

Runaway successes in a stop-start year

Weak equities, developments in DCM and intra-regional M&A trends make for an interesting – if eclectic – mix of Latin American deals of the year

By: Rob Dwyer

Latin American markets promised much but delivered little in terms of equity transactions. Brazil, the traditional engine of ECM activity, flattered to deceive with a successful IPO by Arezzo in January. Then the market fell away as deal after deal has priced at the bottom of or below its pricing range.

After-market performance was typically immediately bad but some deals clawed back lost ground through the year. Away from Brazil there was the helium-like IPO by Arcos Dorados. The deal priced above its range of \$13 to \$15, at \$17, and then kept going, leaping 24.7%. But with Woods Staton, Arcos Dorados's chief executive and controller, seeing his allocation of 2 million primary shares jumping in value the questions about conflict of interest in the pricing strategy dampens our consideration of the deal as one of the year's best. Another notable IPO was the stop-and-start IPO of Mexican real estate trust Fibra Uno, which closed in March.

But instead, and unusually for the region, the only ECM deal of the year goes to a follow-on transaction: the **Gerdau R\$4,985 million (\$3.14 billion) follow-on transaction** that priced in April and raised eyebrows because of who wasn't bookrunner: any international bank.

Oswaldo Burgos Schirmer, Gerdau's executive vice-president and CFO, explains. "We decided to use Brazilian banks as bookrun-

ners considering that those banks have reached global benchmark level," he says. "Additionally, the best structure came from the Brazilian banks at that time. The combination of Brazilian banks as bookrunners and international banks which were invited as co-managers was a good format to attract the attention and interest of a diversified portfolio of global investors."

The deal generated a lot of attention because of both its choice of leads and its size, as well as the timing. At almost R\$5 billion it was a big deal for Latin America in its own right, let alone as a follow-on. Its timing was also difficult, coming just as the eurozone crisis began to snowball at the start of April.

"We visited more than 200 shareholders/investors in Brazil, Europe and North America, and most of them supported the Gerdau strategy," says Schirmer. "The timing and pricing was perfect considering what happened later: Europe crisis and depressed stock prices."

The DCM markets had another good year, with the strong first-half performance front-ending the year's issuance as volatility restricted market access in the second half. In recent years Latin American issuers have tended to be more active in the first half of the year so the impact of the international risk aversion that began in May was less of an issue than it might have been.

Sovereigns across the region issued standout transactions: Colombia attracted a

\$7 billion book for a \$2 billion deal in July, capitalizing on its newly acquired investment-grade status. In November Brazil executed a skilful re-tap of its 5.625% 2041s from \$500 million to \$1 billion, attracting a book of more than \$6 billion.

However, it was Republic of Chile's \$1 billion bond in September that takes our second award. The \$1 billion of 2021s was priced in volatile markets in early September, with the republic taking advantage of an intraday window to achieve a record low all-in pricing of 3.35%, compared with the 3.89% it achieved the year before. On the same day, the Republic of Chile also re-tapped the Chilean peso-denominated 2020s for another \$350 million equivalent. The focus of the re-tap was to minimize yield rather than achieve size and Chile priced the new notes at a yield of 4.4%. Both issues were managed by Deutsche Bank and HSBC.

"The placement of the new 10-year bond

DEALS

Gerdau follow-on

Date: April 12 2011

Value: R\$4,985 million (\$ 3,141 million)

Bookrunners: Bradesco BBI, BTG

Pactual and Itaú BBA

Republic of Chile

Date: September 7 2011

Value: \$1 billion 10-year (and Ps162

billion retap of its Chilean peso denominated 2020s.)

Bookrunners: Deutsche Bank and HSBC

OGX

Date: May 26 2011

Value: \$2,563 million

Bookrunners: Credit Suisse, HSBC, Itaú BBA and JPMorgan

Disposal of AEI's Latin American assets (Ashmore owns 55% of AEI)

Date: January 19 2011

Value: Equity consideration of \$4.7 billion paid in cash

Advisers: Itaú BBA and Goldman Sachs advised AEI

... reached a yield of 3.35%," says Ignacio Briones, head of international finance at Chile's finance ministry. "This was the lowest rate obtained by Chile and by any Latin American country in history. The reopening of the 10-year peso bond for \$350 million was placed at a yield of 4.4%, 55 basis points below the local reference. This represented a saving for the Chilean state of around \$20 million if compared with the funding cost in the domestic market. In addition, the reopening allowed an increase in the size of the first benchmark in peso, reaching approximately \$900 million. This increased its liquidity and the quality of its price reference."

Katia Bouazza, head of global capital markets Latin America at HSBC in New York, says the market conditions weren't conducive to a record-breaking transaction: "The backdrop to this deal was very different from the 2010 transaction. There was heightened volatility caused by the uncertainty surrounding the US economy, its budgets and what the stimulus package would look like. And there was also – as there was in 2010 – volatility caused by Europe. Volatility was heightened to such an extent that even Chile, as a sovereign, had to watch the market carefully and make sure that it made the right decision on timing and that's exactly what it did."

There were other high-grade issuers in the market but none executed so tightly. "That day saw a lot of other high-grade supply, with the average new-issue premium for those deals being close to the 25bp which has become the norm," adds Bouazza. "Chile came in and really established itself with a very tight new-issue concession – with practically no new-issue premium and only curve extension."

Part of the reason the sovereign was determined to return to the market was that it had promised investors during the roadshow for its 2010 bond that it would do so to facilitate a liquid curve. "Those placements are proof of our commitment to generate benchmarks that will facilitate the access to external financing for local companies," says Briones. "This was also part of a contingency plan defined by the finance ministry, anticipating an eventual worsening of the international economic situation at that moment."

Away from the sovereign issuers there were many other impressive transactions, such as Petrobras's \$6 billion issue in January. But the outstanding deal was OGX's debut \$2.563 billion transaction. It was the largest high-yield offering by an emerging market issuer and it was the largest high-yield oil and gas offering. But more than this, it was an example of international capital markets delivering debt financing to the region's vital energy industries and an excellent demonstration of the markets working with the issuer and its investment banks to deliver a mutually beneficial transaction.

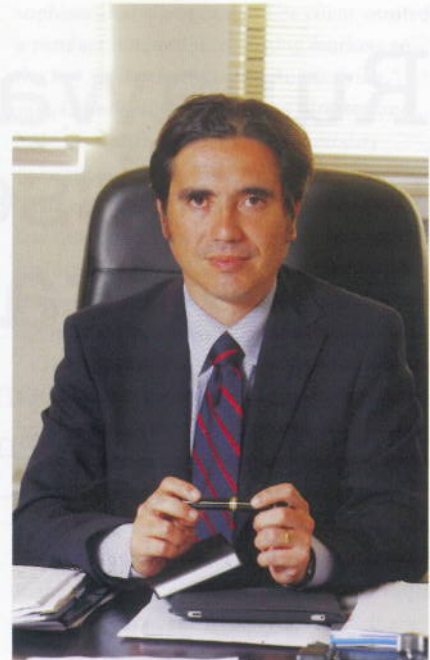
Last January, when OGX mandated Credit Suisse, HSBC, Itaú BBA and JPMorgan it was still one year away from producing oil (which was scheduled for January 28 this year as Euromoney went to press).

"There was a general perception from all the institutions we dealt with that despite the fact that we were somewhat far away from generating revenues the investment proposition – and the fact that we had found a lot of oil and were well on the way to developing first production – would enable us to obtain a rating," says Marcelo Torres, CFO of OGX.

The bond was needed to bridge the time between when it was issued and the end of 2013, which is when the company expects to begin to produce positive cashflows. "It is a very important deal for us," says Torres. "The bond market was ultimately a great solution – it was big and deep enough and gave us the liquidity we needed – effectively as a bridge to the positive free cash which we will see at the end of 2013."

"Selling a credit that was not yet generating cashflows was a challenge – we needed to explain to both the rating agencies and investors what the concept was, what their plans are, what capex needs remained and what that capex is expected to generate," says Roberto D'Avola, head of Latin American DCM markets at JPMorgan. "And at the same time you are raising a significant amount of capital, so I think those are all the things which made the transaction compelling."

But getting the agencies and investors on board wasn't easy. Torres describes the five months leading up to the bond as "very intense work". The rating agencies ultimately rated the deal B1/B+ but there is



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Ignacio Briones,
Ministry of Finance, Chile

acknowledgement that the company could – if the business plan is fulfilled – be upgraded to investment grade within the lifetime of the bonds.

The unusual corporate story meant that price discovery was something of a journey into the unknown. The bond opened with whispers of mid-to-high 7% for the 2018 notes: “We thought it could have been anything from 7.5% to 8% as we approached the market,” says Torres. “A couple of days into the roadshow [around May 20 2011] things started to look bleaker in Greece and then the market got more volatile as we got into the third and the fourth days. Investors were coming back saying we need a little more yield. At the end of the day we ended up paying 50bp more than we were targeting but given the returns we will be able to generate, it wasn’t a problem. What was important to us was to secure the funding we needed to take us to positive free cash.”

Investors sought, and got, an extra no-call year and additional restrictions on future leverage. “We got feedback on covenants and terms and conditions which was a very constructive process – it showed a lot of people were interested,” says D’Avola. “It became a discussion with investors rather than just between the issuer and the book-runners. It had to be very detailed as we needed to make sure the issuer was meeting the market – and vice versa – the covenants had to work for the company and fit with its growth strategy.”

Another interesting facet of the deal is that both high-yield and emerging market investors were targeted. Torres says there was an internal book among those working on the deal about which group of investors would take most of the deal. In the end it was close, but those betting on high yield won, with roughly 55% of the paper going to high-yield accounts and the remainder to emerging market investors.

AEI was a unique deal: a disposal process that enabled the owner to maximize the value of its Latin American assets. The company is an energy infrastructure business with assets in power distribution, power generation, natural gas transportation and natural gas distribution. The company is majority-owned by private equity company

Ashmore Group, which had been looking to sell its Latin American assets in an initial public offering, twice failing to price despite lowering the valuation from its 2009 attempt of \$3.9 billion to \$3.2 billion in 2010.

The complexity of the group of holdings was the main reason why the IPO route ultimately failed: the rating agencies and potential investors needed to do individual assessment on the 30 assets – including regulatory assessments of each of the seven Latin American countries in which they operated.

The company decided that the complexity of the story ultimately lent itself to a private or strategic investor and mandated Goldman Sachs and Itaú BBA, both of which had been working on the proposed IPOs with Santander and Citibank, to manage the disposal process.

In contrast to the IPO valuations AEI sold **nine operating companies for \$4.7 billion**, while also retaining some assets whose valuations were viewed as low by the owners or that they wanted to retain for strategic reasons. The portfolio approach was chosen to maximize the value to the whole of the strongest assets. In the end a consortium led by Iberdrola and advised by Citibank and Santander bought AEI’s assets in Brazil, Chile, Peru, Argentina, Panama and El Salvador. An EEB-led consortium (which is part of Grupo Aval) self-advised the acquisition of AEI’s Promigas and Calidda deals assets in Colombia and Peru.

“A sale to a single investor would have been simpler, easier to negotiate – and much easier to execute. However, the final solution with individual transactions going to two main consortia allowed for each asset to be owned by its best individual buyer,” says Esteban Gorondi, managing director at Goldman Sachs. “The controlling shareholders were extremely value focused and they found a way to maximize the value of the assets. We focused on the larger assets but treated it as one transaction. AEI had received a lot of offers from different parties for some of the assets throughout the years but there was a strong belief from the owners, and from ourselves, that this group of assets worked very well together. It was a very good portfolio and because of that they very intelligently didn’t want to dispose of one or two assets without having a solution for a clear majority.”

The transaction was structured so that if



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Marcelo Torres, OGC

any individual deal hit regulatory obstacles its failure to execute would not affect the progress of the other deals. As well as being an example of a complex cross-border transaction in a regulation-heavy industry it shows the shifting landscape of M&A within Latin America, with local players becoming more active and aggressive in purchasing companies throughout the region. “The process for selling assets in Latin America today versus five years ago is very different,” says Gorondi. “Local Latin American companies now have the cash and valuations to be major acquirers, therefore driving consolidation [in several industries]. Historically, local players used to focus mostly on in-country opportunities, but they have become leading buyers for large regional assets as well, either acting on their own or in regional consortia.”