need to start thinking more about using derivatives to minimize the volatility of their earnings. Indeed, these tools should become a core component of a company’s risk management strategy.
EKT commodities joint venture, which is through the acquisition of the former have a product set with commodities Industries’ Koch Energy. “I think we now venture between Entergy and Koch Entergy-Koch Trading (EKT), a joint commodities trading businesses of Merrill Lynch bought the energy coverage in this area. In November 2004, coincidentally, the firm is broadening by devastating hurricanes. Not and the Caribbean, regions regularly hit derivatives business in Central America Merrill Lynch’s commodities trading and Quigley sees an opportunity to apply weather derivatives to hedge out weather their total exports, should consider using agricultural exports are easily 80% of smaller Latin American countries where fundamental resources should think about hedging base metal risk.”

Broadening Coverage
Quigley sees an opportunity to apply Merrill Lynch’s commodities trading and derivatives business in Central America and the Caribbean, regions regularly hit by devastating hurricanes. Not coincidentally, the firm is broadening coverage in this area. In November 2004, Merrill Lynch bought the energy commodities trading businesses of Entergy-Koch Trading (EKT), a joint venture between Entergy and Koch Industries’ Koch Energy. “I think we now have a product set with commodities through the acquisition of the former EKT commodities joint venture, which is growing incredibly fast, and we need to leverage these capabilities for our Latin American clients.”

Quigley says Merrill Lynch wants to deepen its franchise in Latin America by extracting more from existing relationships and even by originating new clients in the underserved small and medium enterprises sector that Wall Street firms usually ignore. Says Quigley: “Because clients are increasingly finding it difficult to deal with a multiplicity of financial intermediaries, they are facing the same constraints we have with generating pre-tax margins, being more cost-efficient and more disciplined in the ways they manage their businesses. Companies are increasingly consolidating their business in the hands of the top five or so global firms that can provide complementary skill sets and capabilities.”

At the same time, competition from local investment banks is increasing. Merrill Lynch, like most other Wall Street firms, pulled back from Latin America in 2001 and 2002, triggering criticism from corporate clients that the big investment banks are not committed to Latin America. Local banks, such as Brazil’s Banco Pactual and Banco Itaú, stepped in to fill the void. Wall Street likes Latin America again, but the local firms aren’t giving up their business so easily.

Even while Merrill Lynch may have pulled back somewhat from Latin America, it still continued to dedicate resources there. The firm’s debt capital markets team in New York worked with Brazilian regulators to bring a succession of groundbreaking cross-border asset-backed deals to market. Merrill also launched the first Tier-One and Tier-Two hybrid capital deals for Latin American financial institutions. This includes the $300 million Tier-One perpetual offering for Brazil’s Banco Bradesco launched in June, which was the first perpetual bond sold by a Brazilian issuer and the first Tier-One bond deal ever done by a financial institution in Brazil.

But Merrill Lynch has slipped in the regional rankings in the past few years. According to research firm Dealogic, Merrill Lynch dropped from first place in Latin American equity underwriting in 2000 to 12th for the year through October. The firm has held a steadier position in debt underwriting, ranking fifth in 2000, fifth in 2004 and seventh for the year through October. And it is scaling the ranks in mergers and acquisitions advisory, climbing to fourth last year from sixth in 2000. Still, Merrill Lynch lacks scale and has been the target of takeover rumors for years from the likes of Swiss banking group UBS, Germany’s Deutsche Bank, HSBC of the UK and Bank of America in the US. Quigley expects more consolidation to take place in the financial sector as well, diminishing the number of competitors. “Merrill’s work at developing the local capital market becomes more important as access to local non-bank loan provided capital becomes more important,” he says. LF
Breaking the Mold

LatinFinance names the 20 innovators – bankers, business leaders, investors – who have reshaped Latin America’s capital markets in recent years.

Iinnovators

Jconoclasts, troublemakers and agitators are not always popular, but without the disruptive energy of natural-born innovators, change could never happen. We have identified 20 people who have made huge personal contributions to financial innovation in Latin America. Markets in the region have become more sophisticated and complex thanks to the efforts of these people.

Economic stability and deregulation are allowing markets to flourish, helping issuers raise long-term capital more easily and cheaply than ever, while giving investors greater choice and flexibility than ever before. An unusually prolonged period of economic stability, low interest rates and liberalization have created an environment that favors change. Even once-reviled hedge funds – considered the playthings of soulless speculators – have won broad acceptance.

Our group of 20 consists of investment bankers, government leaders, business executives, investors and academics. They are responsible for the legal breakthroughs, the creation of new asset classes and for building new financial markets from scratch. Together they have helped make Latin America one of the most exciting financial marketplaces in the developing world.

Nicolás Aguzín

Although he is not yet 40, Argentine-born Nicolás Aguzín is JP Morgan’s head of Latin America. He has had a meteoric career since joining JP Morgan in 1990. In 1996, he moved to New York to join the firm’s M&A group, covering the Latin American consumer industry. Five years later, Aguzín was appointed head of JP Morgan’s Latin American regional M&A practice. In 2004, he was made head of the bank’s Latin American investment banking group. It was on his watch that JP Morgan led the region’s first successful hostile takeover, a battle fought out this March on the Santiago stock market. JP Morgan’s client Cencosud, Chile’s leading supermarket chain, outbid its rival Grupo Luksic to take over department store operator Almacenes París, paying $602 million in stock.

Jorge Alegría

MexDer, Mexico’s fast-growing derivatives exchange, probably would not exist were it not for its energetic boss, Jorge Alegría. He has transformed the country’s capital markets by leading the shift from an over-the-counter derivatives system to a more transparent and liquid public market. The creation of a modern traded futures market has helped corporates hedge currency risk and pension funds manage the mismatch between their mainly short-term assets and long-term liabilities. Trading volumes soared following regulatory reforms starting in 2000, making MexDer the world’s 10th-largest futures and options exchange by 2003. Alegría introduced an options market in April 2004, where trading is heavily concentrated in an exchange-traded fund sponsored by the government’s development bank Nafin. This year, MexDer began offering equity-linked capital protected notes for pension funds to gain indirect exposure to Mexican stocks.

Pedro Aspe

From the heights of government – he was finance minister for Mexican President Carlos Salinas de Gortari from 1988 to 1994 – to the world of high finance, Aspe has been instrumental in bringing Mexico into the modern financial age. He signed the first Brady Bond deal in 1991, which ended the “lost decade” of the 1980s. After leaving government, Aspe started up his own firm Protego Asesores, which has evolved from a private equity shop to become the premier Mexican investment bank. Focusing on mid-market firms, with a typical investment of just $25 million-$30 million, Protego has brought attention to underfunded sectors, such as infrastructure, energy, and retail. In addition to raising funds for entrepreneurs through private equity investments, Protego now advises state and municipal governments in Mexico on bond issuance and restructuring.

Lee Buchheit

One of the first people a finance minister in distress calls is Lee Buchheit, partner at New York law firm Cleary Gottlieb Steen & Hamilton. Cleary Gottlieb specializes in complex debt negotiations. Buchheit won notoriety in 1999 by introducing exit consents in Ecuador’s debt restructuring. He won the government a 40% “haircut” by requiring investors sign away their rights under the old, defaulted bonds before they could take new performing bonds. This isolated holdout investors, preventing them from
blocking the deal. In 2003, Mexico adopted another Buchheit innovation by issuing the first emerging market dollar bonds with collective action clauses, which are meant to make bonds easier to restructure in a crisis. CACs have now become standard language in Latin American bond deals. Cleary Gottlieb also acted for Argentina when it ended its four-year debt default this year, handing investors a 75% haircut.

**Dirk Donath**

At a time when most private equity investors were too scared to get involved in Argentina, Donath and partners Michael Chu and Mario Quintana set up Pegasus Capital as an Argentine private equity fund. But Pegasus really made its mark by snapping up troubled over-leveraged companies from Exxel, once Argentina’s leading private equity investor. The firm’s investments in former Exxel companies like ice cream parlor Freddo and music retailer Musimundo have done well as Argentina recovers. Pegasus brought strong management, transparency and a focus on creating value for shareholders – values that are as rare as ever in Argentina’s business world. Donath has since quit Pegasus and moved back to New York to join Eton Park, the hedge fund. He will head the firm’s emerging markets private equity business, with a focus on Latin America.

**Mohamed El-Erian**

Investment bankers and issuers around the world probably leapt for joy when they heard that El-Erian was leaving his job at Pimco, where he ran the world’s biggest emerging market bond fund. Early next year he will begin managing Harvard University’s $25.9 billion endowment. El-Erian was feared in the markets for his power to make or break many a sovereign bond deal. He resisted the herd mentality that afflicts most investors, pulling out of Argentina well before others did. He took a calculated risk in 2002 that Brazilian bonds would bounce back strongly. El-Erian’s willingness to upset the status quo led him to challenge Rodrigo Rato’s candidacy to run the International Monetary Fund. El-Erian also critized investment banks and hedge funds, while pushing for a more transparent mechanism for pricing sovereign global bonds.

**Arminio Fraga**

He’s still best known outside Brazil for his inspired leadership at the Central Bank after the country’s traumatic 1999 devaluation and the 2002 election campaign when panic-stricken investors almost drove Brazil over the cliff. Since then, Fraga has become Brazil’s most sought-after money manager. His Rio de Janeiro-based Gávea Investimentos hedge fund, with $2.73 billion in assets under management, has earned annualized returns of 24% for its wealthy investors since Fraga opened for business in August 2003. Fraga is also more than a successful money manager. He has brought the sophistication, tools and vision of a global investor to Brazil’s inward-looking markets. He has made hedge funds respectable in Brazil. Fraga is on everyone’s shortlist for Finance Minister if the opposition kicks out President Luiz Inácio Lula da Silva in next year’s election.

**Gustavo Franco & Winston Fritsch**

After quitting as president of Brazil’s Central Bank, where he helped to halt hyperinflation, Gustavo Franco set up an investment banking boutique called Rio Bravo in 1999. The Rio de Janeiro-based firm has rapidly grown into one of the most innovative investment banks in Brazil. Later, Winston Fritsch, an academic, former government official and investment banker at Dresdner Kleinwort Wasserstein in Rio, joined the firm. The two go back a long time. They both served in government, and Fritsch was Franco’s academic adviser at Rio’s Catholic University in the 1980s. Rio Bravo has expanded into fund management, private equity and venture capital investments, M&A advisory and restructuring. It specialized in real estate investments and became a pioneer in sale and lease-back of commercial properties. The firm also launched securitizations of real estate receivables. Rio Bravo offered Brazil’s first REIT and the first securitization of hospital and college receivable flows.

**Enrique García**

The turbulent and chaotic Andean region has produced one of the world’s finest regional development banks, the Andean Development Corp. (CAF). The credit for this achievement belongs to García, who has run CAF since 1991. He rebuilt the bank’s finances, won it an investment grade rating and launched a series of innovative local market bond deals. CAF reopened the Japanese market for Latin American issuers in September with a three- and seven-year $180 million Samurai bond. CAF is now the biggest source of development lending for the Andean region, approving $3.2 billion in loans last year and posting a record $208 million in net profits. CAF is the highest-rated Latin American issuer even though its shareholders include troubled countries such as Bolivia and Ecuador.

**Pedro-Pablo Kuczynski**

The grand old man of Latin America’s financial markets, Pedro-Pablo Kuczynski breathed life into his native Peru’s parochial capital markets after he entered the government of Alejandro Toledo as economy and finance minister in 2001. In 2002, he orchestrated Peru’s first bond since 1928, raising $500 million. That opened the way for a succession of global and domestic capital market issues, such as this year’s $750 million 20-year bond and $462 million in 12-year local-currency bonds to partially refinance up to $2 billion in Paris Club debt. Kuczynski’s market-oriented reforms, a focus on infrastructure and trade liberalization – plus soaring commodity prices – made Peru one of Latin America’s fastest-growing economies and put it on track for a possible promotion to investment grade.

**Adam Lerrick**

Lerrick is an academic and former financier who was the brains behind ABRA, a vehicle created to represent individual holders of defaulted Argentine bonds. ABRA represented more than 30,000 investors in Germany, Austria, Switzerland and the Netherlands that held a face value of about $1.2 billion in Argentine bonds. He proved it is possible
to coordinate the interests of thousands of disparate investors in a financial crisis. Lerrick has also angered the bosses of the powerful Washington-based international financial institutions, such as the International Monetary Fund and World Bank, by attacking their approach to emerging market financial crises. Lerrick is an economics professor at Carnegie Mellon University in Pennsylvania, but he worked for years on Wall Street as an investment banker at Salomon Brothers and Credit Suisse First Boston.

Raymundo Magliano
Nurturing an equity culture in Latin America isn’t easy, but the São Paulo Stock Exchange, or Bovespa, has made impressive progress in popularizing equities under President Raymundo Magliano. The Bovespa launched the Novo Mercado in 2001 as a market segment for companies meeting stringent corporate governance standards. Ridiculed initially, the Novo Mercado has grown in popularity with issuers and investors and seen a rush of issuance in the past two years from companies such as cosmetics company Natura and e-commerce upstart Submarino. Novo Mercado companies have outperformed companies listed on main market. The Bovespa has also pioneered the adoption of special corporate governance and sustainability indices, encouraging investor support for enlightened capitalism. That marks quite a change from São Paulo’s former reputation as a haven for shady market practices.

Guillermo Nielsen
It can’t be pleasant to be hated by hundreds of thousands of investors around the world, but Argentina’s finance secretary made the most of his role as the bad guy following the country’s December 2001 default. However, even his opponents recognize that Nielsen played a poor hand well, defying pressure from the International Monetary Fund and the US Treasury to settle with bondholders. Instead he and his boss Roberto Lavagna, the economy minister, pushed through the most aggressive sovereign

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Michael Lucente
Although he didn’t invent the asset-backed security, Michael Lucente understood how securitizations and other complex structures could help Latin American corporates survive the rough seas of the 2001-2002 downturn. As head of emerging markets structured finance at Merrill Lynch, he led the adoption of future flow securitizations as a mechanism for Latin American banks and companies as a risk-mitigation tool, enabling them to raise capital cheaply when conventional markets had slammed shut. In 2001, Merrill Lynch led a $450 million securitization for state-run Banco do Brasil. In 2002, Brazilian private sector banks issued $1.5 billion in debt, even as Brazil teetered on the edge of bankruptcy. Now, asset-backed securities are becoming a cornerstone of domestic market issuance. Lucente was recently promoted to be Merrill Lynch’s head of Latin America.

CABEI RENEWS STRATEGY TO SUPPORT MSMEs

Micro, small and medium-sized enterprises (MSMEs) play a significant role in the development of the Central American countries. It has been estimated that this sector accounts for 33% of Gross Domestic Product (GDP), 97% of all enterprises and 44.5% of the Economically Active Population in the region.

For 20 years, the Central American Bank for Economic Integration (CABEI) has fostered and increased MSMEs access to lines of credit through its intermediary financial institutions (IFI). Today CABEI has 110 IFI and a MSMEs loan portfolio of US$196 million. In microfinance alone, it accounts for US$ 72 million of CABEI’s loan portfolio, channeled through 73 institutions to more than 400 thousand clients, namely women, in Central America.

Given the strong influence MSMEs have in the Central American economic and social sectors, CABEI has renewed its strategy to serve this sector and thus contribute to employment generation and poverty reduction in the region. This new strategy will focus on improving and increasing access to financial services; strengthening the development of financial institutions working with MSMEs, and contributing to the expansion, growth and productivity of the enterprises.

To expand and assure long term supply of micro financial services, the Bank will offer both funding and technical assistance to support institutional growth of its intermediary financial institutions.

With support from the World Council of Credit Unions (WOCCU), the Bank will also integrate the cooperative sector to the chain of intermediaries. Furthermore, as from April 2006, CABEI will have new financial products to support education and health of entrepreneurs’ family members.

With the objective of providing liquidity for small and medium-sized enterprises (SMEs) in the region, through factoring, CABEI has launched a productive chain project in the Central American countries aimed at developing, expanding, and increasing productivity of enterprises. The Bank expects to implement this program by mid 2006.

Through an active participation in the MSME sector, CABEI will reaffirm its presence and mission as development institution and key partner of the Central American countries to reduce poverty in the region. For further information, visit www.cabei.org.
innovators

debt exchange in modern history. Although Argentina imposed a 75% cut in principal, a substantial majority of bondholders still took the new bonds. Like it or not, Argentina proved that a sovereign can execute highly challenging debt exchange deals through the global capital markets.

Maria Otero
A leading proponent of microfinance, Otero has been president of Accion International, a US nonprofit dedicated to providing small-scale financial solutions to developing-world microentrepreneurs, since 2000. Otero, born in La Paz, has spent the better part of two decades advocating for microfinance, moving it from a fringe development issue to a multi-billion dollar business benefiting clients that otherwise have no access to financing. Accion has been at the forefront of efforts to bring the region’s poorest into the capital markets, through microfinance, land-titling, and innovative credit-scoring techniques. Accion has supported like-minded for-profits around Latin America such as Financiera Compartamos, a Mexican microfinance company that last year raised $16.6 million in five-year bonds partially guaranteed by the World Bank’s International Finance Corp.

Felipe Sardi
As director of public credit at Colombia’s Finance Ministry, Sardi launched the first of what has become a steady flow of global local-currency bond offerings by sovereigns and private sector issuers. Colombia’s $374 million-equivalent peso five-year issue in November 2004 was so popular that it was reopening two months later for an additional $124 million-equivalent. A 10-year $325 million issue followed soon after. The global issue reduced the government’s exposure to currency risk and lowered is $325 million issue followed soon after. The global issue reduced the government’s exposure to currency risk and lowered its TES bond curve. International investors like the bonds because they offer attractive returns – and currency risk – at a time when yield is evaporating. The new asset class became fully established after Brazil issued a $1.5 billion-equivalent real global bond this year.

Nina Shapiro
Vice president of finance and treasurer of the International Finance Corp., the private-sector arm of the World Bank, Shapiro put capital markets development front and center of the agency’s strategy from the time she was appointed IFC treasurer in 2000 and VP three years later. The IFC supported cross-border structured issues that mitigate risk and helped wake up Latin America’s somnolent domestic markets either through issues of its own, such as its pioneering local-currency issues in Colombia and Peru, facilitating derivative structures for corporates or by providing partial credit guarantees to support innovative local private sector issues. Shapiro argues that sustainable local-currency markets help private sector companies overcome their dangerous reliance on global markets, where they are exposed to currency and refinancing risk.

Carlos Slim
The world’s fourth-richest man amassed his $23.8 billion fortune through his amazingly shrewd business sense and carefully cultivated political connections. In 1990 he led a consortium that took over government-owned phone monopoly Telmex for $2.6 billion and built it into the country’s biggest company. He spun off its cell-phone operation as América Móvil in February 2001. Today, América Móvil is Mexico’s most valuable company, worth $45.6 billion. Slim has made millions from his holdings in distressed companies such as MCI of the US. However, Slim’s health has faltered and the future of his empire remains in doubt. Although his sons are now at the helm of his main businesses, Slim still runs these companies from the sidelines. One of his next projects is to launch Vuela, a discount airline, with fellow Mexican billionaire Emilio Azcárraga Jean.

Alberto Verme
Latin America has produced few financiers of truly global stature. Peruvian-born Verme has come a long way to become head of Citigroup’s Global Investment Bank, based in London. Verme used his Latin American roots to help win key assignments such as advising Mexico’s Cemex in its acquisition last year of British cement maker RMC and putting together a complex financing package for the $5.75 billion deal. Before his March 2004 promotion, Verme served briefly as head of Citigroup’s global power, energy and chemicals group. Before that, he led Citigroup’s Latin America Investment Bank. He oversaw the successful integration of Salomon Brothers with Citibank in Latin America. Verme joined Salomon in 1994 from Germany’s Metallgesellschaft. He began his career in finance at the World Bank in 1979.

Lorenzo Zambrano
Mexico’s visionary business leader turned a second-string cement maker into the country’s only truly global company. Cemex has become one of the world’s three biggest cement makers. Zambrano achieved this through a series of well-timed and skillfully financed acquisitions in Asia, the US and Europe, starting with two investment-grade Spanish companies. Cemex used these companies to finance subsequent M&A deals, culminating in the 2004 purchase of Britain’s RMC for $5.75 billion. Cemex has also become one of Latin America’s most financially sophisticated corporates, using advanced cash management, derivative and capital market tools. Zambrano and his senior management team have also created a highly sophisticated corporate culture that combines an obsessive pursuit of efficiency and economies of scale with an extensive use of advanced technology. Most companies dread post-acquisition integration. Cemex, on the other hand, approaches it scientifically, extracting considerable savings from even the best-run companies.
Key capital markets data over the past decade shows how Latin America’s debt and equity markets are benefiting from recent economic growth and stabilization. But compared to other emerging markets, there’s still a lot of ground to cover.

Do low interest rates help boost stock markets in Latin America? Chile’s low interest rates and its companies’ relatively high market capitalization prove the case. Brazil’s sky-high interest rates have held market development back.

Latin America’s equity markets are making a comeback, with issuance approaching its 2000 peak of $10.31 billion. Even so, this year’s $3.13 billion in initial public offering volumes are still a far cry from the $5.16 billion-worth of IPOs in 1993.

Argentina’s 2001-2002 economic crash killed the Buenos Aires stock market. There have been no equity issues in Argentina since 2000. Luckily, offerings in Brazil have surged even when its economy tanked in 2002. Investors in Mexico are also developing an appetite for equities.

Stock issuance in emerging Asia dwarfs activity in Latin America’s markets. Although Asia suffered in 2001 and 2002, South Korea, India and China have since come roaring back. China’s equity issuance so far this year is more than four times greater than that of Brazil.
Are Latin America’s debt and equity markets decoupling? Equity issuance in the region this year is up by half from 2004. Debt issuance is down by a third, even though interest rates are low.

Global debt issuance by key emerging market countries hit $97 billion through the end of October, up 15% over calendar 2004. Issuance by post-crisis Argentina is zero. Mexico is selling more bonds in its local markets.

Asset-backed bond deals made up 12% of Latin American debt issuance in 1995-2005. This year, these bonds have fallen to 8% of total issuance.

Corporate debt issues account for two-thirds of all Latin American debt so far this year, up from an average 55% since 1995.

Latin America is enjoying unaccustomed growth and stability, but its ratings still leave a lot to be desired. Debt ratios and hard currency revenues are inadequate, justifying junk rating for all but three sovereigns. But agencies have indicated they may upgrade Brazil, Colombia and Peru.
Stronger currencies and surging stock markets clearly go hand in hand. Brazil’s real and the Mexican peso have both recovered from recent lows, driving valuations in both countries’ equity markets. The real has risen by 77% against the dollar since its historic low in September 2002. Mexico’s IPC index has performed somewhat less exuberantly than the Ibovespa index, while the peso has moved sideways over the same period.

According to Morgan Stanley’s MSCI regional equity indices, Eastern Europe has enjoyed the strongest rally since the Dot-Com bubble burst. Latin American stock prices have not lagged far behind, leaving Asia in the dust. Asian equities have doubled in price since emerging markets fell in early 2003, but Latin American stocks have since risen 238%, faster even than Eastern European stocks.
Over a century ago, Johannes Heinrich Kaspar Gerdau quit his home in Hamburg and moved to southern Brazil. There he set up Pontas de Paris, a small nail factory, in 1901. Over the years, the company grew into a mid-sized steelmaker but was dwarfed by government-owned competitors that limited opportunities for growth at home. As Brazil slumped into the lost decade of the 1980s and frustrated by the limits on domestic expansion, Gerdau’s successors decided to invest beyond the country’s frontiers. They began by buying up companies in neighboring Uruguay and Chile first, and then in Argentina, Canada, and the US. These deals helped the company diversify away from Brazil and expand into attractive new markets. Today, Gerdau has seven operating companies from Argentina to Canada and has become the biggest producer of long steel products in the Americas. Gerdau posted $8.67 billion in revenue between January and October.

Many more Latin American companies – most of them Mexican – have since followed in Gerdau’s footsteps. Cemex, the Mexican cement maker, has gone one better and has become a key player in the US and Europe as well as in Mexico. But there are many less well-known companies that have spread beyond their home markets, and many more are likely to follow as the inexorable forces of globalization force open even the most protected markets. Those that fail to expand will become prey to multinationals both from the developed and developing world. Few businesses that have achieved a certain scale – usually once annual revenue hits $1 billion – can expect to remain independent or keep growing unless they, too, become multinationals. “In the globalization process there are actors and victims. The passive players will not survive,” says Rosalio Rodriguez, corporate executive vice president at Mexican food company Bimbo.

Modest Beginnings
Marcopolo, a Brazilian busmaker, became a market leader at home and then began modestly setting up production units in Argentina, Mexico, Colombia and South Africa. The company now has a unit in Portugal and is mulling an expansion into Asia. José Rubens de la Rosa, Marcopolo’s CEO, says: “First we looked at the markets that are close to us, but India and China are very important markets. Our decision is to go there eventually, but with a partner who has the same views as us. Technology and distribution are becoming commoditized, so what really matters are relationships, brands, reputation.”

A botched international expansion can drain companies of resources and management time. Bimbo expanded into the US in 2001 by paying $610 million for George Weston Brands, which brought it a portfolio of popular US brands such as Boboli pizzas and Entenmann’s cookies and cakes. However, the American subsidiary never made any money. Bimbo reacted by firing its senior US executives and replacing them with a new team. “At last we have started to post good figures. We are in the black at last,” says Rodriguez. The company still relies on Mexico for two-thirds of sales and nearly all its profits. This year, the US should generate about 25% of Bimbo’s $5 billion annual revenue and other Latin American markets should bring 7%. Instead of looking for new blockbuster acquisitions, Rodriguez says Bimbo is now targeting smaller foreign companies. In July, Bimbo paid an undisclosed amount for Comestibles Lalo, a Colombian regional food company based in Barranquilla.

Finally, Latin America is realizing that more of its companies should invest internationally to harness the forces of globalization and consolidation.
Despite the efforts of these pioneers, corporate Latin America is struggling to keep up with competitors in Asia as they continue to globalize at a terrifying pace. Unctad, the United Nations trade and development agency, says companies based in developing Asian countries posted an astounding $69 billion in outward FDI flows in 2004. But Latin American companies invested just $10.94 billion in foreign markets. Five years earlier, companies in both regions invested roughly the same amounts overseas. These figures are affected by broader economic factors, and as Latin America recovers, investment patterns – inbound and outbound – are likely to pick up. Furthermore, Michael Klein, chief economist at the International Finance Corp. (IFC), the World Bank’s private sector arm, says there is a clear link between the pace of microeconomic reforms – which directly impact companies – and the volume of a country’s outward investments. Microeconomic reform in Latin America has lagged far behind progress by Asian countries.

Gavin Wilson, a managing director at Goldman Sachs International, agrees that a positive domestic business climate stimulates offshore investments. He says the “strength of a country’s economy, the depth and sophistication of its financial system and the vibrancy of local corporates are driving companies to invest abroad. You really need a deep domestic financial market for corporates to get more [active in] M&A by giving them access to finance.”

Finding the Funds
This trend is surprising, since most developing countries are starved of capital and need to invest carefully in their domestic markets to fuel growth. It seems to make little sense for companies based in a country as poor as Brazil or Mexico to invest their profits abroad,
Council of the Americas. Working actively with our 170 corporate members throughout the Western Hemisphere.

Founded by David Rockefeller in 1965.

SAVE THE DATE


The premier event focusing on the Americas in Washington, D.C. Speakers in the 2005 program included Secretary of State Condoleezza Rice; Secretary of Defense Donald Rumsfeld; Secretary of Commerce Carlos Gutierrez; the Minister of Foreign Affairs of Singapore, George Yong-Boon Yeo; and the Minister of Development, Industry and Commerce of Brazil, Luiz Fernando Furlan.

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especially in a developed country, when they could be creating jobs and helping raise the standard of living at home. But this view is losing ground as economists and business executives come to see that a company’s health increasingly depends on investing around the world. Governments are encouraging the process and even development agencies such as the IFC advise and finance companies’ cross-border investments. Indeed, the IFC held a two-day conference in Mumbai in November, convening business leaders from Asia, Africa and Latin America, to debate the subject.

Mexico’s development agency Nafin and Brazil’s BNDES development bank are both beginning to offer financing and other assistance to companies expanding internationally. João Furtado, an adviser at BNDES, says the bank will finance foreign deals to support mid-market companies’ growth strategy in the belief that growing companies create jobs at home.

Contrary to conventional wisdom, companies are not expanding internationally just to diversify away from their domestic markets. If companies were really seeking to avoid risk, they would surely try to buy assets in developed countries where consumer demand, currencies and interest rates are relatively stable. Marcopolo’s de la Rosa points out that most Latin American multinationals are expanding into volatile Latin American countries because they prefer to operate in markets they understand even if this does expose companies to considerable risks. “Our business in Argentina was excellent. We were doing really well and it was our best market,” de la Rosa says. “Then along came 2001 and our market stopped. Sales went from 1,000 units to zero. We halted production at the plant in Argentina and all that was left there was a guard dog.” It has taken Marcopolo four years to rebuild its business in Argentina.

Companies with a broader portfolio of international subsidiaries can spread risk better. Alfredo Carvajal, president of his eponymous family-owned printing and paper products company, is an example. Carvajal is based in Cali and has 12 companies and 40 divisions in industries that range from pulp and paper to back office electronic procurement systems scattered around Latin America, the Caribbean and Spain. Carvajal says he is happy to live with risk and volatility as long as the combined company can generate reasonable profits. “Sometimes we can make a lot of money in a place like Brazil as we are now, so I love Brazil. Other times it is hard to make money there, but then I will probably be making money in Mexico or in Colombia, so it all balances out.”

Currency Risk
Managing currency risk is obviously an important part of running any global company. However, de la Rosa says this usually complex challenge can be simplified. He says that after expanding into South Africa, Marcopolo struggled to manage three volatile currencies – the Brazilian real, South Africa’s rand, and the US dollar. He gave up trying to satisfy investors by using the dollar as the company’s reporting currency and simply stuck to reais. “Investors have to accept that they are invested in Brazil, in reais, and accept exposure to the currency,” he says.

However, Latin American bosses say their biggest headache is finding good managers. De la Rosa, Bimbo’s Rodríguez and Carlos Piedrahita, CEO of Colombia’s Nacional de Chocolates, all agree that finding financing is less of a problem than recruiting senior executives. Nacional de Chocolates has expanded into Central America and was anxious to hire a non-Colombian as a top marketing executive. Piedrahita hired a firm of headhunters to find a suitable candidate from somewhere in Latin America. Disappointed by the candidates on offer, Piedrahita wound up hiring in Medellín. “Our biggest problem is human resources. I want to have more entrepreneurs in my company. You can’t just go out and buy people whenever you want to. It’s not like buying companies,” Piedrahita says.

Who’s Really in Charge?

This year’s $7.8 billion sale of beverage company Bavaria to SABMiller, a London-based brewer, did not mean that Colombia’s biggest company suddenly surrendered its identity to a faceless multinational. The sale was a combined cash and stock deal and as part of the sale, the Santo Domingo family – the controlling shareholders before the SABMiller acquisition – took a 15% equity stake in the merged company and took two seats on SABMiller’s board in London. The deal put the Colombians in charge of the group’s Latin American business, allowing the Santo Domingos to keep managing the family business as part of a stronger global group.

The Bavaria deal was modeled on a similar sale last year of AmBev, Brazil’s dominant brewer and soft drinks producer, to Interbrew of Belgium. AmBev’s three main shareholders sold their controlling stake to Interbrew for $4.1 billion-worth of stock in the merged company, now called InterbrewAmBev (InBev). Executives from AmBev and Interbrew each have four seats on the InBev board. InBev is headquartered in Leuven, Belgium, while AmBev is still based in São Paulo.

But why did a London-based company with roots in South Africa and a centuries-old Belgian group become global consolidators instead of Bavaria or AmBev?

André Parker, managing director at SABMiller, has an answer. “Being in London meant we were in the heart of the international financial system and our stock became well-known and could be used as a currency in acquisitions,” he says. South African Breweries moved its primary listing to London in 1999, raising £300 million. SABMiller’s stock is included in the London Stock Exchange’s benchmark FTSE 100 index. In 2001, SAB became the first international brewer to enter Central America when it acquired Honduran brewer Cervecería Hondureña and formed a joint venture with El Salvador Beverages Business, a brewery and soft drink distributor. A year later it took over Miller Brewing of the US for $3.6 billion in stock and another $2 billion of assumed debt, in a deal that transformed SAB into a truly global player.
Remittances to Latin America are growing at double-digit rates – more than three times as fast as the region’s economic growth. The Inter-American Development Bank (IDB) says the flow of remittances to Latin America has doubled in the past four years, to an estimated $55 billion this year.

Until recently, wire transfer companies dominated the lucrative remittance business, charging fees of 10%-20% to process transfers. Now, banks and financial institutions are trying to muscle in. They want to grow the industry by using remittance flows as a base for a portfolio of financial products marketed to customers in Latin America and the US. But the banks are having trouble attracting this potential new business, and so the banks are largely still missing out on this growing market.

Remittance payments are greater than foreign direct investment flows or export revenues in many countries. Millions of low-income families rely on cash from relatives in other countries to make ends meet or put children through school and college. Mexico is the biggest recipient of this money, because there are now 11 million Mexican immigrants living and working in the US, predominantly in California and Texas. According to the IDB, three-fourths of all remittances to the region come from the US, and almost 40% of them go to Mexico.

Remittances have grown by 10% a year over the past five years, despite economic downturns in both the US and Latin America. “The equilibrium growth rate is in the high single digits,” says Dan Schatt, a senior analyst at financial advisory firm Celent. Banks have recognized these flows as a way to get cheaper financing. Securitizations of payment flows are becoming increasingly common. Guatemala’s Banco Industrial issued $200 million in securitized notes, backed by international remittance flows, at the end of September.

Money from Europe
While US-Mexico transfers are now the world’s largest remittance market, one of the banks that has shown the greatest advances in developing Latin American remittances is across the Atlantic, not the Rio Grande. Don Terry, manager of the IDB’s Multilateral Investment Fund (MIF) says ties between Ecuadorian microfinance bank Banco Solidario and savings banks in Spain are an outstanding example for US banks to follow. Ecuadorians began emigrating to Spain in the late 1990s, and Terry says some would mail peseta notes to support family and communities back in Ecuador. Their envelopes rarely made it past the Madrid airport.

Banco Solidario began establishing relationships with Spain’s cajas de ahorro or savings banks, many of which were built on handling remittances sent home by Spanish workers in the UK, France and Germany before Spain joined the European Union in 1986. Since 2002, Ecuadorian emigrants can transfer money without charge between their accounts with savings banks in Spain and their Banco Solidario accounts. Wire transfer companies would charge up to
Ecuadorian immigrants in Spain transferred $120.4 million through Banco Solidario in the three years through July 2005, and they deposited $7.8 million, or 6% of that figure, into savings accounts.

Most innovative, however, are the mortgage and loan products Banco Solidario has rolled out for its emigrant clients and their families. Establishing a network of four sales offices in Spain and one in Italy, Solidario’s Vivienda Propia mortgage program is designed to allow immigrants in Europe to start saving for property in Ecuador with as little as $40 to start. When 30% of the value of a home (which can cost as little as $20,000) has been accumulated, the immigrant can buy a house, with the balance financed through a Banco Solidario mortgage. Starting with just five houses financed in 2002, Solidario expects this program will have provided mortgages for a total of 798 houses by the end of this year, with 350 expected for this year alone. Under another program, Banco Solidario will lend out $10 million in 2005 to the families of immigrants in Spain, with loans averaging $1,300 each. Families in Ecuador can apply for a similar loan by providing the paperwork from the last three remittances received from a relative in Spain. Banco Solidario also says it is working with international banks on a pilot program to replicate its Spanish arrangement in the US.

Follow the Leader

Other banks are expressing interest in Banco Solidario’s experience. Bob Annibale, global director of the Citigroup microfinance group, says that Citigroup is working closely with Banco Solidario. According to Annibale, clients will prefer banks that offer additional services, such as serving families on both sides of the money transfer.

“Remittances connect the finances of a family in two countries. The quality of service and products offered by an institution in the beneficiaries’ country will influence the decision of remitters as to who they bank with and send money home through.”

But banks have a lot of ground to cover to catch up to the US incumbents – money transfer companies such as Western Union Financial Services. Such companies process 80% of remittances leaving the US, according to Celent. The four largest firms – Western Union plus MoneyGram International, DolEx Dollar Express and Vigo Remittance – still control over 40% of remittance flows leaving the US. Banks, by contrast, only handle 3%-5% of the flows. This is in part because many of those who use remittances avoid the formal banking system. About 38% of all remittances from the US are sent by undocumented immigrants, according to a study by research firm Bendixen & Associates. These immigrants are afraid of being identified and possibly deported if they were to apply for a bank account.

Even legal immigrants, or those with identification cards issued by Mexican consulates in the US, are not responding to bank efforts to attract them. Among the banks with a presence in the US and Mexico, Bank of America, HSBC and Citigroup offer no-fee transfers, while Western Union charges $10 to send $200 to Mexico. Of the 4 million Hispanics that bank with Bank of America, half still use transfer companies to wire money home, Schatt says. “Some customers don’t look at price – they look at convenience, trust, and reliability,” as deciding factors, he says. “[The wire transfer...]

**Turned Away at the Door**

Wire transfer companies live or die by their ability to process data. “The data center is the nerve center of the operation,” says Dan Schatt of Celent, a consultancy. Data centers record transactions, provide anti-money laundering scrutiny, and route the transaction to the appropriate distribution point.

The fourth largest wire transfer company, Vigo Remittance, was hit hard when Hurricane Wilma barreled across Florida in October, disabling its sole data center. Vigo says its data center was out of action for five days, forcing it to turn customers away at sales points around the world. That was a bitter pill to swallow for shareholders in First Data, the owners of the largest wire transfer company, Western Union Financial Services. NYSE-listed First Data completed the purchase of Vigo only three days before the transaction to the appropriate distribution point.

Still, damage may have already been done. Turning away customers erodes trust and reliability, which are crucial to build loyalty in the remittance business. “People sending remittances aren’t time sensitive – they can wait a day or two,” says Schatt. “But after three or four days of going out of their way [to try to send a remittance], they will go to someone else. And once they do, they might not come back.”

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*Figure: IDB*
companies] have the locations, hours and simple applications that are right for these clients.”

This price insensitivity means that even though competition has driven transfer fees down – Western Union used to charge $40 for $200 transfers in the late 1990s – the fees are expected to remain. “The market is so fragmented, even with competition the price won’t go to zero,” says Schatt, who expects the price for transferring $200 from the US to Mexico to level off at about $8. That still provides a very profitable gross margin of 4%.

Some banks’ efforts to tap into the remittance market have included buying banks in California and Texas to gain a foothold in those Hispanic markets. Spain’s BBVA bought two US banks over the past two years. Other banks are already leveraging their existing infrastructure, which includes payment cards and ATMs. Bank of America established its SafeSend program for its cards and ATMs. Bank of America infrastructure, which includes payment card that has had similar difficulties – the bank won’t disclose the number of clients in the program. “We recognize that it’s a process,” says Stephen Cohen, a spokesman for the bank. “That said, we feel it’s been successful.”

There are limits to how successful card-based programs can be in attracting remittance flows to banks, however. Familiarity with ATM machines is high in some markets such as the Dominican Republic and Colombia, where over 80% of respondents to a Bendixen & Associates survey in 2004 said they were “familiar” with ATMs, and 68% of respondents in a 2003 Mexico survey said so as well. But in other countries the numbers are much lower. Only 37% of Salvadorans are familiar with ATMs, and fewer than 30% of Hondurans and Guatemalans responded positively to similar surveys in 2003. And in crime-ridden Central American countries, pulling several hundred dollars out of an ATM machine can be a major security concern. Recipients – usually women or the elderly – are more comfortable receiving money at a store they are familiar with. “Physical cash movement in Latin America is important,” says Schatt.

Don’t Spend It All in One Place

According to the Inter-American Development Bank (IDB), remittance flows make up more than 10% of the GDP of small economies such as Nicaragua, Jamaica, Haiti, Guyana, El Salvador, and the Dominican Republic. But remittances are not an unalloyed benefit to a country’s economy. “Remittances are an indicator of a failed development strategy,” says Don Terry, manager of the Multilateral Investment Fund at the IDB. “There aren’t enough jobs in Latin America and the Caribbean, and there’s a need for labor in North America and the EU.”

And while the flow of hard currency should drive growth and diversify hard currency revenues in countries that rely on raw material exports, the money can also trigger higher imports of consumer goods. Says Shelly Shetty, senior director at FitchRatings: “In fact most of [the receipts] are going into consumption and higher imports.”

This is probably not the case in larger countries, Terry says. “People assume remittances all go towards immediate consumption, when in reality 15%-20% on average goes to other spending. That 20% is equal to $10 billion – more than the IDB lends in a year.” Over half the remittances to Brazil and Bolivia go to spending on non-consumption items, such as financing small businesses, housing, education, health care and pensions. About 35% of small businesses in Mexico have some funding from remittances. In the Dominican Republic, 17% of all remittances to go to education – more than the government spends on schools and colleges.

Some banks have begun to address this issue, such as Citigroup, which through its Banamex subsidiary is one of the largest banks in Mexico. Citigroup’s Annibale explains that Banamex has started offering remittance services outside its branches through its Banamex Aquí program. Banamex has signed up about 700 third-party outlets that provide many of the same services as bank tellers, as well as receiving remittances, Annibale says. These agencies are in high-traffic locations such as gas stations or low-traffic rural areas that lack bank branches, and often stay open beyond usual banking hours.

Banks should have better luck gaining market share in money transfers if they are presented as a bundled package of services to immigrant communities. “Remittances are about more than just a transfer,” says Annibale. “They are the centerpiece of a wider relationship.” These packages can include credit cards issued both in the US and the recipient country, with the bill coming to the US client. Other credit card products can channel a given percentage of transactions to a local community development fund in the immigrant’s home country. Cohen says that HSBC’s Easy Send product develops, the bank is planning to use it as a platform to sell additional products, such as credit cards and mortgages, in the first quarter of 2006.

As the remittance business attracts both sides of the family – senders and receivers – that makes for a large number of potential business relationships for banks. “Around the world there are 125 million people sending remittances to support 500 million people,” says IDB’s Terry. “That’s a tenth of the world’s population involved in this.” As many of these people aren’t banked, getting in on the remittance game in an intelligent way is a great opportunity for banks to expand their client base and bottom line.
An Awkward Renaissance

by John Barham

Argentina’s economic collapse of 2001-2002 was a catastrophic event for millions of ordinary Argentines, not to mention hundreds of thousands of bondholders around the world. It was also a disaster for the private equity industry. Investors had stampeded into the country in the late 1990s, snapping up everything from cable TV operations to ice cream parlors, in the belief that market reforms and a stable currency would deliver strong economic growth. But the crash turned these investments to dust long before they could be offloaded at a profit to deep-pocketed multinationals. Many of the private equity firms involved in these deals closed down or left Latin America.

Finding Value
That long winter is drawing to an end, although the focus of attention has shifted away from Argentina to Brazil and Mexico. And this time, investors say, nobody is taking leave of their senses by buying into weak companies at the top of the market. US-based private equity firm Advent International closed its Latin America Private Equity Fund III in October, easily hitting its $375 million target. In May, Washington-based emerging markets investment firm Darby Overseas Investments closed its $175 million Darby-BBVA Latin American Private Equity Fund, focusing principally on Mexico, Brazil and the US Hispanic market. In Brazil, São Paulo-based investment firm Stratus Investimentos is fundraising for a new private equity fund.

Firms are focusing instead on value, looking at resilient industries and concentrating on countries that are less likely to unravel than Argentina. Says Richard Frank, CEO at Darby Overseas Investments in Washington: “There is increased interest in private equity investing in the emerging markets, especially Asia and Latin America are benefiting from this. In the shakeout after 2001-2002, some investors were hit hard and they are coming back now. They are the survivors so there are a smaller number of [private equity] companies in business, but they are getting more attention now.”

According to the Latin American Venture Capital Association, private equity funds raised $1 billion to invest in the region in 2004 – the best year for Latin America since 2000 – and that figure will likely be similar or slightly higher this year. Venture Equity Latin America, a specialist publication, says that in the first half of 2005, private equity and venture capital funds invested over $560 million, closed on over $441 million in fund raising and took in more than $720 million from sales of companies. The industry’s performance in Latin America is so vigorous that dealmaking in the first half of the year came close to the totals for the entire year in 2003 and 2004.

Asian Tigers
Although the pace of private equity activity in Latin America is certainly picking up, its recovery pales in comparison with Asia. Investors’ fascination with Asia, especially China, remains as intense as ever. Last year, private equity firms raised $2.8 billion to invest in Asia, or just more than half
the total funds raised for the emerging markets, according to the Emerging Markets Private Equity Association (EMPEA). Investors have committed $8.9 billion for Asia, or three-quarters of the global total, for 2005. It’s easy to see why: investments in Asia achieved $9.7 billion in net realized capital in the first half of 2005 and posted mean internal rates of return of 54%.

The Hunt for Yield
But Ernest Bachrach, who runs Advent’s Latin American business, says Latin America has some important strengths that are obscured by the region’s mediocre economic growth record. “Latin American service sector companies are growing in an environment where the macroeconomic scene is not really the whole story,” he says. “It’s not like Asia, where manufacturing is driving growth. Here it is services that have grown a lot, and that’s been our story in the last 10 years.”

Money is dribbling back to the region anyway because it is beginning to look more attractive. Years of rational economic policies are paying off with stronger currencies, lower interest rates and gradual if unspectacular growth. Above all, investors everywhere are hunting for yield, and exposure to medium-sized Latin American companies in growth sectors could pay off handsomely. However, Alvaro Gonçalves, partner and director at Stratus, says fundraising can still be a struggle. “International investors lost track of Brazil for a while and our first presentations on the new fund were more about changes in the investment environment,” he says. “Since 2001, Brazil has introduced new corporate and bankruptcy laws, approved arbitration and the stock market has a corporate governance index and a new small-cap segment.”

Still, he reports increasing interest by investors who are starting to travel to Brazil scouting investment opportunities.

However, a survey by EMPEA says that investors still see Latin America as a far less attractive place to invest than Asia or central and eastern Europe. EMPEA found that distance, instability and the difficulty of exiting investments are the main deterrents to investing in the region.

Playing it Safe
Those that do invest generally play safe. Advent focuses on service companies that can generate cashflow and revenue growth of 30%-40% annually. Stratus will focus on middle-market companies and hopes to post dollar returns of 30% a year. Since the collapse in Argentina, leveraged buy-outs have evaporated. Interest rates are still too high in most countries – especially Brazil – to justify LBOs, and refinancing risk remains very high. Investors, especially foreigners, often insist on control either by holding a majority of a company’s shares or through a shareholders’ agreement. On the whole, private equity firms prefer low-risk industries that may lack the allure of a high-tech venture, but can reliably generate substantial volumes of cash. Given the substantial risks of
investing in a turbulent region, it makes little sense to double the risk by backing businesses with an uncertain future.

Advent, for instance, owns Central Lav, Brazil's largest industrial laundry. All its Mexican investments are in services, ranging from recently-acquired mortgage lender Hipotecaria Casa Mexicana to Dufry, the world’s fourth-largest duty-free retailer. The latter asset is a nice fit with another Advent property, Inmobiliaria Fumisa, which controls the commercial operations at Mexico City’s airport – the largest airport in Latin America. In July, Advent took over Nuevo Banco Comercial, Uruguay’s largest commercial bank, at the head of a syndicate of co-investors that includes Morgan Stanley Alternative Investment Partners and two of Europe’s largest development banks, FMO of the Netherlands and Germany’s DEG.

Advent did not disclose terms of the purchase.

Brazil’s Role

Most of the excitement is in Brazil, both because it has the region’s best-developed local private equity industry and because it has a wealth of promising but undercapitalized medium-sized businesses. A decade of market-oriented economic policies has convinced investors that an upheaval of Argentine proportions is becoming more improbable by the day. Brazil also has the region’s best-developed stock market, which has allowed some private equity investors to exit through the public markets. This matters, because IPOs generally deliver better pricing than traditional trade sales to bigger competitors that know their markets well and are less prone to overpaying. Last year’s launch of Gol Linhas Aéreas Inteligentes, a São Paulo airline, on the New York and São Paulo stock markets was Brazil’s best-planned and most successful IPO in years. Gol has grown fast, and is now the country’s second-largest airline. Its shares have doubled in price in dollar terms since the IPO.

GP Investimentos, Brazil’s pioneering private equity firm, has taken companies such as online retailer Submarino and railroad operator ALL public in the last two years. Submarino raised approximately $175 million via an IPO on the São Paulo Stock Exchange’s Novo Mercado, selling just less than half its equity in March. Credit Suisse First Boston lead managed the deal. Submarino was backed by such blue chip private equity firms as TH Lee Putnam Ventures, Goldman Sachs and Warburg Pincus, in addition to GP.

The São Paulo Stock Exchange’s Ibovespa benchmark index is up 42% in dollar terms this year and trading volume has increased 60% to $750 million a day. Although Latin America’s stock markets are among the most volatile in the world, even seasoned investors are considering more seriously using the public equity markets as an exit strategy. They say that while valuations and trading volumes are being driven up by the global liquidity glut – foreign stock investors are very active in São Paulo and Mexico City – there are major structural changes in the markets that will affect the private equity industry positively.

Darby’s Frank says that the markets in Brazil and Mexico in particular have become less vulnerable to catastrophic crashes or unsustainable booms. “The domestic markets in Brazil and Mexico are gaining in depth. Portfolio managers there are driving this. An IPO in Mexico these days would be 50% foreign bought, but instead of waiting for a US listing, they will make a play on a Mexican company by going directly to the local markets.”

Given the industry’s past reputation for excess and overindulgence, it is perhaps encouraging that the big players still left over from the bust of 2000-2001 are playing it safe.

So Near, Yet so Far

Progress in private equity in Mexico is disappointing given its considerable advantages as an investment destination. It has an investment grade rating, a stable currency and a free trade agreement with the US. Yet, Federico Patiño, deputy director general at Mexico’s government-owned development bank Nafin, says that the lack of a clear policy supporting private equity investment, limited general knowledge within the country and limited number of specialists is a hindrance. Investors complain that Mexico needs to strengthen minority investor rights. Plans to introduce a new corporate structure known as a Sociedad Anónima Promotora de Inversión (SAPI) is advancing slowly through Congress. SAPIs would offer stronger investor rights and allow them to go public without having to meet the stock exchange’s full listing requirements for three years.

The country still lacks an appropriate US-style vehicle for limited partners to invest in private equity, which has forced funds to incorporate offshore – often in Canada – adding to the cost and complication of doing business in Mexico. Although government officials recognize this is a serious problem, they have yet to decide on a new structure for private equity funds in Mexico. Still, the government is planning to set up a fund of funds to consolidate its disparate private equity investments in a single semi-autonomous fund that would channel financing to privately managed private equity firms.

Mexico’s pension funds barely invest in listed shares so it is no surprise that they spurn private equity, unlike Brazilian or Chilean funds that already hold a sliver of their portfolios in private equity vehicles. However, the government has ruled out any relaxation of rules limiting pension-fund investments in private equity.
Taking the Temperature

by Michael Thomas Derham

At the beginning of December, the São Paulo Stock Exchange, or Bovespa, rolled out a brand new stock index tracking companies that sport a “triple bottom line.” In addition to earning healthy profits, companies must have adopted – and actually meet – strict standards for social and environmental responsibility to win inclusion in the Bovespa’s Corporate Sustainability Index (ISE). This follows the launch in June of ITAG, another Bovespa index that tracks Brazilian companies that offer minority shareholders enhanced tag-along rights.

While traditional Wall Street emerging markets benchmark indices, such as JP Morgan’s EMBI fixed-income indices or Morgan Stanley’s MSCI equity indices, have received the most attention from international investors, some of the most innovative index products are coming from the emerging markets themselves, particularly Brazil.

Besides the ISE and the ITAG, the Bovespa has also developed a series of indices to complement its benchmark Ibovespa index, which tracks 80% of the stocks traded on the Bovespa. The Ibovespa is rebalanced every four months based on the average market capitalization of the previous 12 months. In September the Ibovespa comprised 57 stocks from 49 companies.

The Bovespa’s IBX-100 and IBX-50 indices track the 100 and 50 most-traded shares weighted by their free float. Additionally, just like many exchanges around the world, the Bovespa has dedicated specialized indices for certain industry sectors. Its IEE index tracks 12 electric utility stocks and the ITU index tracks 23 telecom shares.

Working with Valor Econômico, the São Paulo business daily, in 2001 the Bovespa also created the IVBX-2 index to track less familiar, but still fairly liquid, stocks such as Brasil Telecom, Eletropaulo, and Embraer. “The IVBX-2 is made up of 50 stocks, ranked by liquidity, excluding the 10 most liquid companies and the 10 largest firms in terms of market capitalization,” says Neuris Vojciechovski, supervisor of market research at Bovespa. “Valor wanted to measure ‘second tier’ companies.” The higher risk of smaller-capitalized companies is rewarded with a higher return, more than double that of the Bovespa since the IVBX-2 launched.

Quality, Not Quantity

The Bovespa also has developed what Vojciechovski describes as “qualitative” indices – such as the sustainability index or the IGC, the corporate governance index. The IGC, created in 2001, tracks all companies that list on the Bovespa’s Novo Mercado, a growing section of the main stock market that is reserved for companies – 17 so far – that meet strict corporate governance and liquidity requirements. Most Novo Mercado companies have listed since 2004, but the Bovespa also offers less demanding Level 1 and Level 2 categories for established companies unable to radically overhaul their governance structures. The IGC index is weighted by market value and is multiplied by a value representing each company’s corporate governance category. Novo Mercado companies carry a double

Market indices have multiplied in the past years, offering investors hundreds of different ways to measure their returns. Why so many?
weight in the index, Level 2 companies one-and-one-half times, and Level 1 companies are counted once. “The purpose of this index is to see if there is a connection between good governance and performance,” says Vojciechowski. There certainly is. Since the IGC index was launched in mid-2001, it has returned 229%, outperforming the Bovespa by 70 percentage points.

In response to constant shareholder complaints about inadequate minority rights in Latin America, in June the Bovespa launched yet another index, the ITAG, to track the performance of companies that offer enhanced shareholder rights. The 44 companies included in the ITAG give investors tag-along rights in a takeover at 80% of the price offered to controlling stakeholders, higher than the 60% mandated by Brazilian law. ITAG has increased 32% since then, better than the Ibovespa in the same period.

The most recent addition to the Bovespa’s stable of indices is the ISE, tracking the 40 companies that best meet sustainable business criteria, weighted according to their free float. The Bovespa drew up the criteria in consultation with a variety of groups, including the International Finance Corp., the private-sector arm of the World Bank, the Brazilian Environment Ministry, and the International Pension Fund Association.

How It All Began
Investment banks and stock exchanges are always devising new and increasingly complex indices, allowing investors to track the development of new market segments and gain exposure to them. Indices are also an important way to track the performance of managers who earn significant fees to handle client money.

Investors’ fascination with emerging-market indices started with the creation of the JP Morgan Emerging Markets Bond Index, or EMBI, which has become the benchmark of benchmarks for fixed-income investors. It was introduced in 1992 just as investors began growing more and more excited over the promise of big profits in the developing world.

“Ten to 15 years ago, people didn’t know what ‘emerging markets’ were. The EMBI defined the asset class,” says Gloria Kim, vice president at JP Morgan in charge of the Emerging Markets Bond Index Group. The EMBI gives investors and market observers an instant read on how each of the emerging markets are doing. But dollar-denominated sovereign credits are no longer the headline credits in the emerging-market fixed income market. The new fad is local currency global and domestic markets issues that have attracted investors desperate for yield. The Brazilian government’s $1.5 billion equivalent, 10-year real-denominated global bond issued in September shows how fast sovereigns have shifted from hard-currency to local-currency issuance as yield-starved investors show appetite for currency risk. The Brazil local-currency bond is yielding 12.5% compared with 7.3% for the 10-year dollar bond issued in June. Additionally, investors are looking at corporate bonds. The region’s largest corporate issuers, such as Mexican cement giant Cemex, Brazilian mining company CVRD, or Chilean copper miner Codelco, are becoming increasingly larger parts of fixed-income portfolios.

As markets change, so new indices appear. In June, JP Morgan launched its new Government Bond Index-Emerging Markets (GBI-EM), in response to investor demand for global local currency bonds. In emerging markets, hedge funds have become a force driving the market, and Lehman Brothers, Standard & Poors, and Credit Suisse First Boston among others have all unveiled indices to track hedge funds. Wall Street investment banks are looking into launching emerging-market corporate bond indices starting next year. Such an index would reflect the maturity of emerging markets and the rise of several Latin American corporates as global competitors in a variety of sectors.

But not all investors are convinced that these indices will catch on as the EMBI or the São Paulo indices have.

The Business of Indices
Most investment banks provide indices as part of a research portfolio and do not expect to earn significant revenue off the product. “It’s like any research area,” says Nick Gendron, global head of index products at Lehman Brothers. “It’s adding value, but quantifying that can be tricky.” But with high-paid investment bankers on staff to manage these indices — Lehman has nearly 30 people in their index products division — the bottom line quickly becomes important.

JP Morgan, Lehman, and other banks have contracts with third-party vendors such as consultancy securities software firm Wilshire Associates allowing Wilshire to provide index data to investors that are using Wilshire software to manage risk. JP Morgan says it generates a small revenue by providing index data to data vendors, but its main business is trading the underlying securities that are included in the EMBI. And for firms that build indices, there is a lucrative trade in helping institutional investors, such as pension funds, develop new portfolios.
“These are being rolled out at a time that emerging markets are doing well,” says Andrew Feltus, manager of the global high yield fund at Pioneer Investment Management. “But local currency [issues] perform worse during times of crisis.” Feltus thinks that the true test of whether these new indices will become benchmarks will come when the market turns and investors are no longer looking at local issues.

Institutional investors use indices primarily as benchmarks to measure the performance of their portfolios and portfolio managers. “We use them to give our clients an idea of how we’re doing,” says Feltus. “An index represents how other [managers] are investing.” JP Morgan’s Kim says the GBI-EM was designed to meet a simple need. “If our clients are pitching a local currency instrument [to investors], they need a proxy for performance,” she says. Nick Gendron, global head of index products at Lehman Brothers, notes that investors use indices to track risk. Modeling software allows investors to measure the volatility of a given portfolio against a benchmark index. “Investors need to understand where performance comes from,” he says.

But Gendron says investors are also using indices to structure their emerging-market investments. He identifies a transaction called a total return swap as one way in which investors can use an index to enhance the returns of a conservative portfolio. In the swap, the investor exchanges the total return flows from the targeted index for a more vanilla flow, such as a spread over Libor.

**Index Swaps**

Total return swaps can also be used when investors do not wish to be actively involved in portfolio or risk management on a day-to-day basis. This can be because investors are unfamiliar with the underlying issuer risk in individual bonds or because they do not have a large enough cash amount to be properly diversified. “Let’s say you have $40 million you want to invest in a market,” says Gendron. “You could buy 10 or 15 bonds but would have lots of issuer risk.”

Aggressive investors can create more complex tools such as “portable alpha” strategies using indices. Portable alpha is the strategy by which the alpha – a measure of an investment’s risk-adjusted performance – and beta – the measure of an asset’s risk in relation to the market – are split. The alpha is “ported” to another portfolio using derivatives. For example, an institutional investor could invest in Brazilian equities and sell Ibovespa futures, stripping away the Bovespa beta and leaving the Brazilian equity strategy alpha. This could then be combined with a portfolio, or futures replicating that portfolio, that the investor is more comfortable being exposed to, such as US Treasuries. This allows investors to gain a higher investment return from a less liquid market while limiting exposure to the volatility of that market. But anybody attempting such a strategy might not get the yield they are hoping for. “Portable alpha [proponents] are demanding Libor plus 300 [basis points],” says Feltus. “That’s difficult to achieve consistently – I think 200 is risky.”

The development of specialized indices complements the growing breadth of the largest indices – Lehman Brothers expects that its Global Aggregate Index, its broadest index of fixed income securities, will cover $1 trillion in managed assets this year. The creation of innovative indices by Bovespa can open the way for other local stock exchanges – such as the Mexico City Stock Exchange and the Buenos Aires Stock Exchange – to spark a greater interest in

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**Tracking the Hedge Funds**

The rise of hedge funds and their outperformance over other more traditional investments is drawing attention. Increasingly, investors are seeking to track these funds and invest in them. Hedge fund indices are sprouting up to meet this interest. Credit Suisse First Boston launched the first asset-weighted hedge fund index two years ago, and Lehman Brothers launched one index-tracking fund in September.

Hedge funds are secretive about their investments and performance, so CSFB teamed up with fund of funds manager Tremont Advisers and Lehman joined up with [HedgeFund.net](http://www.HedgeFund.net) to provide indices that track the performance of hedge funds. Tremont and HedgeFund.net collect data on the hedge funds and the joint venture uses that data to devise the indices.

One of these indices, the CSFB/Tremont Investable Index, began in August 2003, is rebalanced only semi-annually, priced monthly, and manages to stay liquid by restricting itself to funds with no lock-up period and which are not US-domiciled, among other restrictions. Nick Gendron, global head of index products at Lehman, says his firm only tracks hedge funds that are larger than $25 million in assets. He says the firm can “create slices of the index with higher thresholds than that.”

Liquidity is a concern for hedge funds, as they are often small and invested in illiquid instruments. Often it’s difficult to change an investment in a fund of funds, and investment banks are offering investments in hedge fund indices as a more liquid alternative. Ultimately, these indices are designed to get investors involved in them.

“We want to create a product you can invest in,” says Lehman’s Gendron, who expects to launch an investable index in 2006.
Memories are short in the financial markets, as Argentine multinational Grupo Techint proved when it raised $1.38 billion in July 2005 to support its acquisition of Mexican steel company Hylsamex. BNP Paribas, HVB, HSBC and Citigroup were mandated to arrange and syndicate the three-tranche loan to 16 banks. The facility was split between a $500 million three-year bridge facility, a $500 million five-year term loan and a $380 million three-year term loan.

The transaction was a milestone for three reasons. First, it marked the comeback of an Argentine corporate to the syndicated loan market after the country’s economic crisis. Second, it was the largest bank loan ever structured for an Argentine borrower. Third, it highlighted how banks see lending as a hook to win more lucrative additional business.

It is unlikely that Grupo Techint could have pulled off such a feat, if it weren’t a multinational with operations in four continents. Fernando Aftalion, executive syndications director for Latin America at Rabobank International in New York, spoke at LatinFinance’s syndicated lending roundtable in New York in November. He says the transaction proved that “banks are willing to look at companies on a standalone basis and disassociate them from sovereign risk. Local banks in particular look at these companies on the strength of their credit and their global business.”

Acquisitions such as Grupo Techint’s purchase of Hylsamex are breathing new life into a market that collapsed in the wake of Argentina’s default. Latin American companies are making the most of abundant liquidity in the syndicated loan markets, while banks struggle with thin margins.

Latin America’s strongest corporates are making the most of abundant liquidity in the syndicated loan markets, while banks struggle with thin margins.

Round table participants debate the future of syndicated loans.
dwindling as margins shrink, maturities lengthen and syndicates contract. Capital markets in Mexico, Chile and Brazil give top-tier corporates wider financing options than ever before. Miguel Siliceo, CFO of Mexico’s government-owned trade finance bank Bancomext, says life was a lot harder a decade ago. “After the peso devalued in Mexico in December 1994, it was impossible to get money for Mexico at any price. These days, Bancomext can borrow unsecured long term loans for just 20 basis points over Libor,” he says. Bancomext refinanced a $300 million term loan facility earlier this year, shaving 35 basis points off its first tranche to reduce its margin from 55 basis points to 20 basis points over Libor. It halved its margin on its second tranche to 35 basis points over Libor from a split margin of 70 basis points to 80 basis points over Libor. It maintained its three-year maturity on the first tranche and five-year maturity on the second tranche.

Siliceo expects the pressure on pricing in the syndicated loan market to continue. He says: “The local markets are putting pressure on the syndicated loan market. For the best corporates, Mexico’s peso bond market is their main source of funding.” Daniel Seiner, managing director at Miami-based BroadSpan Asset Management says: “We see borrowers having large amounts of power most evident in pricing being very, very tight. It’s very hard for an investor to invest. The value these days is finding an asset that really pays you for the risk. Experience tells us that in bad times, all borrowers do badly. In Argentina, for example, the good companies went down with the bad companies. Why should I buy the tightest loans in the market?”

**Capital Market Competition**

And bankers doubt that Latin America’s election season will tip the scales back in favor of lenders. Jean-Philippe Adam, managing director of Latin America credit markets at Calyon Securities, says: “The threat to the syndicated loan market comes more from alternative sources of funding than from upcoming election cycles. The loan product is under pressure from other sources of funding such as the local debt markets, securitization and even the equity markets.”

In the more mature markets of Mexico and Chile, where blue chips have driven down pricing in the bond markets, they are still the focus of syndicated lenders. According to Thomson Financial, investment-grade rated Mexico accounted for 59% of loan volume distribution in Latin America in the first nine months of this year, compared to 36% in the same period in 2002. Chile remains level at 9% for this first nine months of this year and the first nine months of 2002. Brazil now accounts for 18% compared to 25% in the first nine months of 2002.

Rubens Amaral, chief commercial officer and general manager of Bladex, the Latin American trade finance bank, says: “With non-investment grade borrowers, banks make a much better return. In countries like Brazil with a high concentration of non-investment grade borrowers, the conversation is probably more on the banks’ side, where you have higher returns.”

Bankers expect Brazilian companies to drive demand for loans next year as corporates take advantage of Brazil’s improving creditworthiness to refinance more expensive debt. Indeed, some of Brazil’s blue chip companies already boast investment-grade ratings. Raul Campos, investor relations manager for Petrobras, says investment-grade Brazilian companies are taking advantage of the opportunity to drive down their cost of funding by refinancing outstanding obligations for cheaper, longer-dated debt.

Mexico’s blue chips led the way in 2004 and 2005. Mexico’s fixed-line telecommunications company Telmex refinanced and increased a $2.24 billion unsecured facility to $2.5 billion, pushing out the tenors on its two tranches to four and six years, while trimming pricing by 15 basis points and 10 basis points on each tranche. Mexican cement multinational Cemex refinanced an $800 million senior revolving credit facility and reduced it to $700 million while cutting 20 basis points and 25 basis points off its three- and five-year tranches.

**Margin Squeeze**

Pricing for blue chips in Mexico and Chile has fallen to such lows that weaker credits are beginning to demand better conditions on their pricing too. Says Calyon’s Adam: “We have seen second-tier companies in Brazil asking us to match the loan packages for first-tier companies, and that just doesn’t make sense.” As a result of margin pressure, some banks are questioning their mission as lenders in Latin America. Says Wilmer: “We see certain banks staying out of the primary syndication and picking deals up in the secondary market if they make more economic sense.” According to Loan Pricing, a syndicated loan market data company, banks have fled the market. At its peak in 1997, 215 banks were active in the market. That number fell to 139 in the first nine months of 2005.

Banks that cannot compete in local currency will be marginalized. In Mexico, a growing number of syndicated loans are in pesos. Marco Solís, head of corporate banking in Mexico for Rabobank International, says: “The secondary banks in Mexico have a lot more funding than they had a decade ago. International banks used to just target the big credits, but they are growing more aggressive in talking to secondary corporates. If you are an international bank without peso funding in Mexico, it is a severe handicap.” Solís says dollar funding is still in demand in Mexico because...
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Mexican interest rates continue to be more volatile than Libor rates. Dollars are also more attractive, because it is cheaper for companies to borrow in dollars and swap the loan into pesos in Mexico’s fast-growing and highly liquid currency swap market.

Wilmer says the pressure on margins is changing a market once driven by relationships. He says: “I think banks are becoming more transactional and more opportunistic, as margin compression and lower returns force them to reevaluate the overall profitability of client relationships.”

Amy G. Dulin, corporate counsel at Hughes Hubbard & Reed, says some borrowers are also taking advantage of the liquid environment to demand less stringent documentation. For example, one borrower recently tried to negotiate dispensing with the Libor meltdown clause, which is designed to provide a framework for parties to a lending contract to follow if Libor cannot be determined. “Typically, it would allow the agent to go out and poll pre-determined reference banks to get a Libor rate or would allow the borrower and agent to negotiate to come up with alternative funding, or would provide a generic reference to a lender’s cost of funds,” Dulin says. “This is an example of how some borrowers are trying to move away from some of the market formalities that are in place and this could be a dangerous trend.”

Growing the Middle Market
Other banks are seeking out new relationships by venturing into the middle market. Marc Brito, senior syndication officer at FMO, the Dutch government development agency, says he sees many opportunities in financing second-tier companies in Latin America that are overlooked by commercial banks. In November, FMO closed a $60 million syndicated loan for an orange juice producer in Costa Rica. FMO arranged the loan and syndicated it to four Central American banks. FMO has been providing subordinated loans as part of its loan packages, but now wants to syndicate subordinated loans to parties interested in providing the quasi equity product. Brito doubts commercial banks would be participants. He says: “Funds experienced in providing mezzanine financing and the European Developmental Financial Institutions (EDFI), a group of European development banks, are more likely to participate.”

Naturally, going down market has its hazards. Aftalion says bankers should pay attention to the structure of ownership and succession, the quality of management, how highly leveraged a company is and its access to funding. Many lenders will not even show their credit committees deals involving companies that are not audited by international auditing companies. Investors such as BroadSpan’s Seiner see opportunities with middle-market companies in countries such as Mexico and Brazil, where structure and security packages can be used to mitigate risks. But Dulin cautions that “as banks move into the second tier, the lenders have a responsibility to make sure that these borrowers, who may not be as sophisticated or familiar with the international market as first-tier borrowers, have an understanding of market standards and what they were agreeing to.”

Seiner says new investors such as private equity funds, asset managers and hedge funds are becoming increasingly important players in the syndicated loan market because unlike commercial banks, few are restricted by country or credit limits. Indeed, hedge funds help Latin America’s nascent secondary market for syndicated loans. Seiner says hedge funds are growing as participants in the secondary loan market where borrowers are often unaware that their relationship banks are selling their loans to hedge funds. Dulin says borrowers still have legal recourse to their lenders, even if they sell their participations in a loan on to a third party. She says: “Typically the borrower will demand that the lender has to retain the decision-making authority for most matters so that the lender stays on the hook, which is important when you start selling participations in the loans to the private equity market and hedge funds.”

Rabobank’s Aftalion says greater competition in the syndicated loan market is forcing banks to become more innovative. “The pressure on fees and margins is forcing bankers to think more creatively in terms of structures, distribution and originating new business. We are no long thinking in terms of the pure loan syndication proposal but the whole suite of debt products.”

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The Midas Touch

by Leslie Hillman

M exico may boast some of Latin America’s biggest companies, but equity issuance has been becalmed for years. The country had only three equity offerings raising $508.8 million in 2004, according to securities research firm Dealogic. In comparison, last year Mexican companies did 91 debt deals worth $24.7 billion.

But this year, companies have been hitting the stock market in quick succession. Through mid-November alone, 10 companies had completed stock issues, making 2005 the most active year for equity deals since at least 1996. Among the companies taking the plunge were two Mexican construction ventures led by tycoon Carlos Slim. In mid-September, Grupo Financiero Inbursa, Slim’s financial services arm, spun off its construction concession development business into a publicly traded company called Impulsora del Desarrollo Económico de América Latina (Ideal), distributing 3 million Ideal shares to existing Inbursa shareholders. And on Oct. 21, Slim’s Grupo Carso sold 620 million shares in its construction company Carso Infraestructura y Construcción (Cicsa) in an IPO, raising 4.7 billion pesos ($431 million).

Ideal was one of only three spin-offs in Mexico in the past decade, according to Dealogic. The Cicsa deal was Mexico’s largest initial offering since broadcaster TV Azteca made its market debut in 1997 in Mexico and New York, bringing in $526.2 million. However, Cicsa’s shares were sold only on the Mexico City Stock Exchange. “Usually deals this size have a Mexican component and an ADR component,” says Enrique Garay, managing director of equity capital markets at Mexican brokerage Accival Banamex, which joint managed the IPO. “It’s a breakthrough in doing a deal this size only on the Mexico City Stock Exchange.” Garay says Banamex distributed about 80% of its allotment to domestic investors.

Inbursa was lead manager for both the Ideal spin-off and the Cicsa IPO but picked three joint managers to work on the Cicsa IPO in addition to Banamex. Shareholders liked both deals because they brought fresh blood to the Mexican stock market, as well as offering exposure to Mexico’s booming construction sector. The government is expected to award $17 billion in contracts for highways, dams and other projects through the end of next year alone. But Mexico only had one publicly-traded construction company, Empresas ICA.

“Before, if you wanted to participate in the sector you only had ICA. Now we have three companies,” says Luis Garilbay, director of equity funds for BBVA Bancomer. Garilbay owns both Cicsa and Ideal. “Even though they are not exactly alike, you have more basis for comparison, and it also allows you to invest in other names.”

The Slim Factor

Ideal traded as high as 47% above its opening price of 5.80 pesos in the month following the spin-off. Investors were attracted by the chance of cashing in on fat government contracts and by the mystique of the Slim name. “Don’t underestimate the Slim name in Mexico,” Garay says. But investors may have gotten ahead of themselves. Carlos González, equity strategy analyst at IXE Casa de Bolsa, held Ideal shares for the firm’s own account but sold them about one month after the spin-off.

“There are other issuers that we believe will bring us better returns,” González says. He says Ideal still has to back up its high valuation. “When you buy a company you buy their assets. In the case of Ideal, the assets are basically four highway contracts and a lot of cash,” he says. “With that cash they are going to acquire additional highway projects and manage them. But in reality, you are really just buying an expectation” that other contracts will follow, he says.

Cicsa shares are little changed since the IPO but they were priced high, González says. He also sold IXE’s Cicsa shares in November, in order to buy retailer WalMart de México. González says that Cicsa’s shares are attractive in part because its profit margins are higher than ICA’s, but that could change as Cicsa starts competing for government contracts. “If they want to grow through federal government projects, their margins will have to be lower,” he says.

Carlos Slim’s recent equity deals helped diversify the Mexican stock market and cap a year of heightened equity activity. But have his stocks done too well?
Telefónica del Perú issued global notes in soles, providing a new segment of investors access to the phone company’s debt.

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Telefónica del Perú issued a 754 million soles ($227 million), 10 1/2-year bond to foreign investors in early October, the first global local currency issue by a Latin American unit of Spain’s Telefónica telecommunications group, and the first publicly traded issue by a non-financial company in Latin America. The issue allowed Telefónica del Perú to tap into a new group of investors and diversify its investor base in Europe and the US.

Demand for yield allowed the company to lower initial pricing guidance on the notes by 25 basis points to 8% and still issue the notes at par.

Telefónica del Perú has issued soledenominated bonds in the Peruvian markets for years, but there was a limit to local investors’ appetite for its longer-tenor bonds. “The local market has developed in the past year, but only out to five to seven years. Telefónica [del Perú]’s longest-dated domestic debt is a six-year note,” says Fermín Álvarez, the company’s chief financial officer. The local market would not have been able to handle a placement as large or as long as the October issuance, he says. “In Peru until last year there wasn’t even a 10-year reference bond at the sovereign level.” Telefónica was concerned that not having enough benchmarks would make it hard for investors to price its bond and might affect its liquidity, he says.

Group Policy
Telefónica del Perú decided to issue in soles anyway, in keeping with the group’s policy of issuing debt in local currency, says Álvarez. “As a telecommunications company, most of our income is in soles. And while we do have some income in dollars – from our cable TV and broadband Internet franchises – that income is sensitive to domestic economic performance and the dollar exchange rate.” The money raised from the issue will go towards paying $92.3 million in debt that comes due in 2005, with the balance financing operations and capital expenditures.

Bookrunner Citigroup marketed the bonds to emerging market investors in the US and Europe. “We didn’t do a roadshow in Lima, because local investors were already familiar with Telefónica del Perú,” says Luis Nuñez, director of debt capital markets at Citigroup. In fact, Peruvian investors contributed 18% of the $550 million order book and took 27% of the bonds.

Nuñez says that being part of the larger Telefónica group made investors in the US and Europe more comfortable about buying the issue, allowing the bonds to be priced 166 basis points above Peru’s sovereign 2016 notes. The notes were rated ‘BB’ by Fitch, the same rating garnered by the sovereign.

Telefónica played up its support for its subsidiary in Argentina during that government’s 2001-2005 default as a selling point. “During the Argentine default, Telefónica de Argentina never stopped paying on its dollar-denominated notes,” Nuñez says.

Hedge Funds
Telefónica del Perú also allowed hedge funds such as London’s BlueBay Asset Management to get in on the deal. Álvarez says that while he is comfortable with hedge funds owning his bonds, he sought out a certain type of fund. “We were looking for investors to provide stability. We were willing to go with hedge funds that do fundamental analysis, but not those looking to flip the notes.” Three weeks after the issue, the bonds were trading at par.

Still, Telefónica’s Álvarez says he is hesitant about repeating this type of issue anytime soon. “The option is always there, but we have no plans to issue globally again.” He notes that this market did not exist before 2004, and it could disappear as quickly as it arose. “If [US] Treasury spreads go up, that can destroy this local currency market” for global investors, he says. That risk makes it difficult for Telefónica to develop a financing strategy that includes Euro-sol issues. But the global market can be a good complement to local issuances in Peru. Issuing in the local market is simpler, quicker, and should be meant for smaller placements, says Alvarez. The global market, on the other hand, will be saved for the big deals. LF
How does the fund work?
It is a fund that invests principally in dollar-denominated bonds of Latin American companies covered by US and English law. It is the first closed-end fund that enables Latin American institutional and retail investors to invest in dollar bonds issued by investment-grade and below investment-grade companies. Latin American corporate bonds have been one of the best investments over the last 10 years, with an average annual rate of return of 9.9%, a risk of 11.4% as measured by standard deviation of monthly returns and a Sharpe ratio, or risk volatility ratio, of 0.5%. That compares favorably to Latin American equities, which posted an 8.4% annualized rate of return over the same time period, a risk ratio of 24.8% and a Sharpe ratio of 0.7%.

When did you launch the fund?
Moneda’s fixed income Latin American investment fund, Moneda Deuda Latinoamericana, was launched in 2000 at an initial amount of $12 million. The shares in the fund were sold to Chilean institutional investors such as pension funds and insurance companies. Since 2000, we have done successive share offerings. These successive share offerings, coupled with the funds’ strong performance, have boosted assets to more than $200 million. In October, we raised another $35 million. This operation allowed Moneda Deuda Latinoamericana to quadruple its number of shareholders to 370.

What is unique about this fund?
It opens up this kind of investment to retail investors, broadening the investors that will support corporate fixed income in Latin America. Because the fund exceeds the 25% equity threshold required by Chilean tax regulations, it is eligible for capital gains tax relief. For small investors, this is the only tax-efficient way to invest in Latin American corporate fixed income. Previously, they had very limited access to these types of bonds. They had to invest offshore in places like London or New York. Therefore this was only attractive to high net worth individuals.

What does the fund invest in?
We have 42% of the portfolio invested in Brazil, 15% in Chile, 14% in Mexico and 8% in Colombia, with the remainder in other countries. Thirty three percent of the portfolio is invested in the petrochemicals industry, 15% in telecommunications, 12% in energy and 9% in financial institutions. Investments in bonds that are investment grade or higher is limited to 45%. The average size of our holding is $3 million and we have around 60 issues.

How will this fund help companies improve funding?
The vast majority of companies are reliant on bank funding, which tends to be short-term in nature. Companies that want to tap the international bond markets must be investment grade. This type of fund provides companies with an additional source of fixed-rate, long-term funding from investors that understand the risk profile of the company and the markets they operate in.

Can this model be replicated in other countries and scaled up?
As the local savings pools in other Latin American countries grow, institutional investors need a wider range of assets to match their liabilities. You should start to see asset management funds being set up to provide local pension funds with alternative assets. As these asset managers grow in size and if their performance is attractive, new investors such as high net worth individuals and mutual funds will look to them for investments. It should follow that more companies will contemplate issuing bonds if they know that there are investors out there willing to buy their bonds, enabling companies to tap a cheaper and more diversified source of regional capital.

Why don’t you buy local-currency bonds?
That will be the next step. We consciously distinguished between dollar and local-currency instruments when the fund was conceived because we wanted to hold bonds governed by the New York and English legal systems. New bankruptcy legislation in several Latin American countries is relatively untested, we felt more comfortable dealing with the Anglo-Saxon legal systems. Having said that, we are definitely looking to include the local issues, especially given the increase in local instruments, but at the same time we are keeping an eye on the developments in the local jurisdictions to advance investor protection.
Through topical panels and insightful presentations, the Forum provided a valuable opportunity for participants in the flow of funds to Latin America to exchange views on the main risks and opportunities facing the region and its investors.

Mohamed El-Erian, Managing Director, PIMCO

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David Rolley, Fund Manager, Loomis Sayles

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