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Destination Latin America

Navigating deal complexities to access new opportunities in Latin America

By almost any measure, Latin America is an attractive market for many U.S. companies looking for growth. A wealth of private, family-run companies, combined with strong fundamentals, such as gross domestic product (GDP) growth and consumer class expansion, makes for a high-growth environment rich in acquisition targets. Favorable trade agreements and local governments friendly to business in popular investment destinations — Brazil, Chile, Colombia, Mexico, and Peru — add to the allure of the region.

	GDP	Real GDP growth 2008–2012	Real GDP growth forecast 2014–2018	Population	S&P Sovereign Rating
	USD billion (market exchange rate)			million	
Source	*EIU*	*EIU*	*EIU*	*EIU*	
Brazil	2252.4	3.20%	3.1%	194.7	BBB
Chile	268.3	3.90%	4.9%	17.4	AA-
Colombia	370.3	4.00%	4.3%	48.3	BBB
Mexico	1183.6	1.80%	3.7%	115.0	BBB
Peru	199.5	6.50%	5.9%	30.8	BBB+
United States	–	–	–	–	AA+

Given the opportunities and the pace of change, an acquisition can be the most expedient way for a U.S. company to gain a foothold in Latin America. The familiarity and local relationships that come with an acquisition can save months of administrative work and potential frustration associated with setting up a business from scratch. First-hand knowledge of the local physical landscape is critical. Chile, for example, is considered one of the region's best and most transparent business environments, but the country's specific geographical footprint makes nationwide distribution a challenge.

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However, even the most experienced multinational dealmakers often find that the transaction process in Latin America is different than in other regions, which can be daunting. Nearly every step of the deal process, from sourcing to closing, requires a cultural filter. Relationships are paramount, particularly with the large family-owned companies that are among the most attractive targets. Quantitative information, such as private company financial reports, is often found to be recorded in unfamiliar and inconsistent ways. In addition, important qualitative information about how power is divided within a company may not surface until late in the negotiation process. Meanwhile, even basic details, such as which executive a potential buyer sends for meetings, how that person dresses, and what they eat or drink, can enhance or reduce the probability of a successful deal at any point along the way.

The good news: U.S.-based companies have a wealth of opportunity to revive their growth and expand their footprints in Latin America if they are willing to learn the cultural nuances. Here, we consider some of the most common challenges that arise in the transaction process and how smart planning and sensitive execution can help avert them.

Target identification

The need for regional relationships starts with the sourcing process. In the United States and Europe, desktop research can generate a reasonably comprehensive list of targets to consider. In Latin America, relying on databases and Internet information is likely to produce an incomplete list that omits attractive candidates and contains erroneous assessments of others. That is because even the largest of private companies in Latin America may not share information with a data aggregating firm, and may still have a limited Web presence. As a result, networking with people who know the industry of interest and setting up in-person meetings can be a much more effective method, even if it seems to take longer at the outset.

The in-person approach is especially necessary if the target is in a regulated industry. When a Spanish company was looking to buy a construction firm in Chile, for example, it was important that potential targets be registered appropriately with the Chilean public works ministry. With this filter in mind, the acquirer's advisors in Chile came up with a list of acquisition candidates and cross-referenced the government's list. The advisors then met with the potential targets to assess the feasibility and probability of a potential transaction. Essential qualitative aspects of the targets, which were not available in any database, only emerged through the face-to-face meetings.

Approaching an acquisition candidate

Finding a target that looks desirable is an important first step, but making contact with the company in the right way is paramount. In the U.S., executives are accustomed to taking meetings with companies or groups they do not know to discuss the idea of a transaction. In Latin America, executives expect to have a relationship prior to engaging in a discussion on a topic as sensitive as a potential transaction. In addition, private company owners in Latin America tend to carry a strong sense of responsibility to their stakeholders — such as family members, silent partners, employees, and the larger community — and may initially feel that selling would equate to failing their obligations to these groups. Given this cultural context, the pace of the deal process in Latin America inevitably will be slower than in the U.S.

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Companies who understand the region look for a warm introduction to an owner, and plan time into their acquisition calendars to get to know key decision makers before introducing the idea of a transaction. For example, executives at one U.S. company invited a Chilean executive to their home office for knowledge sharing a full year before they began a formal offer process. Other companies may find success with a shorter time frame, but the crucial element is that relationships should come before any mention of transactions. An interested buyer may also want to focus initial discussions around less dramatic options like a partnership or joint venture rather

than the sale of the entire company, to allow an owner to acclimate to the idea of involving outsiders. Leading with a buy-out offer and expecting a quick decision is unlikely to be effective in most countries within Latin America.

However, time is not the only necessary ingredient for strong relationships. Throughout the relationship-building process, cultural mismatches around executive rank, dress codes, menus, and formality of written communications can quickly derail progress. One large U.S.-based public company learned this the hard way when it was looking at an acquisition candidate in Brazil. Since the CEO of the company was traveling in the region for other reasons, he met with the owners of the much-smaller private company under consideration. The meeting went well, and several months later, the Brazilian owners came back to express interest in discussing a potential sale. Delighted, the U.S. company set up another meeting — but with a lower-ranking executive who would be the point person for the deal. Unfortunately, the Brazilian executives were insulted at what they perceived to be a bait and switch, and the deal immediately fizzled.

As with target identification, finding the decision maker usually takes local resources and delicate questioning.

On the flip side, buyers should be sure they are getting to know the true decision maker at a company of interest, as titles on business cards may not clearly depict roles. Given the prevalence of large family conglomerates that own many businesses through holding companies, reporting structures can be complicated. In some cases, a family office may make strategic decisions, for example, rather than executives at a portfolio company. As with target identification, finding the decision maker usually takes local resources and delicate questioning.

Managing the transaction process

Many private companies in Latin America that are prime acquisition candidates are likely to be reticent about opening up. Often, they are not familiar with the standard processes for sharing classified information under the protection of confidentiality agreements, and may worry about backlash from employees or other owners if news of a possible sale gets out too soon, or at all. In some instances, companies also prefer that the deal itself remains confidential.

Typically, successful buyers are prepared to respectfully educate sellers on typical stages of a deal, such as

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key milestones and a gradual increase of sharing and commitment over time. They also have a willingness to be flexible about some expectations, including exclusivity periods and the scope of early diligence efforts. Given the reticence many sellers have about sharing openly, buyers might consider prioritizing the items they need to get to a valuation, and leaving aside other confirmatory diligence items until they are closer to a sale agreement.

Some buyers also advocate helping a potential target to form their own team of experts. "If you are dealing with a middle-market company in Brazil, I highly recommend you advise the sellers to not only obtain counsel, but also secure M&A advisors to help them understand that the requests you are making are not out of the norm," said Joe Juarez, global director of corporate development for glass packaging maker Owens-Illinois, Inc. Owens-Illinois, Inc. has had a long presence in Brazil, and in 2010, bought CIV, a glass packaging company in the northeastern region of the country.

Performing proper diligence

As with any transaction, diligence is a critical step for a potential buyer to weigh any risks that come with the target. In Latin America, there are several factors that add complexity. For example, the inner workings of a Latin American company will look different from those of a U.S. one of a similar scale. No matter how rigorous the diligence, the process may not yield the same level of certainty a U.S. buyer can attain with domestic targets. Yet, despite any concerns an acquirer might have around the quality of information, preserving and improving relationships should still be the top priority.

In addition, the fast-growth environment in Latin America means that the sophistication of corporate infrastructures may not match the acquirer's scale. Many attractive and sizeable companies do not have audited financials,

or corporate systems that could make auditing and diligence easier. Even when a private company has audited financial statements, a potential buyer should realize that local accounting standards are typically more open to interpretation than U.S. GAAP or IFRS. It is not uncommon to find inconsistencies in the treatment of revenue recognition, contingent liabilities, accruals, and other areas that may result in significant diligence adjustments, for example. There may also be inconsistencies in whether or not value-added taxes are included in key metrics like revenues and working capital. In other cases, it is the information that is missing that is a problem, requiring a local resource to evaluate the diligence material for completeness and normalcy.

Structuring the transaction

Getting to the offer stage may feel like a victory in itself. However, patience and flexibility are essential in this stage as well. Eager buyers may face reluctant sellers for several reasons, including that owners of fast-growing companies may want to enjoy the fruits of their success themselves rather than sell. The current owners also need to consider how the decision to sell will be perceived by and affect the broader community of stakeholders.

For these and other reasons, the valuation should give the business credit for some future growth and an opportunity to enjoy the upside. Earn-outs or other contingent structures that let owners participate in their organization's future success can be useful. However, simply putting terms on the table is not always enough. It is important for buyers to be prepared to educate potential sellers about what an offer includes — for example, how their debt will be treated — and how more complex features such as earn-outs work. Succession plans should also be part of the dialogue, with explanations of how an owner's willingness to stay or leave may affect the valuation.

Conclusion

Latin America is a region abounding in opportunity, and multinationals that approach it intelligently can reap big rewards. While acquisition candidates may initially seem opaque, companies that marshal the right resources to understand the quantitative and qualitative aspects of the region have an opportunity to win good deals and potentially set themselves up for long-term operating success in the region.

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