Latin America private equity: Reaching out to untapped opportunities

Partners Group Research Flash July 2011

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EXECUTIVE SUMMARY

- Latin America’s political and regulatory framework, the positive economic outlook and rising consumer purchasing power as well as the low private equity penetration make the region an interesting destination for private equity investments.

- Public equity markets in Latin America do not adequately reflect the sweet spot of economic growth - which has consumer-related sectors (consumer services, consumer goods, education and healthcare) at its center. Instead, public equity markets are often skewed towards the more volatile commodity companies and financials.

- Latin American countries are highly diverse in terms of GDP composition, natural resource endowment and institutional and political stability. Therefore, a local presence, local market knowledge and an extensive network of local players are key for making successful investments in the region.

- Partners Group has a positive outlook on private equity opportunities in economies characterized by political stability and strong macroeconomic fundamentals. In particular, Partners Group overweights Brazil, Chile and Colombia. While the Brazilian private equity market is becoming more crowded and valuations in the large cap space are rising, the country still offers compelling long-term opportunities in selective sectors and should continue to be the main private equity market in the region. Partners Group is slightly cautious on Peru on the back of the presidential election outcome and is taking a wait-and-see approach in the short term. Mexico is attractive on an opportunistic basis. Despite its strong macro-economic fundamentals, Mexico has a high correlation to the USA, which ties the economy to the recovery of the advanced world. Fundamentals in Argentina have improved; a regime change in the upcoming elections may create a more favorable investment environment.
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“AGORA VAI” (Portuguese: HERE WE GO)

With a population of more than 570m\(^1\) and an expected combined GDP of USD 5.3 trillion for 2011\(^2\), Latin America is “nobody's backyard”, as recently pointed out by the Economist\(^3\). After decades of subdued growth, elevated inflation and political instability, the region has emerged as one of the main pillars of global economic growth. With 2010 GDP growth of 6.1% year over year, Latin America posted the second strongest growth rate globally, surpassed only by emerging Asia.\(^4\) The effects of far-reaching structural reforms have led to a new economic prosperity and sustained growth in the majority of Latin American economies in recent years. In addition, sound macroeconomic fundamentals and accommodative policy actions have helped the region stomach the recent global recession relatively well, resulting in a relatively short-lived and mild economic downturn with a positive outlook for the years ahead.

Exhibit 1: Latin America: improving economic growth potential

<table>
<thead>
<tr>
<th>Average annual real GDP growth rates, in %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Latin America &amp; Caribbean</td>
</tr>
<tr>
<td>Brazil</td>
</tr>
<tr>
<td>Chile</td>
</tr>
<tr>
<td>Colombia</td>
</tr>
<tr>
<td>Mexico</td>
</tr>
<tr>
<td>Peru*</td>
</tr>
</tbody>
</table>

*pre-election estimates; subject to downward revision post-election result

Source: IMF (April 2011), Partners Group calculations

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\(^1\) World Bank, Latin America Data Profile (2011)
\(^2\) Goldman Sachs, ERWIN Database (May 2011)
\(^3\) The Economist (September 2010)
\(^4\) IMF, World Economic Outlook Database (April 2011)
The reasons for the region’s economic progress over the past decades are well known: privatization and de-regulation rounds in certain parts of the economy, trade and capital market liberalization as well as prudent fiscal policies played central roles in enabling Latin American economies to restore macroeconomic stability and bring fiscal finances under control. After decades of sky-high inflation rates in the 1980s and 1990s, with consumer price inflation ballooning to as much as 480% year over year in 1990, policy makers realized that low inflation was a necessary condition for macroeconomic stability. Vital changes to the monetary policy framework were implemented, ranging from the reformation of the countries’ central banks – including broader central bank autonomy – to increased exchange rate flexibility. Crucially, these developments enabled monetary policy makers to lean against consumer inflation expectations, breaking the mentality of high inflation expectations and to counteract inflationary trends. And indeed, over the past decade, average annual consumer price inflation across most of Latin America has receded to acceptable and comparably steady levels.

5 IMF, World Economic Outlook Database (April 2011)
More recently, comprehensive monetary policy has enabled the region to navigate through what indicated “overheating” economic growth and large capital inflows over the past 18 months. Actions included gradual target rate hikes, selective currency intervention and “macro-prudential” methods, such as reserve requirements and transaction taxes. So far, central banks have been successful in fighting inflationary pressures while avoiding a hard-landing scenario, as shown by the lower and more sustainable GDP growth outlook. Also, the so-called “currency war” cautioned against by Brazilian Finance minister Guido Mantega has not fully materialized. The exhibit below demonstrates the two very different 15-year periods in Brazil:

### Exhibit 4: More stable regulatory and political framework

<table>
<thead>
<tr>
<th>Example Brazil</th>
<th>1980-1994</th>
<th>1995-2010</th>
</tr>
</thead>
<tbody>
<tr>
<td># of presidents</td>
<td>5</td>
<td>2</td>
</tr>
<tr>
<td># of finance ministers</td>
<td>15</td>
<td>3</td>
</tr>
<tr>
<td># of central bank presidents</td>
<td>14</td>
<td>5</td>
</tr>
<tr>
<td># of currencies</td>
<td>6</td>
<td>1</td>
</tr>
<tr>
<td>Average annual inflation (in %, y/y)</td>
<td>730%</td>
<td>7%</td>
</tr>
</tbody>
</table>

Source: Banco Itaú (April 2011)

Sound fiscal and monetary policies coupled with a strengthened regulatory framework have boosted regional sovereign credit ratings. Five Latin American economies – Brazil, Chile, Peru, Colombia and Mexico – are now considered investment grade status by Standard & Poor’s. The ratings agency recently raised Brazil’s credit rating outlook to positive from neutral, at a time when many advanced world economies, including the USA and Japan, are still suffering from recession hangover and escalating fiscal debt levels.6

### Exhibit 5: Stable fiscal debt levels and attractive credit outlook

<table>
<thead>
<tr>
<th>Sovereign debt in % of GDP and Standard &amp; Poor’s foreign currency long-term sovereign credit rating</th>
<th>2000</th>
<th>2005</th>
<th>2010</th>
<th>2016E</th>
<th>S&amp;P credit rating</th>
</tr>
</thead>
<tbody>
<tr>
<td>Brazil</td>
<td>66.7</td>
<td>69.1</td>
<td>66.1</td>
<td>58.6</td>
<td>BBB-</td>
</tr>
<tr>
<td>Chile</td>
<td>13.7</td>
<td>7.3</td>
<td>8.8</td>
<td>8.0</td>
<td>A+</td>
</tr>
<tr>
<td>Colombia</td>
<td>36.3</td>
<td>38.5</td>
<td>36.5</td>
<td>29.9</td>
<td>BBB-</td>
</tr>
<tr>
<td>Mexico</td>
<td>42.6</td>
<td>39.8</td>
<td>42.7</td>
<td>41.4</td>
<td>BBB</td>
</tr>
<tr>
<td>Peru</td>
<td>na</td>
<td>na</td>
<td>24.3</td>
<td>16.1</td>
<td>BBB-</td>
</tr>
</tbody>
</table>

Source: IMF (April 2011) and Bloomberg (June 2011)

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6 Financial Times (24 May 2011)
CONSUMER CATCH-UP

The structural improvements discussed above were accompanied by the emergence of a new Latin American middle class with enhanced purchasing power and vast spending needs. According to the Economic Commission for Latin America and the Caribbean (ECLAC), 56 million Latin Americans joined the middle class over the past decade and a half.\(^7\) In fact, while many people believe that the economic growth engine is primarily fuelled by exporting the region’s wealth of natural resources, private consumption has played an increasing role, accounting for roughly 65% of aggregate regional GDP, compared to just 17.7% for exports (not netted against the contribution of imports which account for nearly 19% of GDP - by itself another sign of strong domestic demand).\(^8\) Goldman Sachs estimates that domestic demand grew by 8.6% across the region in 2010, outpacing overall economic growth, with many Latin American economies posting double-digit gains, including Brazil, Peru and Chile.

This consumer growth is likely to continue, underpinned by favorable demographics: in 2010, more than 50% of the continent’s population was below the age of 30.\(^9\) It is estimated that close to 50 million people will join the economically active population by 2020,\(^10\) which Partners Group is convinced will translate into higher demand for consumer-related products such as accommodation, cars, mobile phones, computers and watches, amongst others.

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\(^7\) ECLAC (April 2011), ECLAC defines middle class as households whose income levels fall between a lower and an upper band, defined as four times the level of urban poverty as the lower band and the value assigned to the 95th percentile of such urban population. Ranges are calculated for every country individually.

\(^8\) Bank of America Merrill Lynch (August 2010), based on averages between 2005-2009

\(^9\) US Census Bureau, International Data Base (December 2010)

\(^10\) HSBC, Latin America Investor Day (May 2011)
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“VIENTO EN POPA” (Spanish: FAVORABLE TAILWIND)

The favorable developments in Latin America have not gone unnoticed by the global investor community: the ever-increasing interest in the region has resulted in it evolving to become an attractive FDI destination in recent years. In fact, according to the 2011 investor survey by Coller Capital and EMPEA, Brazil has turned into the most attractive destination for private equity investors over the next year, pushing China into second place.

With its comparable advantage over its public equity market peers, private equity offers exposure to the "sweet spot" sectors of the economic cycle and long-trend growth stories. Public equity indices are often skewed towards the more volatile commodity companies and financials, as illustrated in the chart below, which depicts GDP composition against sector weights in the MSCI index using Brazil as an example. In addition, Latin American public equity markets are heavily concentrated. For example, in June 2011, the ten largest Brazilian companies accounted for 47% of the market capitalization of Bovespa, the Brazilian equity index. The picture looks similar in other Latin American countries. In Mexico, the ten largest companies accounted for 75% of the public equity index and for 63% in the case of Chile. In contrast, private equity generally offers a broadly diversified exposure.

![Exhibit 7: Public equity markets do not reflect the economic sweet spot](attachment:exhibit.png)

Statistics show that Latin America is quickly turning into the new private equity playground as limited partners and general partners alike are recognizing the region’s untapped potential. Fundraising has boomed: in 2010 fundraising by Latin-American focused private equity funds reached a new record high at USD 8.1bn, more than double the amount raised in 2009, according to the Latin American Venture Capital Association (LAVCA). In addition, private equity players have been able to achieve larger fund sizes. 2010 saw the closing of the two largest-ever private equity funds for the region as Southern Cross closed a USD 1.68 billion fund, exceeding its USD 1.25 billion target, and Advent International held a final close on its Latin American Fund V at USD 1.65 billion. Partners Group has long identified the potential in

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11 Bloomberg (7 June 2011)
12 AltAssets (September 2010)
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South America and has been investing in the region for over a decade. With the recently opened São Paulo office Partners Group intends to not only be closer to its investments but also to further foster sourcing capabilities. Other major global private equity players aiming to increase exposure to the continent by establishing a local presence via office openings or acquiring local players include Carlyle, Blackstone, 3i and Warburg Pincus.

Exhibit 8: Strong rebound in private equity activity in 2010 with no capital overhang

The investment pace has kept up with the fundraising speed: after a temporary slump in 2008/2009 (a global phenomenon that was not just witnessed in Latin America), Latin American investment activity surged in 2010 to USD 7.2 billion, a 120% increase compared to the previous year. As expected, Brazil accounted for the lion’s share of investment activity, as approximately 75% of deal volume (in USD) was completed in the region’s largest economy. Private equity activity has been seen in all sectors: targets include companies from the consumer, healthcare, energy, IT, education, manufacturing, retail, infrastructure, financial services and other sectors. Recent investment highlights include Southern Cross’ acquisition of Brinox, one of the largest Brazilian manufacturers of household appliances, in May 2011, and the acquisition of Casadoce Industria e Comercio de Alimentos S.A (Casadoce), a Brazilian developer, manufacturer and distributor of powdered beverage products, by Alothon Group and Partners Group in November 2010. Casadoce is poised to directly benefit from the purchasing power increase of economic groups C and D in Brazil, as well as to further boost growth through the introduction of new product lines and distribution paths. As another example, in January 2011 Advent International acquired a 50% stake in Terminal de Contêneres de Paranaguá (TCP), Brazil’s third largest container port terminal, with TCP pursuing an aggressive expansion plan aimed at increasing its terminal capacity by approximately 70% through the construction of a third berth and the purchase of new equipment.

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13 LAVCA (2011)
14 Economic groups C and D can be broadly defined as middle and lower middle class
Partners Group was also able to close various direct investments in the region in 2010 and early 2011. For example, Partners Group invested in Grupo Santillana, the leading publisher in the educational text book and general publishing sectors in Latin America and Spain, together with its investment partner DLJ South American Partners in April 2010. Santillana holds the number one market share position in educational publishing in most of the countries it operates in. Partners Group believes Santillana to be an attractive opportunity based on its positive outlook on the Latin American consumer sector on the back of rising incomes, the quest for higher education seen in all income classes as well as its expectation of rising demand for qualified workers across most of the continent.

The attractiveness of private equity investments in the region remains intact: despite accelerating fundraising activity, no capital overhang has developed and the impact on valuations has been limited. In particular, Partners Group favors the small- and lower mid-market space where valuations have not been affected by the recent surge in activity. Valuations in the large-cap space on the other hand can seem stretched; partially driven by the fact that large-cap companies also have the alternative to tap lively capital markets for sources of long-term financing. Multiples in the Brazilian large-cap space have increased to about ten times EBITDA, while comparable multiples in the mid-cap space are at about eight times EBITDA and multiples for small companies are at about five times EBITDA. Partners Group’s favorable view is further supported by the fact that the Latin American corporate landscape consists of 90% of small businesses that generate a significant portion of the region’s GDP.15

In addition, in contrast to more traditional leveraged buyout markets, multiple expansion in Latin America is primarily driven by value creation through sales growth and margin improvement. Latin American private equity-backed investments are levered rather conservatively, and in most cases not at all. Thus, an in-depth understanding of local market dynamics and the ability to identify rising stars are key to successful investing in the region. Partners Group focuses on companies in the growth stage of the business cycle and on companies that will benefit from domestically-driven growth and strong management teams as well as on companies that offer room for operational, managerial and corporate governance improvements, all traits inherent to small- and mid-sized privately run businesses.

Moreover, nearly all Latin American countries show a relative under-penetration of private equity investments in terms of percentage of GDP, indicating that there is still a large catch-up potential compared to their advanced world and other emerging market peers.

15 HSBC, Latin America Investor Day (May 2011)
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The increased exit dynamics further support the case for investing in Latin America. For instance, 2010 was a strong year for secondary buyouts: Apax Partners acquired Tivit from Pátria Investimentos and Carlyle acquired Qualicorp from General Atlantic to name just two. With half of the ten IPOs in Brazil in 2010 backed by private equity investors, these represent another way of tapping exit markets.\(^{16}\) The IPO pipeline remains busy and Brazil’s exchange Bovespa is now the eighth largest in the world in terms of market capitalization at USD 1.5 trillion.\(^ {17}\) In addition, Chile, Peru and Colombia will merge their exchanges in the course of 2011 to form the continent’s largest exchange, paving the way for continued attractive exit routes for private equity investors. The fact that Mexico is currently considering joining them would only further increase the strength of the index. Private equity companies exited 49 investments in 2010 overall – thus almost one a week – and raised nearly USD 3.5 billion.\(^ {18}\)

Partners Group benefited from the busy IPO market with the successful exit of the Argentinean-based investment company Arcos Dorados, in which Partners Group invested alongside its investment partner DLJ South American Partners. Arcos Dorados is the world’s largest franchise of McDonald’s restaurants with exclusive rights in 19 countries and territories in Latin America and the Caribbean.\(^ {19}\)

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\(^{16}\) Institutional Investor (15 March 2011)

\(^{17}\) Bloomberg (6 June 2011)

\(^{18}\) LAVCA (2011)

\(^{19}\) Seekingalpha.com (14 April 2011)
RISK PREMIA CAN STILL BE WARRANTED

Emerging markets will soon account for more than half of global GDP and headlines such as “from emerging to emerged” are making the rounds. While Partners Group fully agrees that emerging economies will be the major driving force of global growth and is convinced that investors should re-define traditional asset allocation policies to allocate a proportionate share of assets to the emerging market asset class, investments are not without risk. The past decades have seen tremendous changes in the political and regulatory space. However, the political situation in emerging markets can be volatile in times of political power shifts, as witnessed in the case of Venezuela under the Chávez administration. Peru's political path will now be determined once nationalist Ollanta Humala, a candidate who frequently changed his political agenda throughout the electoral race, takes over in July 2011.

In addition, despite impressive progress, corruption is still perceived as an existing risk, as exemplified by the recent resignation of the Brazilian Chief of Staff Antonio Palocci over corruption allegations. Red tape can also be an obstacle, as in the case of Brazil, where it takes 150 days on average to set up a business. In addition, further tax, pension and budget reforms still need to be addressed. Finally, a lack of basic infrastructure endowment can hinder economic development, though this also provides an attractive opportunity for private investors.

A country-specific approach

The 2011 edition of the Scorecard on the Private Equity and Venture Capital Environment in Latin America reflects a stable regulatory environment in which the historically top-ranking countries in the region maintain high scores. Chile (score of 76 out of 100 maximum), Brazil (75) and Mexico (63) repeatedly made up the top three positions; and are not far behind traditional popular private equity markets such as the UK (93), Israel (81) or Spain (76) in terms of absolute scores.

Each country entails a unique set of opportunities and advantages. Therefore, Partners Group deems it necessary to look at each country individually.

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20 Tech Crunch (8 May 2010)
21 Overall score is the weighted total of several indicators, ranging from 0-100, where 100 equals the best/strongest environment. The research considers several criteria including laws on private equity/venture capital fund formation and operation, tax treatment of private equity/venture capital funds and investments, protection of minority shareholder rights, bankruptcy regulation and capital market development and feasibility of local exits.
BRAZIL – A PRIVATE EQUITY CARNIVAL

Brazil is the largest economy in Latin America. This continental country (fifth largest territory in the world) with a population of almost 200 million (fifth largest in the world) represents 44% of Latin America’s GDP. Brazil has successfully turned the corner with considerable economic, political and institutional improvement over the past years and is now a reliable destination for long-term capital inflows such as private equity investments. The country is the main destination for private equity capital within Latin America by far (76% of investment in 2010, according to LAVCA). Partners Group believes Brazil will continue to be amongst the main players in the region as a result of several factors including i) favorable regulatory environment ii) strong deal flow, iii) room to add value to portfolio companies and iv) attractive exit channels.

Brazil provides an attractive framework for private equity investing with enough critical mass to host a significant and sustainable private equity industry. With a USD 2.1 trillion GDP, Brazil became the seventh largest economy in 2010 - placing it after only the USA, China, Japan, Germany, France and the UK but before Italy. We estimate that there are over 10’000 family-owned or closely held companies with revenues between USD 20-200 million, representing a large source of deal flow; a number that should increase as the economy develops. Furthermore, investment themes have emerged across all industries: consumer, healthcare, industrials, education infrastructure and real estate are all attractive sectors. As an example, given the rapid growth of the Brazilian middle class, which has increased by an estimated 32 million people since 2003, Partners Group is convinced that some of the most compelling opportunities can be found in the consumer-related sectors, as supported by our investment in Casadocé as previously mentioned.

In contrast to most developed economies, leveraged buyouts are relatively unusual in Brazil given the country’s high central bank rate — currently at 12.25% (July 2011). Consequently, operational value creation is key to achieving a profitable outcome. In this context, Brazil’s large amount of family-owned businesses is highly appealing. These companies often present significant room for operational performance improvements including the establishment of professional management, as well as the development of long-term strategy and financial planning, financial and operational controls, adequate IT systems, corporate governance and optimal capital structures. Private equity firms therefore represent one of the few options available for private companies, especially in the small- and middle-market space, to attract long-term capital and a value-add partner.

Due to consistently increasing M&A activity, private equity firms have recently been able to find the same exit channels as in many developed markets in Brazil. As an example, 787 M&A transactions were completed in 2010, more than double the 337 deals seen in 2003. Capital markets have also been booming, with over 120 IPOs having occurred since 2004 and 2011 having seen a very busy start as well. Finally, although competition for deals has increased due to the entrance of new players, secondary buyouts are now a plausible exit channel. For example, in late 2009, Standard Bank acquired Casa do Pão de Queijo from Patria Investimentos. In 2010, Apax Partners acquired TIVIT also from Patria Investimentos and Carlyle bought Qualicorp from General Atlantic.

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22 IMF (April 2011)
23 Institutional Investor (17 March 2011)
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Exhibit 10: Private equity in Brazil is supported by strong M&A as well as IPO activity

However, Brazil is not only an exciting carnival. The country is facing a number of challenges ahead. Political, pension and tax reforms, infrastructure gaps, low educational levels and fiscal spending are some examples on a long “to do” list the country needs to address in order to maintain a stable environment and increase the GDP growth potential.

Overall, Partners Group overweights the private equity industry in Brazil, which is still in its development phase. Major macro-economic pillars are in place although there are certainly several ways to improve the country’s attractiveness. With the recently opened São Paulo office, Partners Group aims to be closer to its current portfolio and well-positioned to increase its exposure to the region.
CHILE & COLOMBIA: SEARCHING FOR OPPORTUNITIES BEYOND BRAZIL

Apart from Brazil, Partners Group views Chile and Colombia as the most attractive private equity destinations within Latin America. Both countries have demonstrated great resilience throughout the recent economic downturn and offer promising economic outlooks. Chile is the wealthiest Latin American economy in terms of per capita GDP, which amounted to USD 11’828 in 2010 compared to Brazil’s USD 10’816 according to the IMF. However, Chile has a much smaller population of 17.2 million, compared to 193.3 million in Brazil, 108.6 million in Mexico, 45.5 million in Colombia and 29.6 million in Peru.

Chile is also the most “advanced” economy amongst its Latin American peers, in the sense that it offers the most established business environment, combining a well-developed banking sector and capital markets with prudent regulations. In 2010, Chile became the first Latin American economy to join the Organization for Economic Cooperation and Development (OECD). The country has positioned itself as an attractive destination for foreign capital mainly due to strong protection of property rights and minority shareholder rights as well as equal treatment of foreign and domestic investments: Chile is one of the countries most open to foreign equity ownership and full foreign ownership is allowed. These attributes are further supported by a stable political, legal and economic framework coupled with a low corporate tax rate. In addition, a vast amount of free trade agreements connect the Chilean economy with the rest of the world.

According to LAVCA, Chile was the third largest Latin American private equity market in terms of 2010 investment activity, after Brazil and Colombia. Overall, 22 private equity transactions were closed in 2010 amounting to a total volume of USD 346 million. However, average deal sizes are relatively small and there are fewer exit opportunities in Chile as 2010 only saw one private equity exit. Moreover, despite increased interest, commitments by Chilean pension funds to local private equity funds are still relatively low, limiting the upside for secondary buyouts.

Through its relationship with Southern Cross, one of the leading private equity managers in the region, Partners Group has gained exposure to Supermercados del Sur, the fourth-largest supermarket chain in Chile that is well-positioned to benefit from the Chilean supermarket industry’s continued consolidation, as well as various Chilean power generators, including GasAtacama a regional gas transporter and energy generator. GasAtacama owns a 970km gas pipeline network and a combined-cycle power plants with an installed capacity of 760MW, supplying the growing energy demand in the North of Chile and Argentina.

In Colombia, the case for private equity investing is supported by strong deal flow (19 deals amounting to a combined USD 475 million in 2010) and attractive protection of minority shareholder rights. In 2010, investment activity was focused around the energy sector which accounted for almost 70% of investment amount. Colombia has made impressive progress in terms of business environment as reflected by the significant increase in the country’s ranking in the World Bank’s “Doing Business Index” where Colombia gained 40 rankings between 2007 and 2011 when it came in in 39th place. In particular, Colombia ranks 6th highest in terms of investor protection, surpassing the USA and the UK. Also, there have been considerable improvements in corruption and the rule of law. These improvements led Standard & Poors to raise Colombia to investment grade status in March 2011. Further improvement with regard to corruption would pave the way for more private equity inflows into the economy, as well as a strengthening of the local judicial system.
PERU: THE GDP GROWTH OUTPERFORMER BUT POLITICAL UNCERTAINTY

Peru reported an impressive 2010 GDP growth rate of close to 9% and is expected to post another strong year with projected growth of 7.5% in 2011. The country is a small economy with a 2010 GDP of USD 152.8 billion. In recent years, Peru has seen strong improvements in the “ease of doing business” ranking; business formation has been simplified and labor regulations are more flexible. Nonetheless, further progress is required in the area of property and minority shareholder rights protection as well as tax laws.

Partners Group had a positive outlook on Peru prior to the election outcome in June 2011. Peru’s new president, populist Ollanta Humala, has changed his political agenda several times throughout the presidential race. While initially announcing radical changes, such as the nationalization of strategic sectors, he has more recently stepped back from these agenda points. Investor confidence has nonetheless been impaired, with the MSCI Peru (local currency) plunging -15% between the election outcome and end of June 2011. It remains to be seen if Peru has gained a Chávez or a Lula. Our local business partners expect the most likely outcome to be somewhere in between. Humala’s lack of majority in Congress means that radical changes are likely to be blocked and limit his political wiggle room. In the meantime, we have become more cautious and are taking a wait-and-see approach with regards to sourcing further opportunities in the country.

MEXICO: RISING FROM THE SHADOWS

Mexico is the second largest economy in Latin America. Its trade policy is among the most open in the world as it has 11 trade agreements involving 41 countries including the USA, Canada, Israel, Japan and the EU.\textsuperscript{24} Small- and medium-sized companies account for about 99% of all enterprises, more than 40% of GDP and employ about 64% of the workforce.\textsuperscript{25} Growth of this segment has been hindered by an under-penetration of bank credit which tends to be very conservative. Its large export dependency to the USA makes the economy vulnerable to an advanced-world economic slowdown.

The Mexican private equity industry was boosted in 2009, when regulators enabled public pension systems to invest in local private equity, infrastructure and real estate funds. Favorable tax treatment, robust corporate governance requirements and protection of minority shareholder rights support the country’s attractiveness. Property rights are broadly protected but courts can be slow to resolve disputes and are still subject to corruption despite progress made in the area in the past years. According to the Heritage Foundation, foreign real estate investors have found it difficult to secure enforcement of their property interests in state-level courts. LAVCA reports that weaknesses remain in the legal framework for private equity fund activity. Weaknesses in bankruptcy procedures and entrepreneurship as well as perception of corruption and an increase in drug-related violence weigh on investor confidence.

Partners Group looks at Mexico on an opportunistic basis in resilient sectors. For instance, in 2007, Partners Group invested alongside its investment partner Carlyle Mexico in Arabela, one of the largest direct marketers of beauty and personal care products as well as home goods and novelty items in Mexico with a focus on the low-income market. The company’s products are manufactured by regional suppliers and are sold through a national network of over 130’000 Arabela saleswomen, who sell the products on a door-to-door basis, mainly focusing on the lower-income groups. Partners Group likes the investment due to the compelling

\textsuperscript{24} Congressional Research Service (July 2010)
\textsuperscript{25} Worldbank (January 2011)
scalability of the business model which offers significant growth potential through recruiting additional sales representatives as well as the flexible cost base as “Arabela ladies’” compensation is based on a commission structure. Since the investment, Arabela has successfully rolled out its international operations, which today span into Guatemala, El Salvador, Honduras, Nicaragua and Costa Rica. To further illustrate the company’s success, net profits have more than doubled in the first three months of 2011 compared to the same time period last year.

**CONCLUSION**

Partners Group is convinced that Latin America will continue to benefit from structural improvements, rising wealth and strengthening economic ties with other emerging markets, creating a compelling investment environment for long-term private equity investments. Fueled by ongoing strong domestic demand on the back of job growth and increased lending to the private non-financial sector, regional GDP growth should slow to more sustainable levels. Building on the back of rising wages and commodity prices, central banks should continue to gradually increase target rates to tame inflationary pressures.

Partners Group actively sources deal opportunities in countries offering the highest level of political and economic stability combined with attractive growth potential, as well as cross-border opportunities in compelling sectors. From a country perspective, Partners Group has identified Brazil (the more mature market), Chile and Columbia (the “newcomers”) as well as Mexico as promising investment destinations. The outlook for Peru depends on the country’s ability to guarantee political and economic continuity after the presidential elections. Partners Group continues to see Brazil as the center of private equity activity in the near future but expects that attention will shift towards the less-mature markets.
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