

# LATIN AMERICAN

## Law & Business Report



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### HIGHLIGHTS

#### When "Notorious" is Not Enough: Distinguishing "Famous" Mexican Trademarks from the merely "Well-Known"

Under recently passed amendments, Mexico now distinguishes between well-known and famous trademarks. But the distinction, and some benefits, could be lost on many not familiar with the law. **Page 3**

#### Was Brazil Ready to Play the "Compulsory License" Card?

The Brazilian Ministry of Health recently took the first steps that would lead to local manufacture of patented AIDS drugs as a "matter of public interest." The action raises questions over the appropriateness of emergency declarations by Brazil to negotiate a better price of AIDS drugs. **Page 4**

#### Reducing Risks or Limiting Access to Financing? Argentine Central Bank Places Deposit Requirement for Foreign Funds

The latest changes to the foreign exchange regime will require 30 percent of foreign funds to stay in the country for one year. While the government has exempted some types of investments, the rules seem destined to cause misgivings among foreign investors. **Page 5**

#### Making a Modern Company out of Pemex

Mexico's state-owned oil company brings in huge amounts to the federal treasury, yet the company is starved for capital to underwrite badly needed new exploration and development projects. The Mexican Congress passed legislation in June that will help. **Page 18**

#### Exempting Investors in Colombia from Harmful Future Changes to Laws and Regulations

A new law in Colombia frees investors from concerns over later changes in laws that could harm the investment. But there is a cost to locking in the benefits, and legal changes by municipalities are not covered by the law. **Page 16**

#### Tapping Private Equity Funding for Latin American Operations

Private Equity Funds can fill the financing gap, particularly when the need is for later-stage financing. A review of considerations for companies looking for private equity. **Page 26**

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# Capital Formation in Latin America and the Caribbean

## *Private Equity Funds*

by Marc Ricart (BG Consulting)

[Editor's Note: This is the third in a series of articles that examine ways of raising financing for operations in Latin America. Earlier articles explored financing opportunities through multilateral agencies ("Multilateral Financing for Companies in Latin America and the Caribbean," April, 2005 LALBR, p.3) and financing through U.S. Agencies (Capital Formation in Latin America and the Caribbean," May, 2005 LALBR, p. 25).]

Private equity financing may be an appropriate financing mechanism for companies in countries that do not have stock exchanges or countries with immature markets, low liquidity and feeble local institutional demand. While one can argue that most economies in Latin America have adequate capital markets, their services, and especially competitive "capital formation costs," are available only to a few companies, usually those that have a well established market presence and record; moreover the banking industry is still based on short to medium term collateralized loans. This limiting aspect therefore creates an opportunity for private equity investors who, with their investments, complement a portion of the capital markets that would otherwise be untapped. Furthermore, private equity financing is also perceived as a critical change agent for the operations of an enterprise. It is sometimes summoned to act as the catalyst for bringing on board professional management, structuring the right strategic alliances, and positioning the company for a liquidity event.

Private equity includes shares in both mature private companies and in newly started businesses. Because the market is less liquid than publicly traded equity, investors expect on average to earn a higher risk premium from their investments. There are various types of private equity investments, angel investing, venture capital, leveraged buyouts, and later stage financing.

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### Emphasis on Later-stage Financing

We have found that the focus in Latin America is on later-stage financing. Later-stage private equity funds focus on identifying investment opportunities in more mature, proven companies with customers, revenues, and profits; companies with solid products and with management teams that have track records of success. Companies in these stages tend to use the financing to enter new markets or expand products or technologies.

Private equity in Latin America is a fairly new industry. The industry formally started in the early '90s when a handful of funds entered to the market and the overall assets under management in the industry experienced significant growth. From 1993 to 2004, a total of

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***From 1993 to 2004, a total of \$17 billion was raised through 158 Latin America funds.***

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\$17 billion was raised through 158 Latin America funds. Capital raising reached its peak in 1997 and 1998 when the industry raised \$3.4 billion and \$3.7 billion, respectively. However, it then plummeted in 2002 and 2003 when only \$0.4 billion was raised. Nonetheless, there seems to be renewed hope in this asset class since \$1 billion was raised in 2004, representing a 145 percent increase from the previous year.<sup>1</sup> The majority of funds raised for Latin America have been for country-specific funds rather than regional ones.

The capital invested in private equity and venture capital deals, including global funds and proprietary investing, amounted to \$20 billion through the years 1996-2004, with a peak of \$5 billion invested in 1998. However, since then, invested amounts have been declining and hovering at or under \$1 billion from 2001 to 2004.<sup>2</sup> The number of actively investing private equity firms has also steadily increased from 30 in 1996 to 39 by 2004,<sup>3</sup> having peaked in 2000 at 77 firms.

From 2003 to 2004, private equity fundraising in Latin America doubled to \$1 billion compared to the prior year. When compared to Asia's 50 percent increase to \$6.5 billion and Central and Eastern Europe's 50 percent increase to an estimated \$464 million during the same period,<sup>4</sup> these figures prove that emerging markets' private equity fundraising is growing at steady rates.

The main recipients of private equity and venture capital in Latin America during the period of 1993 to 2004 have been Brazil (32 percent), Argentina (29 percent), and Mexico (10 percent).<sup>5</sup>

*Private Equity Funds, Continued on page 27*

## Private Equity Funds (from page 26)

### Infrastructure Investments

According to a survey by KPMG<sup>6</sup> of participants at a Latin America Private Equity meeting in February, most respondents said the greatest investment opportunities lie in infrastructure investments in the region, followed by consumer markets and financial services. The survey also indicated that the expected private equity focus over the next two years will be in Mexico, Brazil and Argentina, followed by Chile and Venezuela.

Not surprisingly, some of the most notable deals this year have taken place in Mexico and Brazil. In January, Darby-BBVA Latin American Private Equity Fund acquired a 53.3 percent control equity interest in Laboratorios Kendrick, a leading drug manufacturer in Mexico. Last year Darby made another investment in Mexico when it purchased a stake in EWI Holdings, a privately-held U.S. company with an office in Mexico City, which focuses in the growing payments processing industry. In November, Boston-based Advent International closed on the acquisition of Proservvi, a Brazilian back-office processing operation for financial institutions.

Companies considering contacting funds to accomplish their capital formation needs, usually do so by consulting their investment bankers or advisors, who would

get in touch with the fund's headquarters directly or by speaking with a fund's local representative or representing firm. While it is common for companies to contact private equity funds to raise capital, it is very important that they contact funds whose investment philosophy matches the company's business and future strategy. The investments of a fund are limited to activities that fit the fund's investment philosophy, as established in the fund by-laws. Moreover, it is important that the company has a ready-to-defend business plan for the capital influx that shows room for fast growth and a clear exit strategy for the fund. Additionally, there are many questions a company should consider when pondering an investment from a private equity fund. Can the investment officers add value to the company? Have they added value to their portfolio companies? Will they remain partners for the long term? Do we share the same vision and investment perspectives for the company? To what extent will they interfere with existing management?

<sup>1</sup>Venture Equity-Latin America.

<sup>2</sup>VELA, 2004 figures VELA estimates.

<sup>3</sup>AssetAlternatives, VELA.

<sup>4</sup>Emerging Markets Private Equity Association

<sup>5</sup>AssetAlternatives, VELA.

<sup>6</sup>As published on the Economist Intelligence Unit's newswire on 3/10/05. □

## Latin American Project Developments

### *Argentine Incentives for Oil & Gas Drilling; Tax Increases on Mining in Chile; and Foreign Oil Companies in Ecuador*

by Keith Martin (Chadbourne & Parke)

#### *Argentina*

Argentina is expected to adopt incentives for new oil and gas drilling.

The government sent Congress a proposal in late May that would allow oil and gas companies to claim faster tax depreciation on assets used for new drilling—both at expansions of existing projects and at completely new projects. The measure would also exempt equipment imported for such drilling from import duties.

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Companies are also supposed to receive faster refunds of value added taxes paid on such equipment. The measure is expected to pass Congress easily.

There is a tradeoff. Companies will have to enter into some unspecified form of association with the state-run oil company, ENARSA.

Meanwhile, the province of Buenos Aires said in early June that it has secured court orders to seize wages of 41 executives of multinational companies who are delinquent in paying real estate and vehicle taxes. It has also commenced court proceedings against another 83 executives at such companies.

#### *Bolivia*

Bolivia is bracing itself for lawsuits after it increased government levies on oil and gas produced in the country

*Projects, Continued on page 28*

## Developments (from page 31)

(ANAUCO) against the company Liberty Taxis, which renders services in all Sambil shopping centers of Caracas, due to supposed abuse of dominant position and unfair competition practices.

### Anti-dumping

On April 15, 2005, the Anti-Dumping Commission (CASS) issued a notice of expiration of definitive anti-dumping duties for imports of seamless and welded steel pipes for fluid conduction at pressures of a nominal external diameter lower than or equal to 16 inches, originating in Japan and disregarding the country of export. (Official Gazette No. 38,201 of June 3, 2005) These duties will expire on July 13, 2005. Within 30 working days immediately preceding the 30 working days before the expiration of the measure, local producers of similar goods may file a request of review before the CASS, so that this resolves whether or not the continuation or re-appearance of the dumping and of the damage to local production would occur after such expiration.

### Miscellaneous

The Organic Law of the Municipal Public Power which substitutes the Organic Law of the Municipal Regime, was published in the Official Gazette of June 8, 2005. This new law covers the organization, functioning, government, administration and control of the Municipalities. Among the most important issues covered by this new law we can point out the following: (i) calculation of municipal taxes is based on gross income received, not caused as previously; (ii) municipal taxes are only applicable on customary activities of taxpayers; (iii) telecom activities are taxed (contradictory with Organic Telecommunications Law); and (iv) connection parameters for telecom services are established.

The law approving the Integral Treaty for Energy Cooperation between Venezuela and Uruguay was published in the Official Gazette of June 13, 2005. The purpose of the treaty is to promote cooperation between the two nations for studies, preparation and execution of joint projects in the areas of exploration, extraction, production, transport, refining, storage, processing, distribution and commercialization of hydrocarbons, as well as the strengthening of the ties between the oil companies of both countries. □

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