Future of the deal
Winds of change for M&A deals in Latin America
February 2020
What’s the expected landscape globally?

From a global point of view, we have high expectations for this year. Even though possible trade wars, political instability and uncertainty might have a potential impact on investments, executives focused on M&A anticipated an acceleration of business flow in 2020 and forward – both in the quantity and in their size and values.

In Deloitte’s sixth M&A trend report, we collected information from 1000 executives on their business activities in the current year and their expectations for the next 12 months. Given the current uncertainties faced by traders ("dealmakers"), the surprising results point to a strong and sustained business activity. The figures are impressive: 76% of U.S. based corporate M&A executives and 87% of leaders in M&A in private equity firms expect the number of deals that organizations will close this year to increase. In addition, seven out of 10 respondents anticipate larger deals. This shows that investors are confident but still waiting on structural improvements.

From a LatAm perspective, what are the key expectations for M&A?

From a LatAm perspective we have a moderate expectation. M&A activity in the region could pick up as a result of cross-border trade agreements, and reformist policies. The resource-rich advantage of many Latin American countries is expected to drive investments in the oil & gas and mining sectors.

In 2018-19, Energy, Resources & Industrials registered the highest M&A activity with deals worth ~USD 53 billion. Financial Services recorded 384 deals worth ~USD 45 billion over the same period and Technology, Media and Telecommunications M&A was mainly driven by IT outsourcing, adoption of 4G, and Internet of Things (IoT). In Life Sciences & Health Care (LSHC) the M&A volume was driven by Health Care Provider & Services and Pharmaceuticals.

In 2018-19, the majority of M&A activity in Latin America was intra-regional, with economies such as Brazil, Chile, and Mexico being the top investor countries by value. Outside the region US, France, Italy, China and Japan were the top investors by value in Latin America.

(*) Argentina’s inflation rates were released only until November
For the past months, Chile is facing several challenges regarding policy uncertainty due to the civil unrest and the upcoming new constitution referendum. Chile is leveraging its monetary policy to appreciate the local currency while strengthening its ties with countries in Asia and the Americas and focusing on renewable energy to attract investments. The outlook remains positive considering that Chile has a great wind and solar potential, with a high energy demand driven by the mining sector, and a sound investment and fiscal foreign reputation.

In Mexico, Fitch Ratings downgraded Mexico’s sovereign debt from BBB+ to BBB as a reflection of the increased risk to the sovereign’s public finances from Pemex’s deteriorating credit profile, some domestic policy uncertainty and ongoing fiscal constraints. It is important to highlight that this situation is expected to be offset by rising consumer demand, falling inflation and rising foreign direct investment from its trading partners in North America. Recent US Senate confirmation of the United States-Mexico-Canada Agreement (USMCA) creates a certain level of certainty for the Mexican Economy and the investors market.

In Colombia, we see an accelerated growth after the end of the FARC. M&A may receive a boost due to the privatization of state-owned companies, increased Moody’s rating and growth in mining. These privatizations and oil block auctions will reduce the fiscal deficit, increasing investor confidence and attracting investors. In addition, the growth of the mining sector behind a strong pipeline of projects is expected to increase GDP growth from 2.7% in 2018 to an average of 3.4% between 2021 and 2023. The impacts of the riots of the past few months could not be estimated yet.

Brazil is the largest economy in the region and has a significant domestic economy. Besides its continental size, Brazil has abundance of natural resources that attracts the interest of foreign investors. The implementation of structural reforms (e.g. the labor legislation reform and the advancement of pension reform), the reduction of bureaucracy, greater access to credit at lower rates are expected to bring the Country growth and investments. Brazil is beginning a process of recovery from the crisis of recent years and investors want to take advantage of the fall in asset prices in the hope that the reforms promised by the current government will come off the ground. Brazil has also announced several privatizations of state owned companies. This will attract investments in several sectors and can drive the M&A Market in the country for the next years. The lower interest rates ever seen at this country impact not only the cost of capital but also the price of shares, contributing for the economic growth and investments.

Argentina is in a deep economic instability. With a 51.4% inflation rate, 55% of basic Interest Rates and the currency devaluation, according to economists, the country is in on the brink of insolvency. The new government postponed the payment of Government bonds and the risk agency Fitch Ratings reduced the ranking from “CC” to “RD” (“Restricted Default”). To improve the economy, the new government has proposed several initiatives, including tax increase and spending freeze. Those fiscal initiatives were welcomed by the Financial market but criticized by the population. This initiatives are deeply dependent on the value of the Dollar, which has significantly increased when compared to the local currency.
What are the main challenges & risks?

**Economic highlights - Risks**

- The price of commodities is extremely **volatile**, increasing certain **risks** and restricting M&A activities.
- **Currency volatility**
- **Uncertainties** in decisions related to the U.S. Canada Mexico Agreement (USMCA), besides the impacts of economic issues relating to the **U.S. and China** are pointed as major risks.

**Investor’s highlights – Challenges**

- Social and political **unrest** causing **potential execution risk**
- High **Complexity** regarding the **TAX system**
- and the **legislations**, specially when it comes to **labor legislation**
- **Infrastructure** requires additional investments
- **Cultural and language** considerations

How to make a **successful deal** in LatAm?

Tips for a successful deal preparation in this macroeconomic environment

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<th><strong>M&amp;A Strategy</strong></th>
<th>In a slow economic scenario, strategic complementary acquisition is the best way to add value to your business as other investment opportunities may have a lower rate of return.</th>
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<td>The structuring of deals should be analyzed carefully due to the complexity of local tax rules and the changes made to it by the introduction of IFRS.</td>
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<th><strong>Target screening</strong></th>
<th>LatAm has a big proportion of family businesses that often offer good investment opportunities but require additional screening.</th>
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<td>Investing in businesses with tax assets may help to increase return on investments but there are restrictions and regulatory timing impacts</td>
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<th><strong>Due diligence</strong></th>
<th>According to Deloitte’s 2017 Latin America Mergers &amp; Acquisitions Study, the nº1 prerequisite to execute a successful divestiture transaction is to perform a detailed sell-side due diligence.</th>
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<td>A good practice whilst realizing the due diligence process is to already design the synergies’ plan to quickly capture them after day 1.</td>
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<th><strong>Transaction execution</strong></th>
<th>Tax structuring preparation increases chances of lowering acquisition’s cost and maximizing the selling price on eventual taxation of capital gain.</th>
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<td>Analyzing the potential deduction of goodwill payed on acquisition can potentially accelerate the return of the investment (considering the tax amortization of goodwill and intangibles to be accounted for as a consequence of the acquisition).</td>
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<th><strong>Integration</strong></th>
<th>When capturing the synergies, it is important to set up and share goals as well as tracking their realization. The management team should sign off the objectives as a way to have a full commitment throughout the project.</th>
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<td>Deals where added value is related to employees, should focus on change management and talent retention policies in a way to secure the deal value.</td>
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Specific considerations for cross-border projects

M&A projects (divestiture or integration) in general are challenging and cross-borders ones even more so. That’s why they should receive special attention:

- **Determining what’s the exact scope of the deal** (Geographies, business units, shared assets and resources...)
- **Clearly establishing the end-state legal entity structure**
- **Understanding cross-border tax implication and impacts on the business plan**
- **Knowing local and foreign laws** (Government intervention, Foreign Corrupt Practices Act, regulatory filing process)
- **Planning in advance for the separation** putting in place a strong cross-border IMO
Contacts

Deloitte has assisted thousands of M&A deals for companies in nearly every industry and geography and across the entire transaction lifecycle. We are a world-wide fully integrated practice with experienced accounting, tax and consulting professionals who are fully devoted to M&A projects. We offer practical hands-on support supported by a battle-tested methodology specially adapted to the deal you may be facing.

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