SPECIAL REPORT 2013 LATIN AMERICA: CONNECTING THE DOTS

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Having been largely spared from the world's financial crisis, Latin America's economies are under construction with lucrative deals and opportunities across all sectors. But foreign investors looking to capitalise face cross-regional competitors as well, so there is no time to waste in linking up with the region's opportunities.

Over the last year, the aggressive expropriation of Argentina's energy reserves, mirroring the

nationalisation drive begun by former Venezuelan President Hugo Chávez, has turned investors' attention to other economies in the region where, it would seem, opportunities abound.
Brazil, the region's largest and fastest growing economy, has seen infrastructure investment increase as it gears up to host the 2014 FIFA World Cup and the 2016 Olympic Games. Preparations have exposed the need to upgrade its highway and communications networks, with investors also sizing up its energy sector.
Venezuela's heavy oil industry is a little-known success story, say lawyers, with the construction of multiple megaprojects providing opportunities in construction, services and technology. Chile and Peru remain important mining destinations, in spite of the many challenges faced by investors, while Colombia's continuing stabilisation has made it emerge as a new destination for foreign investment.
And with a new Government in Mexico, many reforms are to be announced in the coming months, and a boost in private investment in the energy sector is expected. Fernando C. Alonso, a Partner at Hunton & Williams in Miami, also highlights Mexico's lessened vulnerability to the negative effects of the economic crisis in the US as it becomes less dependent on that economy for exports, especially since it has recently signed further free trade agreements with other countries.
The much smaller economies of Central America are also becoming targets for foreign investment. Despite obstacles and challenges still being present, the region's lawyers are poised to advise on lucrative deals across all sectors in investment, joint venture and M&A.
Despite the drop in commodity prices, especially gold, and the resulting worldwide slowdown in mining, M&A remains active due to the opportunities offered by the disposal of distressed assets. Greenfield projects are still moving ahead, especially in Colombia, Peru, Chile and Brazil.
"But perhaps the biggest challenge that is common to most Latin American countries is the cost represented by public and regulatory processes, including licensing," says Glenn Faass, Managing Partner at Norton Rose Fulbright in Colombia. "In most of the region, governmental agencies tend to function poorly; they are often under-resourced, inefficient and immobile." Lawyers also highlight the courts as being amongst the more inefficient institutions in Latin America, given their slowness, exaggerated costs, unpredictability and politically biased verdicts.
Investment opportunities vary greatly across the region, lawyers say. "Currently, the hottest possibilities in Colombia are in infrastructure and banking M&A, while this will be a big year for oil and gas in Brazil, with a bidding round just finished and another for late fall," says Faass at Norton Rose Fulbright. "We are also seeing increasing interest from international investors in retail opportunities in Central America and there are even a few brave souls looking at Argentina."
Argentina, however, is not currently an attractive location for foreign investments, lawyers agree. "High inflation, de facto impossibility to repatriate capital and transfer dividends, strict foreign exchange control with a wide margin between the official rates of exchange and the informal market, together with a lack of respect for the rule of law, have practically stopped foreign investment," says Máximo Luis Bomchil, Managing Partner of M&M Bomchil in Buenos Aires.

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Upwardly mobile Mexico

As Mexico's new President took office, the country's three main political parties signed the 'Pact for Mexico', unleashing a flood of legislation aimed at improving the country's economic future, mainly focusing on breaking monopolies and encouraging competition.
One such industry is telecommunications. An amendment to the Constitution recently attacked the competitive barriers head-on, creating agencies charged with monitoring anti-competitive practices and metering out sanctions, explains Juan Francisco Torres Landa, a Partner at Barrera, Siquieros y Torres Landa in Mexico. "The amendment has also eliminated some restrictions on foreign investment and softened others, such as in telecommunications and communications technology,

where 100 percent foreign investment is now allowed, and in broadcasting where up to 49 percent is permitted, something that has vastly increased the attractiveness and competitiveness of the sector."

The energy sector has great potential, with a reform package expected in the coming months. Renewables are seen as offering the greatest opportunities, says Juan Carlos Serra, an Energy and Mining Partner at Basham, Ringe y Correa in Mexico, as well as infrastructure works, such as replacing the out-dated distribution network.

There will soon be an increase in private sector activity, particularly in the oil and gas business. Although reforms are unlikely to relinquish the nationalised rights to hydrocarbons and Petróleos Mexicanos' (Pemex) inherent monopoly, says Torres Landa, and some are predicting a substantial increase in the role of private companies. To entice private investment into the hydrocarbon sector without giving up actual rights to the hydrocarbons themselves, reforms will need to level the risk allocation that currently sits unequally on the private investor, say lawyers. But Mexico is willing to open the door of the hydrocarbon industry to private investors in order to increase its energy security and decrease dependence on imported fuel.

Nonetheless, the risks and challenges faced by investors in the energy sector are substantial. One important issue is exactly how much of the industry the Government is willing to open up to private investment. Lawyers question whether it will be able to maintain a strong hold on the hydrocarbon industry, while at the same time make the sector enticing enough for foreign investors. This will be an extremely difficult task for legislators, say experts.

Another risk is that private investors will be dealing with just one company: Pemex. The reforms do incentivise contracts under which firms supplying Pemex, for example, are paid for production quotas, even though the resources produced remain the property of Pemex, explains Serra at Basham, Ringe y Correa in Mexico. "Pemex has also created partnerships with private firms in the petrochemical sector, allowing their participation in the secondary process, while retaining a monopoly over all basic petrochemical processing."

How this monopoly will play out in a way in which it is both legally clear and economically sound has yet to be confirmed, say lawyers.

Consumer Colombia

Parallel to its pacification, Colombia has emerged as a major recipient of direct foreign investment over the past few years, increasing by 18 percent year-on-year in 2012, according to figures from the Latin American and Caribbean Economic Commission (CEPAL). Colombia has achieved various milestones in recent years, both in terms of economic performance and the trade accords that have removed barriers for international investors, says Jaime Trujillo, Head of Corporate at Baker & McKenzie, Bogota.

Colombia's infrastructure industry has become an area of focus, with the Government announcing a 10-year US$55bn investment plan, as well as a formal endorsement of public-private partnerships as a means of driving infrastructure, in turn supporting an active concessions market, explains lawyers. While momentum has been created, infrastructure projects have been hit by delays, with barriers caused by environmental licensing and other matters signalling risks for investors.

The Government has identified 16 strategic sectors (the so-called 'Sectores de Clase Mundial') that are being given special promotion using means such as strategic policies, aid and more-favourable legislation, says Martín Carrizosa, Founding Partner of prietocarrizosa, Colombia. These sectors include the country's three main industries – agriculture, manufacturing and services – which are likely to experience a significant increase in activity and investment in the coming years.

The move from the country to the cities and the consolidation of Colombia's middle-class is also causing a housing shortfall that requires the construction of new houses in the country's larger cities, adds Antonio Sánchez, International Transactions Adviser also at prietocarrizosa. Moreover, it is likely that coastal areas will require the development of infrastructure and hotel facilities in order to capitalise on the increase in demand for tourism.

And while Colombia is, in general, now regarded as a safer investment target, there are provincial discrepancies, and a huge difference between Bogota and the southern Amazon region or the eastern plains. But there is an urgent push to expand its oil and gas reserves, so companies with technology or experience in the development of unconventional petroleum resources should be looking carefully, say lawyers. The Government is also looking for billions of dollars of investment in infrastructure of all types, but notably roads, ports, railways, public transit and utilities.
However, according to lawyers, it is important to note that foreign investment is allowed in all sectors of the economy, with the exception of defence and national/private security, the processing and disposal of hazardous or radioactive substances not produced in the country, and where foreign investment would exceed 40 percent of the paid-up capital of television service companies.
Having signed free trade agreements with Israel, Costa Rica and the EU, Colombia continues to make great strides in removing barriers to trade and investment. It also has the potential to become a driver for regional growth as Colombian companies continue to invest in Central America and countries such as Peru. "With the outlook of sustained GDP growth, Colombia's attractiveness will only increase," says Trujillo at Baker & McKenzie, "as its policies, infrastructure and industries continue to evolve toward the standards of the global market."

Chilean chances
Perceived as 'low risk', Chile is a very attractive market for investors, with free movement of capital, a stable legal framework and sound communication infrastructure, according to Juan Francisco Gutiérrez, a Partner at Philippi Yrarrázaval Pulido & Brunner in Chile. "It is a country that does not have discrimination between domestic and foreign investors, and where there are legal mechanisms for the protection of investments, an absence of restrictions for hiring foreign workers, an abundance of competent executives, as well as low start-up and transaction costs."
Chile ranked seventh worldwide in foreign direct investment growth in 2012, with an increase of 52.7 percent, lawyers say, while the country's Corporations Law does not set a minimum capital requirement in order to form a company.
However, one disadvantage is the small size of its market – just 17 million – when compared, for example, with Brazil or Mexico, and the low income levels of a large percentage of consumers, with 60 percent living outside the Santiago metropolitan area. The country's geographical characteristics also imply elevated transport costs. Moreover, the banking system is very rigid, which is a major obstacle, especially for non-resident foreign investors. As for the most attractive sectors for investment, Experts cites the strong impetus being given to innovation, the introduction of value-added agricultural exports, services and information technology, and communications.
But the first choice for investment in Chile remains copper mining, third behind Australia and Canada for capturing foreign investment. Chile's mining sector accounts for a third of the world's copper and half of the country's revenues. This sector therefore continues to attract foreign investment, say lawyers. "Outside of the large international and local mining companies, there is a wealth of investment opportunity in supporting the mining industry," says José Miguel Carvajal, a Partner at Morales y Besa in Chile.
"And despite concerns that it is only a small retail market, Chile's long history of economic growth – largely thanks to record commodity prices – means the sector remains ripe for consolidation, with numerous international retailers looking at Chile."

All eyes on Brazil
Despite reports that Brazil's economy is beginning to cool down, the country continues to be one of Latin America's top destinations for foreign direct investment, says Claudia Prado,

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Managing Partner at Trench,
Rossi e Watanabe Advogados, due to the opportunities it still offers across several key industries, such as infrastructure and construction. “Brazil maintains policies and regulations for international commerce that are designed to create a balance between protecting the domestic market for the country’s industries, as well as the importation of foreign products and services.”
With the World Cup less than a year away, Brazil is capturing the attention of infrastructure investors. And the oil and gas sectors, ports, airports and railways are being seen as attractive targets. “A new regulatory framework was recently established for the Brazilian port sector, designed to enhance competitiveness between port terminals and optimise efficiency and costs – and new investment is expected,” says Marcos Flesch, Managing Partner at Souza, Cescon, Barrieu and Flesch in Brazil.
The Government has also privatised the airport sector and plans to spend US$45bn in the construction and upgrade of more than 10,000 km of rail lines over the next 35 years, creating opportunities in public-private partnerships and concession agreements. In terms of risks to investors, lawyers warn of heavy bureaucracy, uncertainty over taxes and a slow judiciary, making retaining a lawyer vital for navigating the legal pitfalls.
As well as infrastructure, investors will also be eyeing growth areas such as retail, education and health services, buoyed by increased middle class purchasing power and low unemployment, says Gustavo Lian Haddad, Head of Tax at Lefosse Advogados in Brazil. “The crisis in global markets has taken its toll on the Brazilian stock exchange and equity activities alike, although M&A and private equity continue to be strong. However, bureaucracy, rigid labour laws, complex taxation and conflict resolution systems mean that investment growth in Brazil is stymied.”
However, the so-called ‘Brazil cost’ – the high cost of doing business – remains a bottleneck for investment. This is one of the main risks and challenges that international investors face, according to Albert Castelló, Spanish & Latin American Desk Manager at Felsberg e Associados in São Paulo, as well as the overpriced Real against the US dollar. “The ‘Brazil cost’ and the overprice of the BRL made the GDP grow only 0.9 percent in 2012, while other LatAm countries grew an average of 3 percent.” And as well as changes to the regulatory framework in anticipation of general elections in 2014, Alexandre Bertoldi of Pinheiro Neto in Brazil also sees a possible future devaluation of the real as a risk factor.
Despite its size, the weight of Brazil in international trade is very low, and represents less than two percent of imports and exports. On the other hand, Brazil has a very strong domestic market that can help business face times of uncertainty when international trade is weak, says Carlos Roberto Siquiera Castro, a Partner at Siquiera Castro Advogados in Brazil. “Notwithstanding the problems that Brazilian commodities are having abroad, inside the country, consumption of food and industrial goods is rising and the economy operates with almost full employment.”
A point of concern is related to the sectors that still can grow above the national average, both in the domestic and international markets, but are facing logistic problems such as bad roads, lack of ports, railroads and airports, lawyers explain. An example are sectors such as automobiles and home appliances that are being fuelled by domestic consumption, but which in turn have created problems due to a lack of infrastructure.
And while spectators’ eyes will be on Brazil as it showcases the world’s sporting achievements, investors will be closely monitoring how the country’s social and political situation plays out. “While it captures the largest inflow of foreign direct investment into Latin America, the recent political and economic developments have raised concerns regarding the sustainability of its on-going GDP growth, increasing the economic and political risks for investors,” according to Pablo Viñals Blake, a Partner at Marval, O’Farrell & Mairal in Argentina. However, lawyers say that there is no political, economic or legal risk that, through proper due diligence and adequate structuring, may not be identified or properly factored in. “But in terms of economic stability,” says Leonardo Briganti, Founding Partner of Briganti Advogados in Brazil, “we are in a much better position than we were ten or 15 years ago, and the outlook is very positive”.

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Up for grabs

Latin America has been largely spared from the world’s financial crisis, with some economies growing steadily at an average rate of between five and six percent. “Latin America’s middle class is rapidly expanding, and so is its demand for more products, services and infrastructure,” says Xavier Ruiz, a Partner at K&L Gates in New York and Miami. “Catering to the needs of the middle class is the main opportunity.”

But for foreign investors looking to capitalise, they face competition from the Latin Americans themselves. Countries such as Chile, Colombia and Peru have been concentrating a significant bulk of their inbound foreign investment in Latin America, mainly because their Governments recognise that their chances of attracting more foreign investment depends on making their domestic climates more competitive, says Blake at Marval, O’Farrell & Mairal. “And so they did so, by putting together frameworks striving towards predictability of these countries’ legal environments.“

Countries with poor and constantly changing legal environments and strongly regulated economies, therefore, are running far behind those countries that have adopted a pro-market economy.

The opportunities that Latin America offers seem endless. But the competition to capitalise is fierce, with Iberian companies having to compete, not only with countries within the region, but also with US and, in particular, Chinese investors. “The competition of Chinese multinationals in their mission to secure control over natural resources and key commodities in Latin America is a great challenge for EU and US players, given the Chinese firms’ aggressiveness and access to funding,” adds Ruiz at K&L Gates.

The overwhelming advice from lawyers is that those investors looking to Latin America had better do so quickly, as there is a new wave of companies entering the market, and cross-regional competition is only going to get stronger. And the window to capitalise is only open for so long.

A Pacific Alliance

A new and rapidly growing trading bloc – the Pacific Alliance – created by Chile, Colombia, Mexico and Peru in 2011, which together represent around 35 percent of Latin America´s GDP. One of the cornerstones of the Pacific Alliance is the Latin American Integrated Stock Exchange, which has seen the integration of the Colombian, Peruvian and Chilean stock markets, with Mexico´s stock market in the process of joining, say lawyers.

Two years on, Pacific Alliance constitutes the world’s eighth largest economy and, according to lawyers, deserves closer attention as it develops mature capital markets. The alliance will create good opportunities in the production and services sectors, but investors must differentiate between the four markets.

“Economic growth and political stability do not always go together, and there is a question of whether free market governments will be able to confront an increasing sense of demagogy in some countries, which we have seen in Argentina, Bolivia and Venezuela, where the risk for foreign investment is the highest, and which investors may see as affecting other countries,” says Roberto Guerrero V. of Guerrero, Olivos, Novoa y Errázuriz in Chile. Commodities, energy, retail and financial services are the growth sectors, as Latin American countries are primarily producers of raw materials and commodities, which may make them more vulnerable in certain economic cycles. However, demand in Asia is still high and costs are way below those in developed countries. And, across Latin America, there is still an unsatisfied demand for energy infrastructure that will need to be met.

With purchasing power on the increase, demand for more and better quality consumer goods is rising, creating a huge opportunity for retailers. And while financial services remain in their infancy, there will clearly be opportunities, especially with indirect investment through mutual and investment funds and participation in the capital markets.