

Argentina
A Destination for Investment?

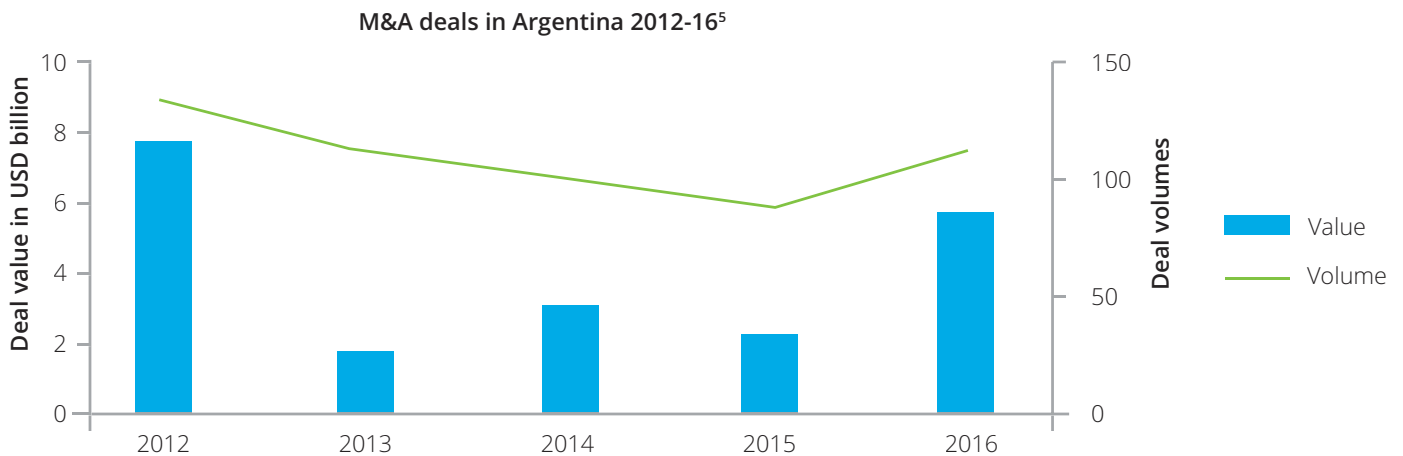
For years, many foreign investors viewed Argentina with a certain wariness due to restrictive capital and currency controls, and limited their investments in the country accordingly. With the election of President Mauricio Macri in late 2015, however, the country is experiencing a renaissance. A series of government initiatives aims to make the country healthier and more open to foreign investors, and M&A deal trends are slowly beginning to respond. However, the opportunity to enter the market is still fresh, and we expect to see even greater interest emerge as the new administration implements its agenda.

In an effort to help restore Argentina's economy, Macri has resolved past debts and plans to invest heavily in rebuilding infrastructure, announcing more than US\$12.5 billion in planned investments in housing, telecom networks and education over the next several years¹. He has also bolstered the economy through a tax amnesty program that brought in nearly \$10 billion in additional tax revenues and nearly doubled the recurring base of taxable assets². As part of a concerted effort to win foreign investment, Macri has eliminated the controls³ that once impeded foreign investors from converting their money to other currencies or moving their money out of the country. Anti-corruption legislation is also winding its way through negotiations, in the hopes of improving the business environment ([see timeline on page 5.](#))

Since these changes have been implemented, many macro-economic measures are beginning to improve. Better credit ratings for both the country itself and companies in Argentina have lowered the cost of debt, while economic activity picked up enough in the second half of the year to pull the country out of a prolonged recession⁴. Combined, these changes lower the barriers to foreign investment, and increase the attractiveness of opportunities within the country for many internal and external investors.

In this article, we look at how a new influx of foreign investors has helped accelerate Argentina's deal flow to date and how an even greater wave of interest is likely to develop in the years to come. As the economy improves, we expect the rising tide to buoy all sectors, with all types of companies benefiting from stronger fundamentals. We also explore the three key industries – energy and natural resources, infrastructure, and agribusiness — that are likely to offer the most compelling near-term opportunities, given their direct alignment to top government policy and investment priorities.

M&A activity



Argentina has generally languished when it comes to M&A activity compared to other parts of Latin America. Between 2013 and 2016, it saw an average of 99 deals per year worth US\$2.9 billion⁶. The election of Macri in late 2015 catalysed renewed interest in deals in Argentina, albeit still at relatively low overall volumes. In 2016, 102 M&A deals worth US\$5.4 billion closed in Argentina, representing a 19% increase in volume compared to 2015 and a 227% increase in deal value.

Topping the list for deal values was the telecommunications & media sector, with US\$2.19 billion of deals in the year⁷. That value was largely driven by rule changes that allowed larger ownership stakes in media companies. Deals included the acquisition of Sofora/Telecom Argentina by US-based Fintech and the takeover of Nextel Argentina by Argentina-based Clarín Group, among others.

Close behind in deal value at US\$1.84 billion – and the leader in deal volume – was the energy and natural resources

sector⁸. Some of the most prominent deals in this sector included the sale of electricity distributors EDES/EDEN to Desarrolladora Energetica (DESA), Petrobras' divestiture of its Argentine subsidiary to Pampa Energía, and the acquisition of several oilfields previously owned by Pampa Energía by YPF.

Notably, about one-third of those deals involved investors based outside of Latin America, with 15% coming from North America, 13% from Europe and the Middle East, 4% coming from Asia and 1% from Africa⁹.

While these trends indicate an increasing interest in Argentina, we have not yet seen the explosion of deals that many predicted. Rather, many investors remain on the sidelines, waiting for economic fundamentals to improve before making a foray into the market. Once metrics such as fiscal deficit, inflation and GDP growth improve further; however, we expect to see a much greater influx of foreign investors into the market.

Looking ahead: areas of opportunity coming out of planned reforms and the desire for internationalization

As a result of government initiatives to improve the Argentine business environment and stimulate both local and foreign investment, we expect most sectors to benefit and increase in attractiveness for corporate and private equity investors. Three sectors — energy and natural resources, infrastructure, and agribusiness — stand to become particularly compelling to investors given the fact that they represent priority areas for the government.

Energy and Natural Resources

Argentina has a rich set of natural resources, but its potential has historically been hampered by poor infrastructure and policies. Old government policies, for example, offered massive subsidies to energy consumers, but often failed to incentivize energy suppliers. New government support for various types of energy exploration and production may present opportunities for investors to buy assets with long-term value in the sector.

Some of the most compelling opportunities currently lie within the vast Vaca Muerta, one of the world's most promising yet under-developed shale fields. While it has gone untapped for years, Macri's election catalyzed new efforts to pair public and private investment for maximum impact. New Minister of Energy Juan José Aranguren recently confirmed as much as US\$8 billion in investment in the region for 2017, a figure that is expected to grow as high as \$15 billion next year and \$20 billion from 2019 onward¹⁰.

Renewable energy will likely continue to grow in popularity, undergirded by new legislation and new subsidies. The country set a goal of obtaining 20% of its energy from renewable sources by 2025, a goal that the World Bank is supporting with a \$480 million guarantee to help promote private sector investment¹¹. Additionally, in April 2016 Argentina established a landmark renewable energy policy, which created a trust fund for renewable energy and outlined bidding processes for renewable energy projects¹².

A similar situation holds true in the mining sector. After a long fallow period, new opportunities are emerging. In April 2017, for example, Canada's Barrick Gold Corp. announced a strategic partnership with China's Shandong Gold Group which involves a \$960 million investment by Shandong in Barrick's assets in the Veladero region, with the expectation of continued joint exploration in the Pascua-Lama and El Indio Gold Belt regions. "In this global economy, it is more important than ever to find international partners with a common vision for developing mines and generating prosperity in an environmentally and socially responsible manner. We are excited to enter Argentina's dynamic mining industry in partnership with Barrick at Veladero, while exploring other opportunities in one of the most prospective mineral districts in the world," said Shandong Chairman Chen Yumin in a press release announcing the partnership¹³.

Infrastructure

The Macri administration has launched or continued to support a number of major infrastructure projects across the country that bode well for companies involved in construction, roadways and other types of significant building activity.

In March 2017, for example, Macri announced a \$3 billion budget for the construction of affordable housing, bolstering an economic development program from the previous administration known as the Procreate Plan¹⁴.

In May 2016, he signed a \$2 billion agreement with the CAF Development Bank to fund Plan Belgrano, which will deploy a total \$16 billion to restore the under-developed and flood-damaged Northern part of the country¹⁵. A number of telecoms projects are already underway to improve internet access across that region. Regional economics, meanwhile, should be fundamentally bolstered by removal of export taxes on key crops and livestock, as discussed in next section.

Agribusiness

New and more favorable policies surrounding exports of Argentina's major crops – soybeans, corn, and wheat — have helped boost production of each, helping improve the prospects of growers and food producers in the region. After the Macri government eliminated a 23% tax on wheat exports, for example, the harvested area of wheat in 2017/18 is projected to hit 5.2 million hectares, its highest level since 2008/9, according to the US Department of Agriculture Foreign Agricultural Service¹⁶. Meanwhile, both corn production and corn exports—sans a previous 20% export tax—are expected to hit their highest level ever in 2017/8.

The softening of currency exchange controls has also played an important role in these developments by making

agricultural exports even more attractive to buyers, both in grains and other sectors. Dairy company Sancor, for example, reportedly found interest from a range of buyers. when it announced plans to restructure in 2016¹⁷.

The removal of export taxes and currency devaluation is also beginning to contribute to a boost in production in the meat sector¹⁸. While Argentina was once a top global producer of beef, past tariffs and other governmental controls prompted some ranchers to cut production¹⁹. Now, cattle herds are slowly growing again, and other meat sectors are also gaining ground. For example, Brazilian food conglomerate BRF in 2016 acquired pork producer Campo Austral in Argentina with a view toward expanding its footprint in Argentina's meat market²⁰.

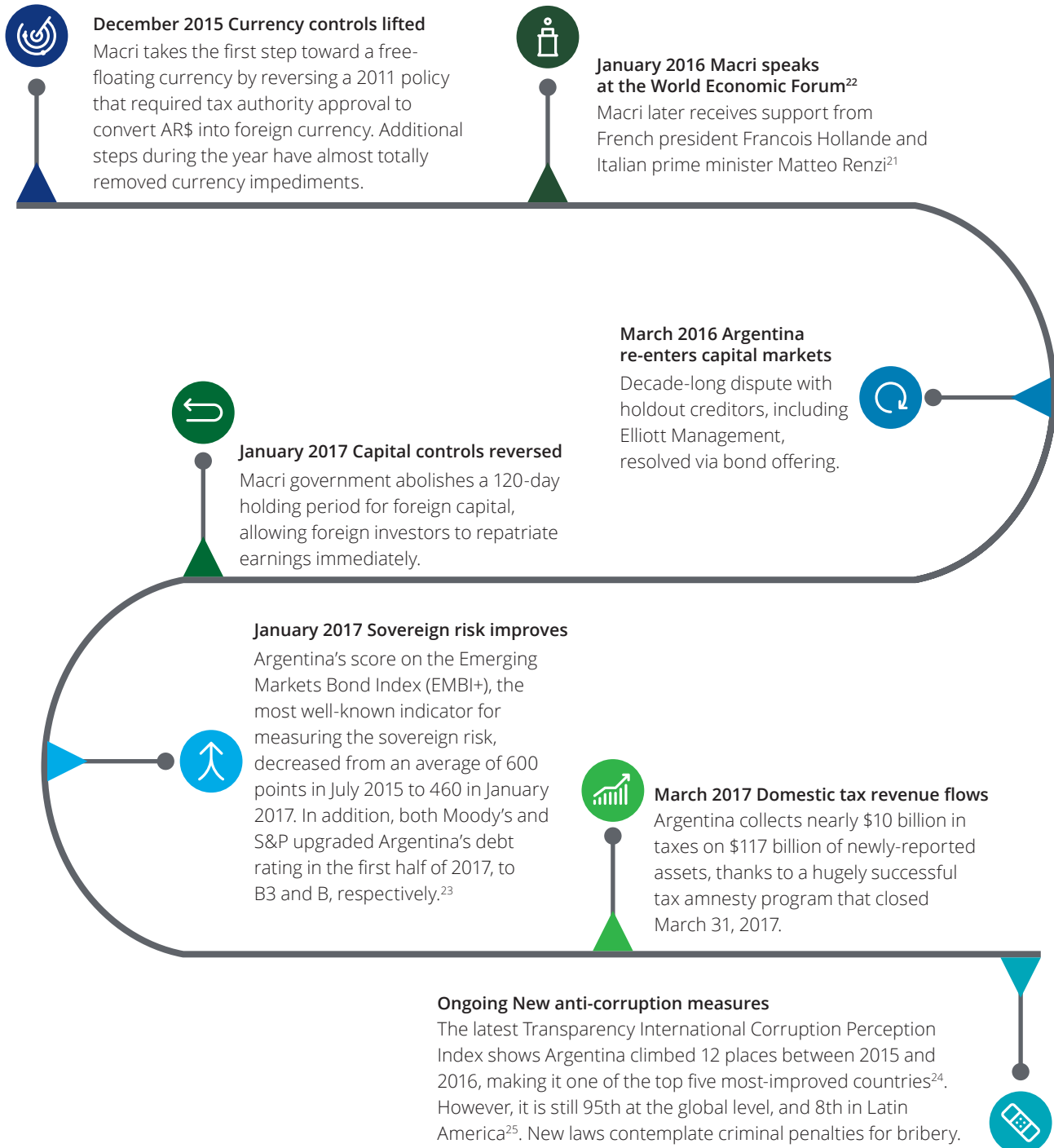
Due diligence concerns

As with most Latin American countries, potential acquirers from outside the region will want to carefully probe the intricacies of doing business in Argentina, from complex regulations surrounding labor, taxes, and other legal areas to environmental compliance and anti-corruption/US Foreign Corrupt Practices Act (FCPA) review.

Hidden liabilities associated with loose compliance surrounding tax, social security and labor regulations can be common. Notable areas of risk often include informal economy transactions like unrecorded sales and compensation to employees, aggressive tax positions and disguised employment contracts.



Race to Reform



Argentina is on the precipice of an exciting transformation. Over time, however, the Macri administration should continue to prove itself on some key agenda items. For one, international investors will be looking for Argentina to progressively reduce public

expenditures and decrease inflation, two goals which can take years to accomplish. They will also be expecting progress toward Argentina's long-standing goal of obtaining an investment-grade bond rating. If the Macri administration can sustain the

momentum it has created in its first two years and show continued improvement on these fronts and others, then the future for foreign investment in the country may be bright indeed.

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End notes

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⁷ Mercado de Fusione Adquisiciones de Latinoamerica, Informe Anual 2016, Enero 2017, p. 12. <https://www2.deloitte.com/ar/es/pages/finance/articles/ma-informe-anual-2016.html>

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¹⁴ <http://www.efe.com/efe/english/business/argentine-president-announces-3-billion-housing-investment/50000265-3204858>

¹⁵ <https://www.bnamericas.com/en/news/ict/telecom-infra-shapes-argentin-belgrano-plan/>

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²⁰ <http://www.lanacion.com.ar/1850830-el-grupo-brasileno-brf-compra-campo-austral>

²¹ https://www.nytimes.com/2016/01/20/business/dealbook/trudeau-macri-and-biden-are-among-the-big-names-at-davos.html?_r=0

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