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The JOBS Act and Its Implications: Behind the Curtain of Hedge Fund Advertising

Post-Crisis Trends in Offshore Investment Structures

E-Learning Arrives in LatAm

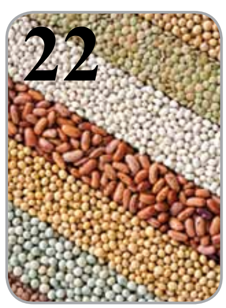
The Truth About Nationalization

Education Special Focus

Investing in our Future... and Present

Contents

Sectors



Issue Focus: Education

Cover Stories

Letter from the Editor

When looking at emerging and developing markets, fundamental economics come in to play and are crucial for the creation of a sound foundation on which growth and prosperity can be built. The generally accepted father of modern economics, Adam Smith said, "It is not from the benevolence of the butcher, the brewer or the baker that we expect our dinner, but from their regard to their own interest." This philosophy stood as competition's Rule No. 1 for centuries until John Nash made a few corrections, saying, "The best for the group comes when everyone in the group does what's best for himself and the group."

It has become abundantly clear over the past few months that Argentina is unfamiliar with Nash. The beautiful country and home of Alternative Latin Investor has been plagued with head-scratching economic decisions emerging from the Kirchner administration, from past nationalization of pension systems to recent nationalization of YPF/Repsol and prohibitive foreign currency restrictions. A strange tactic, having spent the last decade attempting to rebuild investor confidence ruined by the 2001 economic meltdown.

The luck of past years' high commodity prices will come to an end, leaving the nation in quite a predicament, with no possibility of any FDI to the rescue. This is not to say there aren't opportunities in Argentina — there are. As we are strong proponents of comparing country risk with real asset risk, the latter is significantly lower than the former in many sectors. However, the uncertainty created by the current administration makes the risk unbearable for many investors, especially in a region with so many other offerings.

Other LatAm nations understand there is competition for investors and act accordingly. Chile has blazed the path for foreign investment over the last two decades. Colombia has been diligent in changing its public perception from drug haven to investors' paradise, and Brazil has managed perhaps the toughest legislation that encourages foreign investment while protecting domestic interests. It can be done, Argentina. We eagerly wait for you to realize this and make the country as prosperous as we all know it can be.

Nate Suppaiah
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Imagine...
Imagine the fun
Imagine the freedom
Imagine the luxury
Imagine yourself onboard
Diamond Collection
ONBOARD WITH THE BEST
MY IMAGINE is just one of the hundreds of stunning yachts we have available for charter this summer. Please contact one of our expert charter brokers for more information.
MY IMAGINE | 65m (214') | Amels | 2011 | 12 guests | €465,000 per week
Photography by Marc Paris

Getting into Deep Water in Brazil

Mark McHugh

Recent ultra-deep water offshore discoveries are reconfirming Brazil as the largest and most significant new oil and gas prospect of the last few decades. Brazil produces around 2.8 million barrels of oil equivalent per day, including biofuels, ranking 9th among oil producing countries today. Meanwhile, Petrobras is forecasting daily production of 6.4 million barrels by 2020, which would place Brazil in the top 5 globally. The aggressive targets particularly for the deep-water development over the next 10 years will require as much as US$1 trillion investment, in an extraordinary undertaking, which represents the most challenging frontier yet for the offshore oil industry. Despite the general belief that the country may fall short of its ambitious goals, there can be no doubt that Brazil will become one of the leading non-OPEC producers in the coming decade. While political unrest in the Middle East continues to create volatility in global oil markets, the value of a major new stable source of supply cannot be underestimated. Such an important development is also destined to have a profound effect on Brazil's economy, already the 6th-largest in the world and on a fast growth trajectory as one of the BRIC economies. The greatest impact is expected to occur in the oil and gas service sector, which accounts for 10% of Brazil's economy now and is predicted to grow to 25% by 2020. This provides a unique opportunity for Brazil to become a leader in the high-tech deep-water industry and for international suppliers and investors to participate in a share of the prize, but only if they can avoid the hindrance of supply-chain issues.

The Oil Boom in the Pre-salt and Beyond…

Deep-water discoveries in the pre-salt or pré-sal ("below the salt") fields offshore, southeast of Brazil, commenced in 2007 and have increased the country's total estimated recoverable reserves by over 50 billion barrels. Many believe the recoverable reserves could eventually be as much as 100 billion barrels or greater. As a result Brazil now vies with Russia for 2nd place among non-OPEC countries in terms of potential reserves. Meanwhile, Brazil is only just getting started on expanding its production. As new wells come on stream it is projected that the pre-salt oil fields will account for 40% of the country's production by the end of the decade, up from less than 2% at the moment.

Early exploration success in the Campos and Santos basins has put the spotlight on the pre-salt there. Yet many more opportunities exist. Late last year Petrobras, the state-controlled oil company, reported one of several new ultra deep-water discoveries off the coast of Sergipe in northeast Brazil, where they proved a reservoir with characteristics similar to the Campos Basin. In addition to the focus on deep-water offshore, it is worth observing that Brazil has 29 sedimentary basins with oil and gas potential, covering 5 million square kilometers, with less than 5% under concession and over 50% onshore. Vast areas of this resource-rich country are yet to be explored, serving to highlight the extensive underlying prospects and representing an upside not so far taken into account by Petrobras.

In essence the Brazilian oil and gas opportunity can be divided into four main segments:

- Deep and ultra-deep offshore
- Shallow offshore
- Mature onshore
- New frontier onshore

Unconstrained Potential Growth by Segment

Hence, Brazil's potential production is significantly greater than even Petrobras' projections, assuming no development constraints. For now the main burden for the development of the deep and ultra-deep basins falls upon Petrobras as the primary driver of the industry in partnership with the oil majors. The company is planning massive capital expenditure of almost $225bn in the 5 years to 2015 and is grappling with the huge tasks involved in bringing on stream pre-salt production in a timely manner. Yet other players are finding a niche; OGX, the largest independent Brazilian oil company, has recently demonstrated that substantial reserves lay in the more accessible shallow waters of the Campos Basin.

Additionally, there remain a number of mature onshore basins, which continue to produce up to 20,000 bpd, which Petrobras is seeking to divest from, as their attention is increasingly drawn to the key challenges of the pre-salt. Moreover, ANP, the Brazilian regulatory body, has been encouraging new frontier exploration in recent licensing rounds, such as in the Amazon region with the Solimões Basin. However, these pros-

There is a unique opportunity for Brazil to become a leader in the high-tech deep-water industry and for international suppliers and investors to participate in a share of the prize.

pects are typically in remote areas with high associated costs for infrastructure development. They are attractive only to those with a long-term perspective.

The True Prize

In spite of such a huge opportunity, the pursuit of oil in the pre-salt will not be successful without the ability to effectively manage the growth over the coming years. This is not only because of the massive capital budgets involved and the immense technical challenges of deep-water development, but also because of the underlying need to develop a world-scale oil service industry to support the expansion. Brazil is very quickly becoming capacity-constrained in terms of production, rather than reserve-constrained as most non-OPEC nations are. On the other hand the true prize will be in generating a sustainable benefit, based upon creating the right conditions for the oil service industry to flourish and to attract the necessary capital and technological capability, then providing trained resources to meet the challenge.

Precision-Engineered Subsea Components in Campinas, SP

Much depends upon how the politicians react to the situation. Countries with big oil finds are prone to the curse of oil and an ominous list of economic ailments such as

- Dutch disease: oil exports pushing the currency to a level that hurts other industries.
- Capital absorption: the diversion of funds from other worthwhile investments.
- Reform fatigue: governments' unwillingness to tackle structural economic problems when they can see vast wealth on the horizon.

Perhaps mindful that the real bottleneck is in the oil services industry, the government does not appear to be in a hurry to hold the next round of tenders for the deep-water blocks. The process has been bogged down anyway by a political row between Brazil's state governments over how to distribute royalties.

Conquering the Deep Frontier – Technology and Politics

So far Petrobras has been drilling in the pre-salt fields to verify reserves and to fine-tune the technology but has been producing little oil. The pre-salt development represents an enormous technical challenge, and not just because of the depth, and thus the pressure, at which the drills must operate. New seismic techniques are needed to see what's going on due to the thick layer of salt. The salt shifts during drilling, as the salt layer is softer than rigid rock, which means that solidifying drilled wells is more difficult and expensive. The oil comes out of its reservoirs very hot, and must then pass through wellheads that are only a few degrees above freezing. There are contaminants in the pre-salt oil that make it highly corrosive, so Petrobras has been working on new alloys for its equipment.

The possible complications are numerous. Huge, technically challenging projects always tend to run late and over budget. There is a lot of national pride at stake. As a Brazilian friend remarked the other day, "This is not Africa." Outsiders must recognize that Petrobras is set to overtake Exxon Mobil as the world's biggest listed oil company by 2016 and it already leads the industry in a number of technical areas. Yet the rumors of delays abound, as well as suggestions that the 2020 target will be missed by as wide a margin as 1 million barrels per day or more. Petrobras is highly sensitive to the political implications of this and appear unwilling to openly acknowledge any possibility of set-backs. Meanwhile, it has struggled to meet its 2011-15 business plan and over the past three years has been able to add only 150,000 b/d in supply.

A recent incident underlines the fragility and sensitivity of Brazilian authorities to the technical risks and the possibility that something might go wrong on the scale of the BP oil spill in the US Gulf. Brazilian federal prosecutors in December 2011 announced they are seeking $10.6 billion in damages from Chevron citing environmental harm caused by an offshore oil leak. The Frade leak, which occurred 230 miles offshore after a pressure kick during drilling, later resulted in oil seeps of about 3,000 barrels from the seafloor, which never even reached the Brazilian coast. Most believe that this is an overreaction, and the massive damages sought in the case are unreasonable. The increased risk such fines represent would scare away most potential investors and likely bring the country's ambitious plans for the pre-salt to a grinding halt.

Only for the Big Boys

The huge capital budgets and numerous challenges for E&P asset development in deep-water Brazil mean it is only for the big players. Since Shell became the first international operator to start oil and gas production in Brazil in 2003 under a concession agreement, ending the former monopoly of state-owned oil operator Petrobras, at least 36 foreign companies have entered the country's upstream market. Most of the other international oil majors are represented in Brazil as well: BG, Chevron and Exxon Mobil have interests in blocks in the country and BP has bought $7bn in assets from Devon Energy that include interests in Brazil.

As part of their global quest for resources, Chinese companies have become the largest foreign investors in Brazilian oil and gas, particularly the oil and petrochemical group, Sinopec. This mirrors China's dominance over the US as the largest foreign investor as a whole over the last 2 years. In November Sinopec paid a total of $5.2bn for a 30% stake in the Brazilian assets of Galp Energia, the Portuguese energy company. This follows Sinopec's $7.1bn purchase of the Brazilian assets of Repsol YPF in 2010. Among the other Chinese groups, Sinochem has a $3.1bn stake in a field off Brazil's southeastern coast operated by Norway's Statoil.

After a major revision to petroleum laws in late 2009, all E&P activities relating to the pre-salt region are now governed by Production Sharing Contracts (PSCs). This new production framework is designed to replace the concessionary model in place since 1997 for those blocs denominated "strategic." Furthermore, the law dictates that pre-salt reserves are to be explored and developed in partnership with Petrobras, which has a minimum interest of 30% in any given consortia. In addition, the law declares that Petrobras can be awarded pre-salt exploration contracts without a competitive bidding process. After incorporating the various taxes and government takes, an operator can expect to keep 25% to 30% of revenues, making the offshore development robust down to $35 - $40/bbl oil prices.

Petrobras Platform Under Construction in Angra dos Reis, RJ

The government regulatory body, the National Agency of Petroleum, Natural Gas, and Biofuels (known as the ANP) has held 12 exploration and production licensing rounds, under the concession framework. The licensing rounds begin with the publication of the bidding pre-notice and drafting of the concession contracts. Public consultations are held to address technical, environmental, fiscal and legal issues. Upon resolution of any substantive issues, the ANP makes the necessary data available to interested companies and opens up the qualification process. Interested parties make their bids through a transparent, sealed auction. The bids are evaluated by a special committee, the winner is selected and the contracts are signed.

Long Gestation in the Service Sector

Brazil already accounts for 22% of the world's deep-water production, a share that is expected to grow to 50% by 2020. With the main focus of the offshore oil industry globally now on Brazil, international players in the oil and gas service industry are scrambling to set up business locally. One international joint-venture manufacturer of offshore equipment recently described how they were unable to meet even 5% of the potential demand from national sources, which is not untypical.

However, perhaps the biggest challenge for Petrobras will come from the strict local-content requirements the government is imposing on pré-sal projects. The government intends to make these progressively more demanding, applying them to the entire supply chain. By 2017 they may reach as high as 95% for some parts of it. Meanwhile, Brazil's FPSO fabrication yards are operating at maximum capacity. The outgoing Petrobras head Mr. Gabrielli recently stated: "What's going to be the main constraint that we face is the speed of the supply chain worldwide to provide the goods and services that we need." By contrast, in her first press conference in February, incoming Petrobas President Maria das Graças Foster highlighted the importance of the government's policy of incorporating local content of up to 65% in the national oil services industry. Petrobras says its level of local content is close to three-quarters.

Undoubtedly, meeting the world's largest corporate capital expenditure program, valued at $225bn over five years would be a challenge even without local content targets. Increasing the local content remains a basic requirement of the nation and of Petrobras according to Ms. Graças Foster. Arguably, the ambition to get the most out of the know-how being developed and to become the world leader in ultra-deep drilling is the right approach for Brazil. However, experience of other countries' local content programs would suggest that the creation of true national capability will take many years to bear fruit. Even if Brazil did have the manufacturing capacity, its industry is not yet internationally competitive. A mid-range tanker can cost $66m to build in Brazil, twice as much as in China, Credit Suisse estimates. In line with its policy, Petrobras recently approved a major contract for 26 rigs. All units, which have local content requirements ranging from 55% to 65%, are to be delivered within 48 to 90 months. The project includes the construction of new shipyards in Brazil and the use of existing infrastructure. Nevertheless, there are already concerns about higher costs and delays.

FPSO Cidade de Niteroi

The attempt to stimulate supply-chain industries is in part a way to offset the Dutch-disease damage of high exchange rates. Yet forcing Petrobras and its partners to buy Brazilian, and international companies to relocate, is estimated to cost the Brazilian oil and gas industry 10-40% more than world market prices.

Meanwhile, companies in Brazil's exploration and production sector struggle today to recruit key workers. For instance, the Brazilian government estimates that 250,000 skilled workers will be needed for the development of new oil fields over the next four years. Brazil's labor market is already so tight that employers complain about a "labour blackout." While Petrobras itself is unlikely to suffer —it gets hundreds of applicants for each job — its suppliers are struggling.

The huge energy infrastructure deficit, stringent local content requirements and the rush to develop multiple projects simultaneously will undoubtedly lead to delays and eroded value.

The Politics of Oil

Petrobras' downstream operations weighed heavily on its performance, as demand in Brazil for petrol is soaring on the back of a growing economy. This is straining Petrobras' domestic refining capacity and forcing it to import fuel at higher global market rates and sell it at lower local prices. Although Brazil does not officially subsidize fuel, Petrobras has not increased prices for eight years. Analysts believe this has been at the insistence of the government, which uses Petrobras as a means to control inflation.

The company has forecast it will more than double production to 6.4m b/d by 2020. While this target is based on existing fields, it will require Petrobras and the government to also make more progress in developing the vast new ultra-deep water discoveries. This is amid continuing concerns of government meddling in the company and that the push for locally made equipment is leading to supply-chain holdups.

Since the pré-sal was discovered, Brazil's politicians have talked much less about reforming burdensome tax and labor laws. The corrupting tendency of oil is worrisome in a country where the president sacked five ministers last year over accusations of illicit enrichment. Without a lot of care, oil might block development as much as spur it on.

Investor Perspective

With only a few wells drilled to date in the high-potential pre-salt fields, largely underexplored interior and coastal areas, Brazil will become a major focus for E&P activity worldwide over the coming decade. Equally important, sustained global demand for hydrocarbons and political instability in the Middle East will continue to make deepwater, pre-salt and other high-cost developments in Brazil relatively low-risk and thereby highly attractive. This dynamic will continue to direct capital toward the country. Local and foreign companies with experienced and competent management teams in the E&P sector will take advantage of this; these companies will have a high chance of achieving exploration success and consequently generate significant profitability. In the near term, investors with exposure to such companies will benefit from the country's exploration potential. However, the huge energy infrastructure deficit, stringent local content requirements and the rush to develop multiple projects simultaneously will undoubtedly lead to delays in the development of projects and erode value. The oil service industry is not yet getting the traction it needs to fulfill its promise. Levels of foreign direct investment in this sector are hampered by the high "Brazil cost" and complexities of doing business in Brazil. Nationalism is also on the ascendancy: with the new petroleum law that grants Petrobras an effective monopoly over all future pre-salt projects, with the push for local content, with the excessive fines of Chevron for the recent oil spill and with political arguments between the states over sharing royalties. While the near-term opportunities in Brazil are compelling, investors have to remain cognizant of project development, execution and political risks.

Author Biography

Mark McHugh is Managing Partner, Brazil, for Oilfield Services Capital, a boutique investment firm representing equipment and service providers in accessing the fast-growing Brazilian oil and gas sector. He has extensive experience in marketing, sales, strategy consulting and general management in the international downstream and mid-stream oil industry. He spent 26 years with Shell, where he became vice president of regional marketing for the Americas. During his time at Shell, he was a key member of the management team of regional and global business.

He has an exceptional track record in leading new business development, implementing global business strategies, mergers and acquisitions, and managing startups. As an entrepreneur, he is currently working on a pipeline of more than US$800 million in oil and gas and renewable energy deals. He has undertaken a number of market-entry studies for international companies tapping into the Brazilian market.

The Argentine Dream: *Shale Oil & Gas*

It's been an exciting and ultimately strange year in the world of Argentine oil and gas. In 2011, the country catapulted into the industry's limelight when the US Energy Information Administration (EIA) reported that Argentina had the third-largest technically recoverable resources of shale gas in the world, behind only the US and China, most of it within the Vaca Muerta (Dead Cow) shale in the Neuquén Basin within the western provinces of Neuquén and Mendoza. Having seen how the shale revolution rejuvenated the US oil and gas sector in the last decade, the global industry's major and minor players positioned themselves to enter Argentine shale. At a 4-day conference in Buenos Aires last January, hosted by American Business Conferences and chaired by Antrim Argentina's Nicolas Davies, the hundreds of attendees included exploration and production (E&P) chiefs, engineering experts, suppliers and servicers, upstream and downstream executives, investors and the press. A highly informative conference, its prevailing mood was one of cautious optimism tinged with a subtle and unspoken dread – a general sense that Argentina was sitting on a huge opportunity, qualified by the awareness of many looming risks and unknowns.

Swept up by the same excitement, and curious to find out how an issue with such immense and complicated economic, social and environmental implications would unfold, ALI attended the conference in January with the intention of using the information gathered there and interviews with as many attendees as possible to produce a long, stand-alone report on the subject. We wanted to find out what the Argentine shale play's prospects were, and what it meant for alternative asset investing in Argentina, particularly in the energy and infrastructure sectors. What neither we nor, it seemed, anyone at the conference could quite foresee, however, was what an odd twist the entire issue would take in the following few months, with the downfall and nationalization of YPF/Repsol by Cristina Fernández de Kirchner and the Argentine federal government – a turn of events that plunged us into the same frustrated and bemused state as the rest of the LatAm investing world, and gave pause to our own E&P (as it were) ambitions.

Instead of our tell-all report, then, we've decided to broach the subject with a more modest article containing some observations and information that, however limited, will be valuable to investors who are following this story. It also offers several important considerations that we believe investors intrepid enough to be entering this play must bear in mind. Please note that many of the interviewees spoke to us in the immediate wake of the conference, well before the YPF takeover, but in all cases, their words are just as relevant now, if not more so.

Energy Crisis

The EIA's announcement last year, as well as YPF/Repsol's announcement last November that the company – Argentina's largest oil producer by revenue – was sitting on about a billion barrels equivalent of shale oil and gas, was a massive dose of good news in the midst of what everyone in the Argentine energy sector considered a crisis. Long a major producer and net exporter of natural gas, with a handful of multinational and domestic producers operating profitably and fueling the domestic market, Argentina had seen its position slip significantly over the course of the last decade, as price controls and subsidies ensured lower production by producers in the country, even as domestic demand and consumption skyrocketed during the country's ongoing economic boom.

The result was the first trade deficit in years; a Boliva-to-Argentina gas pipeline that, long in disuse, suddenly flowed with imported Bolivian gas; and an oil and gas industry which, unable to sell its products at international rates, was left with little incentive to ramp up E&P.

For many critics, such as Scott Swenson, Chairman of Conduit Capital Partners, this situation was a recipe for disaster. "Economically what they are doing makes no sense," he said, shortly before the YPF takeover. "They have this populist orientation where they think they're doing the citizens a favor by keeping the prices arbitrarily low, but all they're doing is reducing the supply of domestic natural gas and importing LNG [liquefied natural gas] that costs 10 times as much."

"I'm a capital allocator," Mr. Swenson added, speaking shortly before the YPF takeover, "and I would never put money in Argentina when I could go to Brazil or Peru or Mexico or a half-dozen other countries that let the market work and let competition determine what prices should be."

James Knight of Pionero Parners, an Argentina-based advisory firm, speaking shortly after the YPF takeover, concurred, summing up the knotty, unsustainable situation the Argentine government had found itself in: "Argentina is 90% dependent on hydrocarbons. Subsidies currently mean that gas is imported from Bolivia at around US$11/barrel. It is sold in Argentina for around US$2.65/barrel. Energy subsidies were almost ARP46 billion in 2011, and in a country that prioritizes economic growth above everything else, that's a concern, because every new bit of activity will have to rely on imports."

Cue Massive Shale Discoveries

Suddenly, last year, the world knew that Argentina possessed an immensely valuable, if hard-to-quantify, asset, which some estimate could supply the country's domestic gas market for some 400 years, but which (the late) YPF/Repsol had estimated would require US$25 billion in investment annually for the foreseeable future. This was a resource that had to be developed, but no one quite knew how it would happen. Nevertheless, there was widespread optimism that, if managed right, the shale play would be a boon to Argentine production and exports and the many industries surrounding them, meaning jobs, development and the current government's most highly coveted jewel: dollars.

Let's Get Together

That was the context for the conference in January. Listening to the variety of speakers,

> *The downfall and nationalization of YPF/Repsol by Cristina Fernández de Kirchner and the Argentine federal government plunged us into the same frustrated and bemused state as the rest of the LatAm investing world.*

all of them impressively knowledgeable, the sum of information and evaluations fell into a few categories: describing what we know; describing what we still don't know; envisioning the best-case scenario in terms of development; and discussing what would have to fall into place for that best-case scenario to be realized.

Robin Hamilton, Exploration New Ventures manager at Shell Upstream, who gave a presentation at the conference, spoke to ALI shortly afterward (but well before the YPF takeover) and articulated what seemed to be the consensus opinion there. "Technically, the Neuquén Basin scores very well against many of the North American shales," he said. "If the fiscal environment can be created for this to happen, it will be huge for Argentina, and there will be growth across all of the segments of the industry that you associate with a large onshore play development."

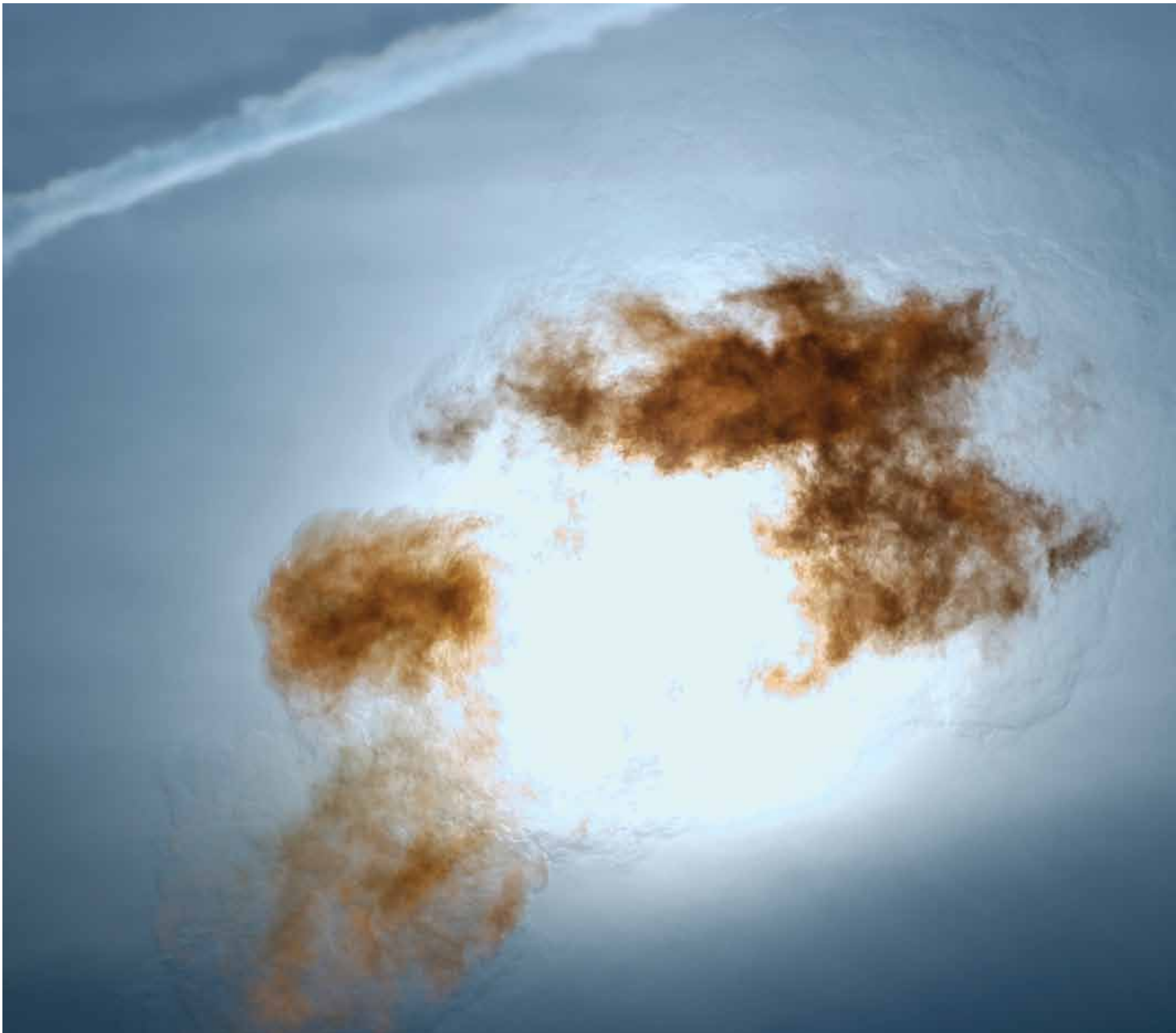
Alison Esquivel, a consultant at Strategias Americas, whose clients include international investors interested in small and mid-cap investments in the region, agreed with that assessment, emphasizing the potential opportunities in store for service, supplies and construction companies both up and midstream, many of whom attended the conference and set up stands there. "Some North American services and equipment companies stand to expand heavily from any production of shale oil and gas in Argentina," she said, shortly after the conference.

Additionally, there was excitement about the positions of certain Canadian juniors, such as Azabache and Americas Petrogas, who stood on massive acreage in the Neuquén Basin. It was clear that these smaller companies would need help and investment from more capital-flush majors; Americas Petrogras had recently announced a joint venture partnership with Exxon Mobil.

The Great Unknown(s)

There was, however, some controversy regarding the quantities, nature and, most importantly, recoverability of these shale gas and oil resources. Some pointed out that only a relatively small portion of the basin and other areas of Argentina had been explored. As Francisco Macias, partner and oil and gas expert at Buenos Aires law firm Marval, O'Farrell & Marval, told ALI, "Argentina's exceptional geological potential is encouraging. Only 6 out of the 23 Argentine sedimentary basins are currently under production. The remaining 17, covering 3M km2, remain mostly unexplored."

Others, meanwhile, maintained a healthy skepticism regarding the Neuquén Basin shale. "Let's make sure we describe the



Argentina shale plays as resources, not reserves," said Gervasio Barzola, Subsurface Vice President for the Eagle Ford Asset Team at Pioneer Resource (Eagle Ford being a massive shale field in Texas), in response to a clumsily worded question. (Reserves are resources that are proven to be technically and profitably retrievable.) "I am convinced there is a lot to learn to identify whether this potential is as extensive as it seems or dominated by isolated sweet spots."

Making It Happen

But if most of the attendees took it for granted that a major resource of some kind and quality was there, Mr. Hamilton, of Shell, posed the key question: "How producible will it be?"

Leaving aside the complex technical issues at play (the gist of that discussion was the developers in Argentina could borrow much from North American shale E&P techniques, but that the Argentine shale posed its own set of unique problems), many of the conference's speakers mentioned prices, fiscal concerns and political stability as essential to any long-term development – emphasizing that shale development is far more complex and investment-intensive than conventional gas and oil development. "The nature of shale gas development is quite different from conventional development," Mr. Hamilton explained. "The margins are smaller, so the cost environment and contract stability are very important issues."

There was also a general consensus that Argentina did not yet have the equipment and services necessary to develop the play, nor the expertise, and that rigs, supplies and intellectual capital would have to be imported – an issue that everyone recognized as tricky, to put it mildly, given the current government's increasing import restrictions. In short, the conference attendees seemed to agree that certain essential factors, many of them government-controlled, would have to fall in line in order for development to be feasible and profitable.

¿Dónde Están?

If the talk was more or less optimistic, though, the federal government's conspicuous absence from the conference, and the general lack of concrete facts regarding precisely these key issues, boded ill to some. "I was very sad the last day of the conference," said Mr. Barzola, "when after several interesting talks, the mood was still dominated by uncertainties, and those were not geological or engineering, but political."

Over the next few months, with the international community watching as YPF/ Repsol was stripped of several licenses by provincial governments and menaced by the federal government for its alleged failure to invest in exploration, even as the Oil Plus program of exploration-promoting subsidies was repealed – all in the context of an inflation-riddled and seemingly unsustainable economic situation – those political certainties were cast into sharper, if not positively lurid, relief. Though it remains impossible to know the exact ramifications of the YPF takeover and Repsol's ripostes, it was clear that the dream of Argentine shale was taking a dramatic step backward.

Jill Hedges, senior LatAm analyst at Oxford Analytica and an expert on Argentine history, speaking during the ominous buildup to the YPF coup, summed the whole Argentina shale situation up best: "The initial reaction to this kind of thing is that everyone throws their hats in the air and says, 'Oh, this is wonderful, we're saved, everyone's going to want this,' but then, when you start looking at the logistical and legal problems, it doesn't look so brilliant."

Don't Go There

Some critics think the entire play was and remains a fool's errand. For Mr. Swenson, of Conduit, who spoke to ALI shortly before the YPF takeover, Repsol's problems, not to mention its final fate, were a friendly reminder. "Argentina is one of the countries we won't touch," he said. "It is a fabulous country with fabulous people and resources, but it's got a government that doesn't understand basic economics, and the people who own power assets there are struggling because they're not allowed to earn a fair return."

Luciano Gremone, an Argentina expert at Standard & Poor's, had a slightly more optimistic view of the general prospects for foreign companies at that time: "In general, I would say that the cost structure to operate in Argentina is still competitive and still results in positive operating profitability in E&P, even under the current price regime." But he noted that "what's important is not only operating profitability but return on capital and the incentives necessary to explore and replace reserves," adding that Argentina's sovereign credit rating of "B" already implied substantial political risk.

Ms. Hedges, taking a more historical perspective, noted that those returns and incentives, and the entire investment climate, are perennially difficult to predict in Argentina. "There is always a problem with legal stability in Argentina," she said. "They change the rules on a frequent basis. So the conditions you have when you start may not be the same conditions you have in a year or two."

She added she expected more of the same in the coming years: "Everything in Argentina is always temporary, but also quite cyclical. There's a long history of protectionist policies, but also of 180 degree turns of policy at regular intervals. Down the line you could see total liberalization, and if things go bad again, increased protection. But I wouldn't count on it getting any better soon. On the contrary, Kirchner has been elected with 54% of the vote, she's got 4 years, and there's talk of reforming the constitution to let her stay another term. There's no serious opposition in Argentina. I wouldn't bank on there being some other form of government for some time."

Mr. Knight, of Pionero, speaking after the takeover, agreed, emphasizing how much depends, now, on the government's next step. "In the wake of the YPF saga, what Argentina still lacks is a coherent energy strategy that sets out clearly how it intends to develop both conventional and non-conventional reserves. Which means that policymaking still has the potential to be capricious, responsive, and led by the requirements of a populist government."

Learn from Their Mistakes

Yet Mr. Knight also held onto some highly conditioned hope, seeing the takeover in context and as an object lesson, and urging investors to see the general pall cast over investment in Argentina as the more nuanced reality on the ground. "The federal government is taking a lot of heat for the YPF expropriation," he said, "but the fact is that hydrocarbons law in Argentina states that any underground resource (unless it's offshore) belongs to the provinces. Therefore, building strong links with the provincial administrations, and even with local mayors, can be key. This is done by showing them the positive benefits, in terms of jobs and economic development, that your investment is going to be bringing, which can be converted by them into votes."

Mr. Knight gave further advice for investors still interested in entering this play: "What I would say is that you really need to do some due diligence on the province you want to go into. Neuquen and Rio Negro are two of the better ones, especially Neuquen, which has a reasonably developed services industry. Many companies in Neuquen are longing for capital to be able to expand their operations into neighboring Mendoza, for example, to take advantage of extractives opportunities there by complying with provincial labor legislation that often stipulates quotas for local firms.

"Also, ask the provincial chamber of mines for details of their previous solicitation processes, which should be publicly available. In cases where the preferred bidder does not have a proven track record in oil or gas, be prepared to ask some tough questions about why the license was awarded."

Where Do We Go From Here?

As for ALI, if we set out originally on our own kind of E&P mission in hopes of producing the final word on the matter, we came up a bit dry. No one knows what path Argentina's federal government will take in the coming months and years, and until that is clear, it will be very difficult for the alternative asset investment community to evaluate the potential risks and returns of this play. But if most things are unclear at the moment, it's clear that the Argentine shale play – enacted with quintessentially Argentine histrionics in recent months – is still in its first act. We will continue covering it in upcoming issues, and invite you to send us any critiques, observations or contributions that may help.

Mobile Payments

Latin America Primed For Mobile Payments Boom

The way in which we pay for goods and services is changing. New technology is turning smartphones into all-encompassing banking devices, gradually making checkbooks, credit cards and even cash obsolete for the modern, mobile consumer.

Mobile payments broadly refer to any regulated financial transaction conducted using a mobile device, either via SMS, WAP or, more recently, through contactless scanning, as introduced in Starbucks in the US in January 2011. Its use is growing at breakneck speed: A report by UK-based Juniper Research last year estimated that the global market for mobile payments will almost triple in value to US$670 billion by 2015.

Rodger Desai, the Founder & CEO of PayFone, a leading mobile payments processing company backed by American Express and Verizon. The company aims to make "m-commerce" more efficient and secure by using existing mobile operator networks for real-time authentication, something Desai says will help expand the use of mobile payments.

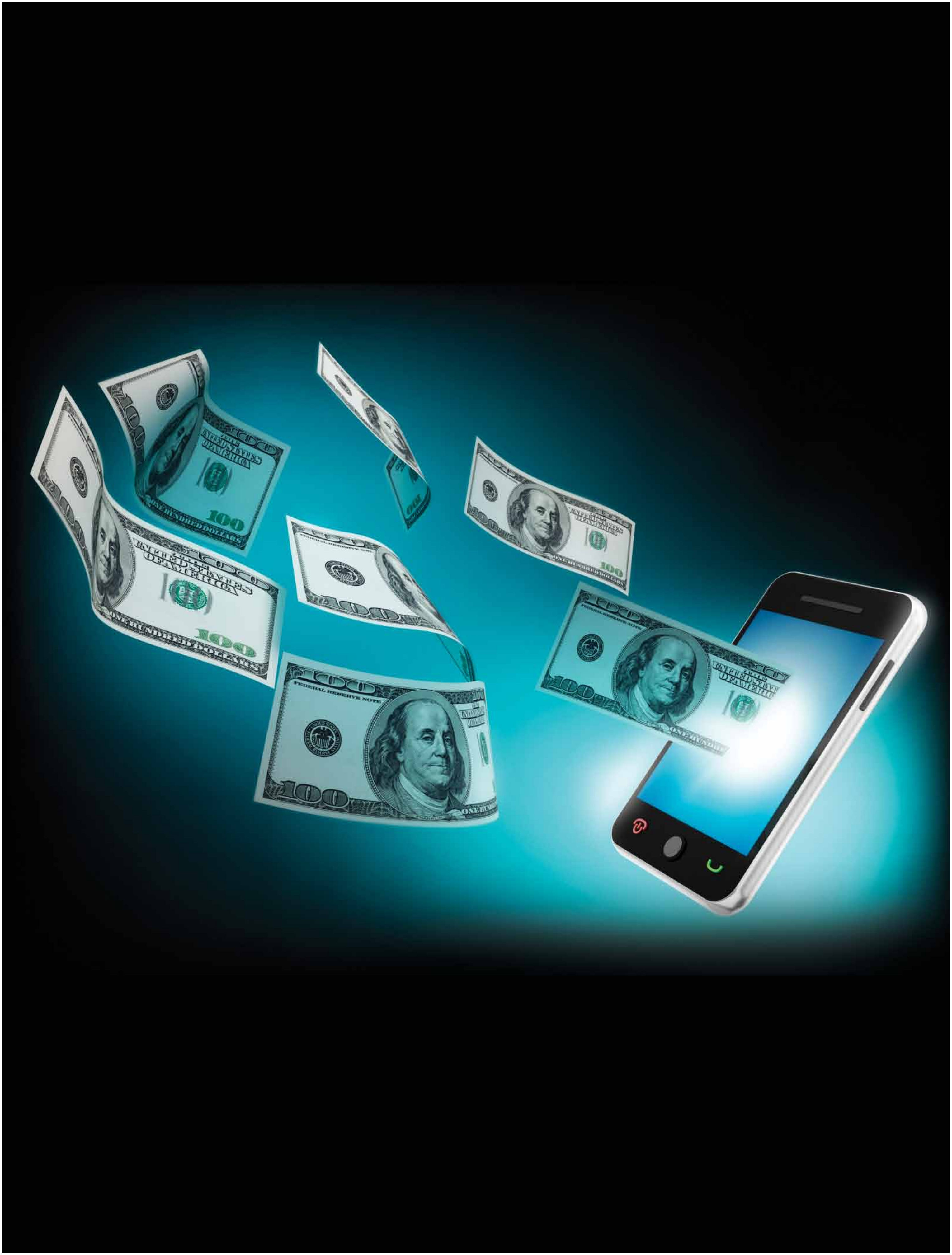
"Ninety-six percent of the time you try to buy something on your phone, you don't. Telephone operators try to ask the banks for money [on all purchases made on mobile devices], and the banks say no, because there are too many people already sharing the pie. If they just figured out more innovative ways to add value, by making it easier and safer to buy things on your phone, which is what we try to do, then I think they can have a business model."

If successful, Desai estimates that mobile payments could have a huge impact – even more so than credit cards – in terms of reducing our dependency on cash. "Ultimately it's about cash: 52% of Walmart sales in the US are in cash still, that's pretty striking." He estimates that "on average, globally, 85% of the volume of transactions are in cash or some cash-like form," meaning a big opportunity for growth.

Financial Empowerment for the Unbanked

Latin America is an area with one of the biggest potentials when it comes to using mobile payments. Despite an unprecedented period of strong growth and modernization, the banking industry remains undeveloped, and economies of the region still function overwhelmingly on a cash basis.

The majority of the region's large population is unbanked and have an innate distrust of banks and credit due to memories of devastating financial crises and currency deval-


FEDERAL RESERVE NOTE
ONE HUNDRED DOLLARS
100

uations. A recent Gallup poll showed that credit card ownership in Latin America and the Caribbean stood at 18% in 2011, compared with 50% in developed economies.

Cell phones, on the other hand, are abundant throughout Latin America, even in poorer areas, and network infrastructure and coverage are improving all the time. With this type of cellphone market penetration and no attachment to traditional banking methods, companies are unsurprisingly excited by the potential of mobile payments in the region. Rolando Salcedo is one entrepreneur looking to develop this industry for the mass market in Latin America, where he says over 60% of the population don't have access to banks, or are scared of using banks.

"What we try to do is financially empower people with few resources who don't have any means to pay except cash," says Salcedo. Interested in creating financial access for the large informal economy, he found that the most efficient network distribution method was the basic prepaid cellphone. "We developed for the last seven years the concept and the proprietary technology to support it, that was called electronic prepaid systems, a universal system you can use with any kind of cellular phone, regardless of technology, model level or carrier. This allows something unique. You can pay phone-to-phone and phone-to- POS, ATM, ECR and WEB."

As the technology was being developed by Platamóvil International, of which he is founder and chairman, Salcedo used 35 years of experience in banking to set up Mi Plata, Compañía de Financimiento, the complementary business that brings the mobile financial transaction services to the unbanked.

"Mi Plata on one side has the technology that allows you to pay whatever, wherever and whenever you want from your savings account with your phone, and is deploying and contracting vast networks of third-party merchants, basically a teller in any kind of store, from a beauty parlor to a 7-11. […] That is the only way it can work, by creating an inclusive business that [third-party] merchants can participate in, and get paid for whatever transaction is made, which is much cheaper for us than having our own bank branches."

Overcoming Teething Problems

Yet despite the buzz, this is still a nascent industry facing significant challenges. Both Salcedo and Michael Desai admit that drawing the large institutional investors to new mobile payments systems has been a challenge, despite a great deal of interest that they have already generated.

Salcedo says it took many years to convince Latin American Development Bank (CAF) to invest US$5 million in his sister companies. "They are 2 different types of investments. One is a banking business and the other technology, and for both it has proven very hard to raise money, especially if you are in Latin America."

"What we try to do is financially empower people with few resources who don't have any means to pay except cash,"

However, progress is being made in the region. Banamex, Banco Inbursa and America Movil recently announced the launch of a mobile payments system called Transfer in Mexico, with plans to move into Brazil, Chile and Colombia in the coming 12-16 months. Telefónica and MasterCard have also joined forces to create Wanda to 12 Latin American states under the tagline:

Your Mobile Money

The recently launched Mobile Payments Readiness Index (MPRI), created by MasterCard as it expands its own mobile payments facilities, ranks Brazil as the most prepared Latin American state for mobile payments. Interestingly, however, MPRI finds that not one of the 34 countries included reaches the 60 (out of 100) inflexion point score, that would signify "the stage at which mobile devices account for an appreciable share of the payments mix."

In the US, one of the more "ready" states, guaranteeing secure transactions is the main challenge in getting more people using the mobile payments system. Desai says that by banking on the safety of the network operators rather than using a method of authentication installed on the device itself, is what makes PayFone stand out from the crowd.

"Moving money is not actually very hard, but the problem is moving it into the wrong places or someone hacking into something […]If you look at mobile phones they always keep you logged in to apps, so if you lose your phone, all someone has to do is pop your SIM card. So we are leveraging against the fact that the operators have spent billions of dollars to authenticate people."

Desai expects major banks to spur growth in mobile payments going forward. "The way the market works is that retailers want solutions to reduce costs of transactions and to get better services to compete with the internet [merchants], so if the banks respond with solutions, the mobile carriers will participate and people like us will hopefully enable it all."

Eventually, he says, the system has the potential to change both consumer and production habits by customizing our shopping needs and experiences. "The biggest opportunity is about the supply chain being inverted. You are going to tell a phone what you want, and new businesses will be created around those intentions. That transformation will take years but ultimately will make life better."

A Home Away from Home: International Schools in LatAm

ALI speaks with Paige Geiger of the American School of Sao Paulo

As LatAm has become, in the eyes of many, a land of opportunity, its international population has grown. The new wave of European, American and Asian professionals emigrating to LatAm has led to a rising demand for K-12 schools that meet the standards of schools back home. Demand has also increased among LatAm families and students looking for K-12 education that meets global standards and prepares them, in some cases, to attend university abroad or, at least, enter a predominately Anglophone, Westernized job market.

As a result, international schools, building on a centuries-old presence, are springing up across the region, particularly in the high-growth markets, offering a wealth of opportunity to private education investors targeting K-12.

According to Paige Geiger, Lower School Principal of the American School of Sao Paulo, the demand is so high that even the most well established schools are struggling to keep up. "The growth of international schools rises and falls with the economy worldwide. It has grown significantly in the last 10 years in LatAm, particularly here in Brazil, where we're having a hard time simply finding enough seats for all the students applying."

The American School of Sao Paulo is part of the Association of American Schools of South America, or AASSA, an organization comprising members from across the region, many of which have been in existence for decades. American Schools are private institutions, run by designated, self-perpetuating boards, with accreditation from US boards. Though American Schools are not-for-profit, their success as private international schools is an example for school operators of all stripes.

Successful international schools, Ms. Geiger says, like all successful private schools, offer what public schools don't, a distinction largely rooted in the allocation of funds and an emphasis on certain values. "It has to do with where you are investing your money in programs and facilities. It's not necessarily just a question of class size." The most important asset to emphasize, she says, is teaching. "With any school, the first ticket to success and building a good reputation is the teaching. Parents are going to look for teachers with outstanding qualities; many will want these teachers to have previous international experience if this is an internationally focused school. If you are starting a school locally, it is important to maintain top professionals and then demonstrate that your students are achieving the goals that were established."

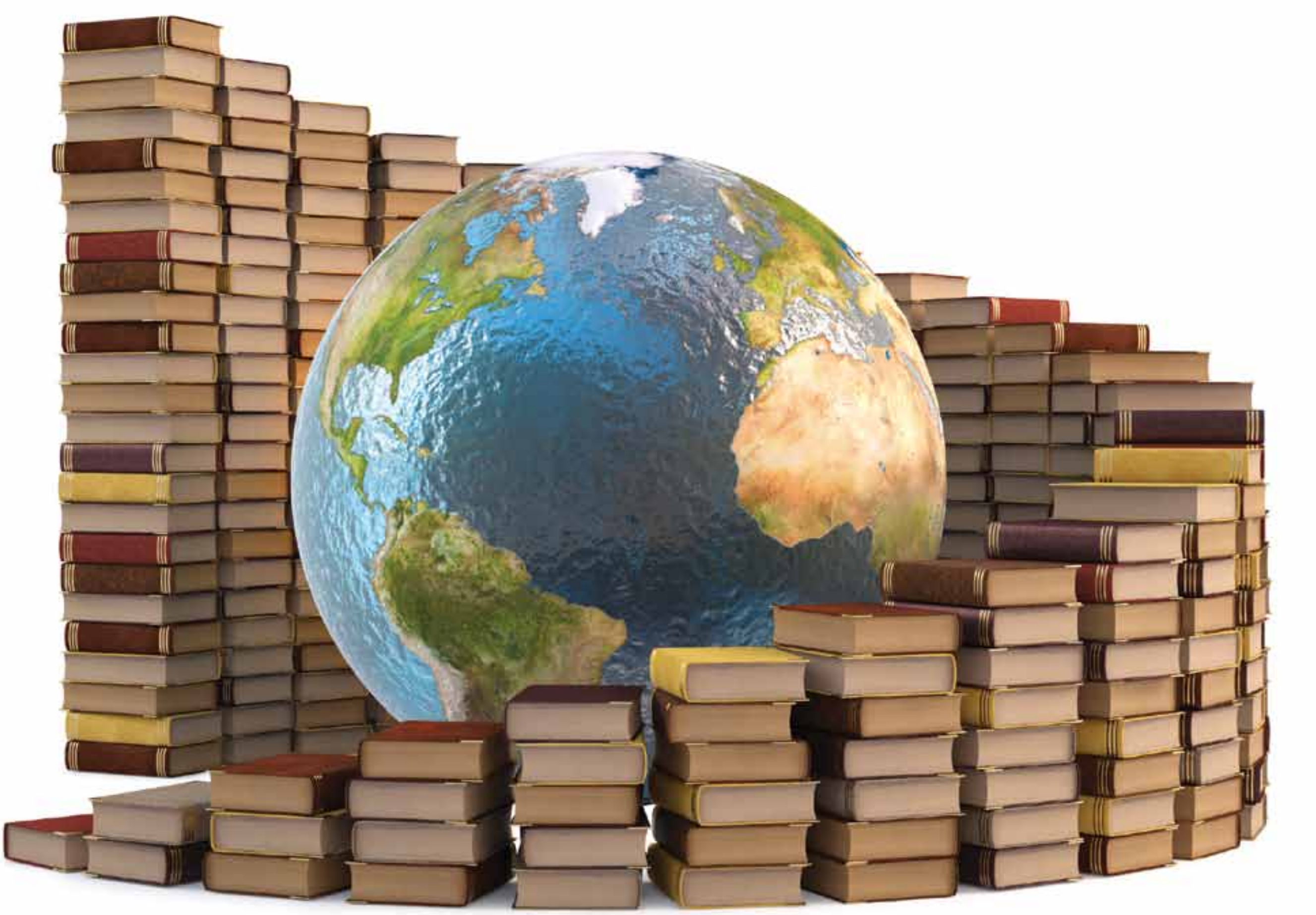
The distinction may manifest in curriculum and program offerings. For example, one area that is often cut in public schools, due to cost, is the arts. "But the arts attract people to your school," Ms. Geiger says. "A very significant part of the private school demographic sees the arts as a very necessary part of the program, even though it is costly and even though not 100% of students will be using the full arts program in a high school. The arts are definitely an essential curricular choice and a calling card for your school."

Building a strong reputation is obviously important for new schools, but Ms. Geiger says, in context of concentrated expat communities within uncluttered emerging markets, reputations can and will grow and spread quickly. "People are cautious of private startups, though in an international setting, it may not take as long to develop a positive reputation as in the US. In an international setting and a growing city there is consistent turnover, so there will be a lot of conversation about your school in the community. You can build your reputation rapidly." She notes, however, that a positive reputation can be damaged just as quickly.

"The first ticket to success and building a good reputation is the teaching. If you are starting a school locally, it is important to maintain top professionals and then demonstrate that your students are achieving the goals that were established."

Paige Geiger, American School of São Paulo

To meet mounting demand, the American School of Sao Paulo has launched an expansion program, aiming to increase enrollment over the next 8 years from about 1,200 to about 1,500, while building enough capacity for 1,600, Ms. Geiger says. The school is also increasing its offerings of electives, and as rising numbers of students are native Brazilians who increasingly prefer to stay in Brazil for post-secondary education, the school is starting to offer more classes in Portuguese, including at the primary level, though it is still not technically bilingual. Ms. Geiger also notes that international schools have been more tuned in to e-learning developments than many of their local counterparts, and they intend to pursue those developments further.



Dry Bean Investment Potential

Stephen Kaczor

When investors think of bean futures they often think of coffee, cacao or soy beans. Red beans, black beans, lentils, garbanzos and pinto beans are also graded and traded on international commodities exchanges. The leading producers of edible beans are China, Brazil and India, each with more than 3 million tons of production annually. In Latin America, Mexico is the major bean producer with 2 million tons annually, and Argentina is a niche player.

According the Dry Bean Initiative, "Edible beans represent 50% of the grain consumed as a human food source. Dry beans are an understudied crop with research programs remaining limited and spotted when compared to other commodities. However, we believe the future of dry edible beans in the US and throughout the world is on the brink of explosion due to the multiple varieties of beans available for consumption, each unique in their own right in terms of agronomic issues and health-promoting properties." (University of Nebraska)

It comes as no surprise that one of the world's leading hedge fund managers sees opportunities in alternative protein sources. Ejnar Knudsen commented on this potential at a recent agriculture investing conference. Sustainable agriculture researchers have been troubled for decades about beef as a protein source due to the amount of grain feed required. "Half of India is vegetarian, and that's unlikely," Knudsen commented, noting that meat consumption in the USA is falling annually. Knudsen sees an increased focus on selective proteins as a potent force. Nicola Kerslake of Real Assets Junkie reported on this opportunity in Seedstock last month. "As an investment manager, once you've established that your chosen theme is valid, you still have to figure out how to find investments that best capitalize on it. For animal protein alternatives, some have invested directly in crops, others in sustainable aquaculture operations. Knudsen's particular bent is to find technologies that concentrate fish oil. Further, he is fascinated by the nut industry, noting that it is a palatable alternative to meat for many Americans. Knudsen attributes the revival of the nut industry to this trend, noting that California's almond production is up 75% in the past 5 years.

Beans, however, have a distinct advantage over nuts. It takes very little water to grow beans, just 43 gallons per pound compared with the 368 gallons per pound it takes to grow peanuts. (Hoekstra, Argen & Ashok. Globalization of Water. University of Twente, Waterfootprint.org)

Dry beans are an excellent alternative to other vegetarian protein sources, but where does one look for such investment opportunities? One exciting new food investment forum is the Global Project Marketing Network, where project developers advertise their investment opportunities and business partner proposals in order to find investors or business partners. Multiple exchanges trade red bean futures including the Tokyo Grain Exchange. The US Dry Bean Council provides international industry resources at www.usdrybeans.com/resources including contacts in Mexico and Central America.

Alliance Grain Traders provides investment opportunities. Members provide value-added processing of pulses and buy lentils, peas, beans and chickpeas from farmers around their 24 facilities located in the best pulse growing regions in Canada, the United States, Turkey, Australia and China and ship them to more than 85 countries around the globe. Their state-of-the-art production facilities feature production lines for cleaning, sizing, splitting, color-sorting and packaging a full line of lentil, chickpea, pea and bean products. Investor presentations can be seen at www.alliancegrain.com/investor-relations/presentations.html.

Author Biography

Stephen Kaczor is Chairman of the Big River Foundation, a nonprofit focused on river and watershed ecology conservation initiatives throughout the Americas. He is an organic farmer, eco-entrepreneur, consultant and writer with a documentary film in production in Central America. As a Panama-based consultant, Stephen's focus is sustainable organizational development, research and management. In addition to consulting and writing, he is passionate about sustainable agriculture, Latin American culture, travel and ecology. For more information, visit www.BigRiverFoundation.org

Expert Perspectives

LatAm Art in 2012 Part II

Interview Provided by Artvest LLC

Carmen Melian, Sotheby's, Senior Vice President, Latin American Art

Carmen Melián joined Sotheby's Latin American Art department in September 1999. She has since been instrumental in a number of important sales, including property from the Estate of Stanley J Marcus; property from The Collection of Barbara and John Duncan; the May 2006 sale of Frida Kahlo's Roots, which sold for $5.6 million, a record for the artist; and Rufino Tamayo's El Comedor de Sandías, which sold for $3.6 million.

Ms Melián began her career at the Center for Inter-American Relations/Americas Society in New York during the Rufino Tamayo—Works on Paper exhibition in 1979. After teaching in Paris for 3 years, she returned to New York and joined the Nohra Haime Gallery in 1983, serving as Director from 1989 to 1996. As a private consultant, Ms Melián created and directed the International Client and Visiting Museum Directors programs for Art Miami '97.

For several years, Ms Melián has taught the Latin American Art course for New York University's Appraisal Studies. A graduate of Manhattanville College with bachelor's of arts degrees in History of Art and Studio Art, Ms Melián is fluent in English, Spanish and French.

MS: Mary Sabbatino, Galerie Lelong, Partner

Mary Sabbatino is a partner at Galerie Lelong, a contemporary art gallery in the Chelsea neighborhood of New York City. Under her leadership the gallery has developed a diverse program of international contemporary and modern artists from the United States, Latin America, the Pan-Pacific region and Europe. She has a particular interest in art from Latin America. In 1994 she co-organized "Art from Brazil in New York" which presented the first solo shows of artists Waltercio Caldas, Cildo Meireles, Helio Oiticica and Neville D'Almeida, Mira Schendel and Tunga in 11 museums and galleries in New York City. She also curated the exhibition and authored the catalogue for Juan Downey: Drawings, Installations, Films at the Museo Bellas Artes in Chile.

Mary Sabbatino has a B.F.A from Parsons School of Design and an M.A. from New York University. She lectures and sometimes writes on contemporary artists. Her most recent essay is Ana Mendieta: A Narrative Biography in the 2011 exhibition catalogue of the same name.

Mary is an active member of the Art Dealers' Association of America; she previously served on the ADAA board and wrote the association's first code of ethics. She now serves on the ADAA Membership Committee, the Selection Committee for Art Basel Miami Beach and Council for the Elizabeth Sackler Center for Feminist Art at the Brooklyn Museum. She lives in Brooklyn with her husband and 2 children, ages 12 and 14.

AS: Ana Sokoloff, sokoloff + associates, llc, Founding Partner

Ana Sokoloff is a founding partner of sokoloff + associates, llc, art advisors, a firm focusing on advising high-profile individuals on collecting Latin American and contemporary art. Before founding sokoloff + associates, Ms. Sokoloff was Vice President–Head of Department for Latin American Paintings at Christie's Inc., where she was responsible for all business development, expertise, management and administration of the Latin American Paintings Department including the coordination and organization of 2 annual evening sales.
A champion of contemporary Latin American art, Ms. Sokoloff was instrumental in broadening the market by introducing works of a new generation of artists into Christie's Inc.'s auctions. Among the figures that she first introduced to the market are Francis Alÿs, Gego, Helio Oiticica and Doris Salcedo.

Prior to joining Christie's, Ms. Sokoloff was cataloguer for the Arcade department at Sotheby's, exhibition coordinator at the Americas Society and Director of Exhibitions and Cultural Programs at the Permanent Mission of Colombia to the United Nations, where she oversaw the cultural activities of the Colombian government in the United States and eastern Canada. In addition, Ms. Sokoloff has curated several exhibitions for international venues, given conferences and written critical essays on Latin American art for international art journals. She is currently on the advisory board of the Americas Society and on the international advisory council for the Museum of Latin American Art, MOLAA. Ms. Sokoloff earned a law degree at Universidad de los Andres, Bogotá, Colombia and received an M.A. in Theory of Art History from Columbia University in New York.

(Interview continued from last issue – April/May 2012)

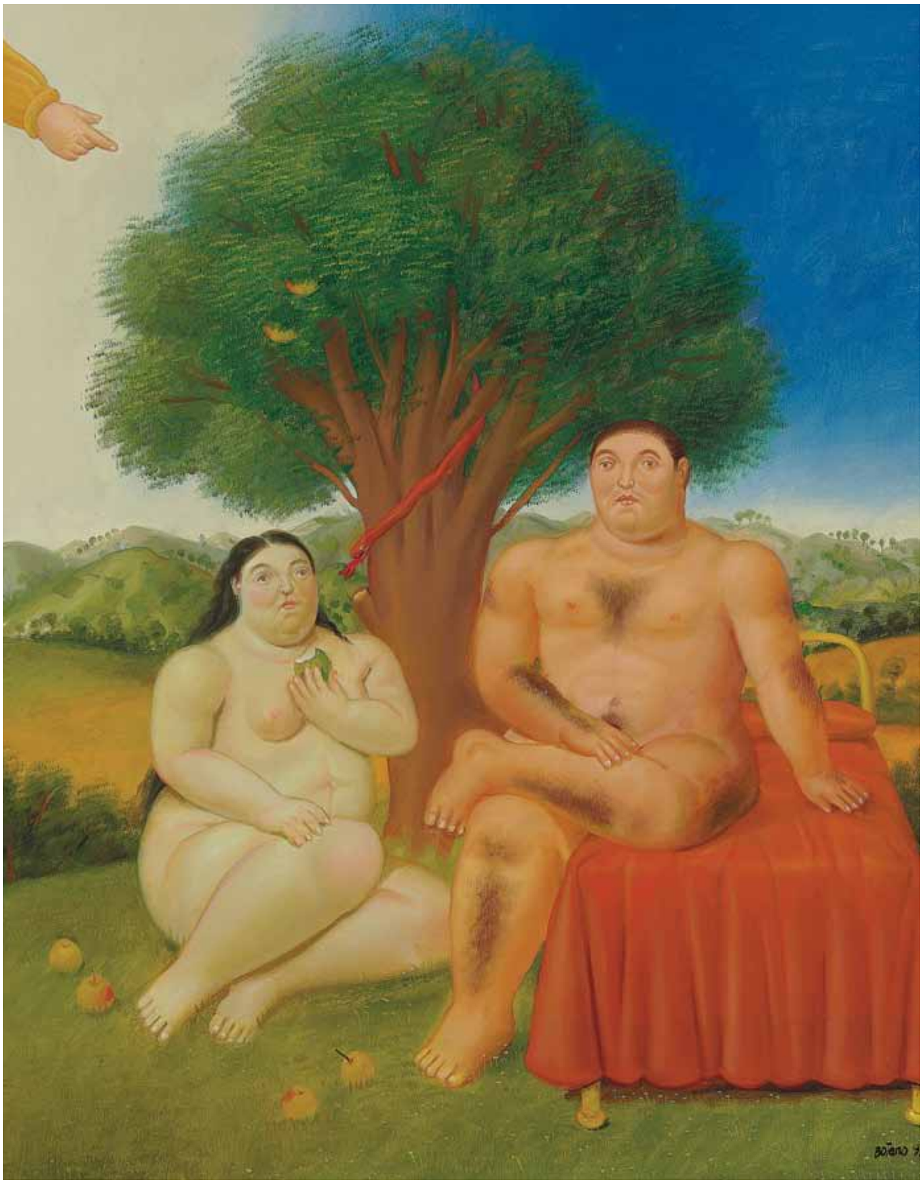
Are Latin Americans collecting primarily from their own country or are they buying art from all over Latin America?

AS: Most Latin American collectors tend to have a solid collection of the art of their country of origin. The trend today is to also have a strong interest in the region as a whole or a more international perspective.

MS: Anecdotally, I think you would find more Brazilian artists in a collection in Brazil than artists from Colombia or Chile. However, there are also more significant Brazilian artists to collect (in quantity) so it is hard to say what is the driving force.

Do you think Americans will develop an increasing interest in Latin American art going forward? Why?

CM: Ms. Melian believes that Americans already have a strong interest in Latin American art, and that interest in this sector is cyclical, with Latin American art being discovered again and again. If you look retrospectively during 1940s when Americans had to focus on the Americas, especially because of WWII, there was a huge amount of exhibitions dedicated to art within the Americas," she says. She points out that



Above:
Lot 36
Fernando Botero (Colombian b. 1932)
Adam and Eve
signed and dated 'Botero 93' (lower right)
oil on canvas
45 x 35¼ in. (114.3 x 89.5 cm.)
Painted in 1993.
Estimate: $400,000 - $600,000
Price Realized: $662,500
(PLEASE CREDIT TO CHRISTIE'S IMAGES LTD. 2012
Latin American Paintings
Sale 2483
New York, Rockefeller Plaza
15-16 November 2011)

Above:
Hélio Oiticica
Penetrável Filtro [Filter Penetrable], 1972
Mixed media installation
98.43 x 238.98 x 317.72 inches
(250 x 607 x 807 cm)
© Projeto Hélio Oiticica, Rio de Janeiro
Courtesy Projeto Hélio Oiticica, Rio de Janeiro
and Galerie Lelong, New York

Below:
Lot 34
Jesús Rafael Soto
Vibración
Est. $150/200,000
Sold for $362,500
(Sotheby's New York
Latin American Art
16 & 17 November 2011)

Mexican art was very popular in the US in the late 30s and 40s because there was a rise of nationalism in the Americas.

AS: Many US museums have appointed curators that are knowledgeable in Latin American art and are looking to expand their collections with works from the region. The Museum of Fine Arts Houston, MoMA, the Boston Museum of Fine Arts, the Aspen Museum and the Seattle Art Museum are amongst a few that are looking closely at Latin American art.

MS: I've sold the majority of Oiticica works to collectors outside of Latin America. I think that US collectors in particular don't like to collect by "country," but many have works by Vik Muniz, Ana Mendieta, Beatriz Milhazes, Ernesto Neto, etc., in their collections.

Armando Reverón
Mujer con mantilla
Est. $800,000/1 million
(Sotheby's New York
Latin American Art
23 & 24 May 2012)

What advice do you have for a new collector starting out collecting Latin American Art?

CM: Ms. Melian's advice is to "Look at the auctions", which she notes are "perhaps the biggest exhibition of pan-American art you will find on a continuous basis." She also advises looking at younger artists and following what's being shown at major museums and historical museums. The Denver Art Museum, she points out, has one of the best collections of Mexican colonial art, and the Brooklyn Museum has an excellent Peruvian colonial collection.

AS: Travel the region and enjoy discovering the various artistic manifestations. Every city has a major museum, some galleries and collectors that can open doors to the newcomers.

MS: You are in a lucky time because there are excellent resources for research and knowledge development. The first rule is to look and to think. I like the "game" a great US collector (Moo Anderson) taught me. She said, "Go into a room and pick out the best one, do it in every room and at the end pick one or two 'best ones' from the show." We accept that we have to train our minds to learn everything and train our bodies to achieve in sports, so training our eye is part of that. If you are sufficiently interested and wish to commit to building a collection, join a support group for Latin American art; you will be with extraordinary curators and collectors, at different levels in their collecting. Visit the Sao Paulo Bienal every 2 years. Read the art magazines produced in Latin America. Visit the Latin American galleries at Basel and Miami Beach. Galleries love to have supporters of their artists and are always interested to help potential clients develop expertise.

What role has the internet played in the growth and development of the Latin American art market?

CM: The internet, according to Ms. Melian, has "shattered the panorama" and "enlarged … doubled, tripled, quadrupled the market, and opened everyone's eyes."

AS: The role of the internet is still mixed. Of course it allows information to flow and that is an important aspect, but most sites emanating from Latin America are based on e-commerce and thus fall into a commercial endeavor, not an educational one. I believe that the quality of the works being offered for sale by these sites does not reflect the powerful art being developed in the region.

About Artvest Partners LLC

Artvest Partners LLC is an independent advisory firm that provides investment advice for the art market. With 3 decades of experience in art and finance, Artvest offers impartial guidance and custom strategies for acquiring and selling, protecting art wealth and passing it on to future generations. Artvest fills a need in the market by introducing a disciplined financial focus for collectors at all stages.

The World of Austral Forging the Silicon Valley of Argentina

On a gorgeous, pastoral campus on the fringes of Pilar, Argentina, about a half-hour's drive from downtown Buenos Aires, a collaborative project led by a world-class real estate investor and developer and sponsored by one of the finest private universities on the continent is forging a cutting-edge center for LatAm-based businesses, tech developers and entrepreneurs.

Parque Austral, developed by Taurus Americas in collaboration with Pilar's Universidad de la Austral, is a new business and technology park that rents office and work space to a variety of innovative businesses across sectors. Directly facing it stands the university's internationally renowned IAE Business School, which has long spearheaded the study and practice of entrepreneurship in the region, and whose Centro de Entrepreneurship (Center for Entrepreneurship) has strong links to the Parque. Together, these institutions exemplify various ways in which investment, both international and domestic, in real estate and education is helping the region's young businesses and business leaders grow.

Parque Austral

Parque Austral, still in its early stages of development, was founded by Ramiro Juliá, a native Argentine and MIT-educated real estate investor and developer. Mr. Juliá is founder and director of Taurus Americas, a subsidiary of Boston-based Taurus Investment Holdings, a global real estate investment advisor and developer. Mr.

Juliá's specialty is in real estate involving universities, and when, a few years ago, he learned that the Universidad del Austral was looking for a developer for a massive, investment-heavy business and technology park, he heard opportunity knocking.

Funded entirely by Taurus – whose investors include mostly family offices and high-net-worth individuals from Europe and the US, as well as some from LatAm – the Parque consists of 4 buildings on a grassy campus. Ninety percent of the office space has been rented to companies from such sectors as biotech, information security, education, software and communications, with the number of companies tripling in 2011 alone. Tenants include Oracle, Redguard, Kheiron, TekGenesis, Fundación Argentina María Montessori and FlexSpace.

Though the Parque is growing quickly, both in occupancy and developed square footage, it is still in its nascent stages. "We have a master plan approved for 3.2 millon square feet, and only 4% of that has been developed," says Mr. Juliá. "This is a high-potential operation."

Taurus and Parque Austral, he says, are "always looking for new investors." Investment is generally on a project-by-project basis, and future development projects at the Parque include facilities supporting the resident businesses, such as an on-site hotel.

For Mr. Juliá, investing in projects like the Parque Austral is an increasingly appealing option in the contemporary real estate market. "Real estate is a commodity," he says, "and the margins are getting smaller, so you have to be creative in understanding niche markets. Here there is a lot of value generation beyond the mere real estate asset. We're not only leasing space but offering other opportunities and benefits as well." These benefits include tax breaks and incentives, access to national and international networks for business development and promotion, world-class health care at the university's hospital, and intimate contact with a top-notch university, including the Parque's immediate neighbor, the IAE Business School. "The companies that are most valuable to us are the ones who want to be here because of the university, who value that proximity," he says.

IAE Business School

Internationally ranked and one of the best in South America, the IAE Business School (literally across the street from Parque Austral, on a similarly serene campus) offers both part-time and full-time MBA programs to a global array of students, mostly from LatAm and particularly the Southern Cone. The school is another component of the Austral complex that is benefiting from increased and more creative investment.

Diego Blasco, Director of Corporate Development in charge of fundraising for the school, says that the school's endowment is growing consistently, and they plan to see it reach US$50 million by 2015. Funding is needed, he says, for 4 main reasons: scholarships and financing for students; research development; technological and infrastructural development; and staff education and development, including regularly sending faculty abroad for advanced degrees.

"Real estate is a commodity and the margins are getting smaller, so you have to be creative in understanding niche markets. Here there is a lot of value generation beyond the mere real estate asset."

Ramiro Juliá, CEO of Parque Austral and Founder & Managing Director of Taurus Americas

While the majority of part-time MBAs are sponsored and funded by the companies they work for, full-time students, most of whom have left the labor market to study intensively, are being given greater financing options to pay for their education, says Andrea Fernández Boll, head of the full-time MBA program. IAE turned to alumni first to sponsor students and fund structured loans that the student begins repaying several months after graduation – a task made easier by the high salary margins for students graduating from the program. "This initiative has much to do with the lack of student credit in the region," Ms. Fernández Boll says. "Student credit is much more common in other countries, such as the US, but it has not proliferated here." She says it is possible that this credit program may open up to non-alumni investors in the future.

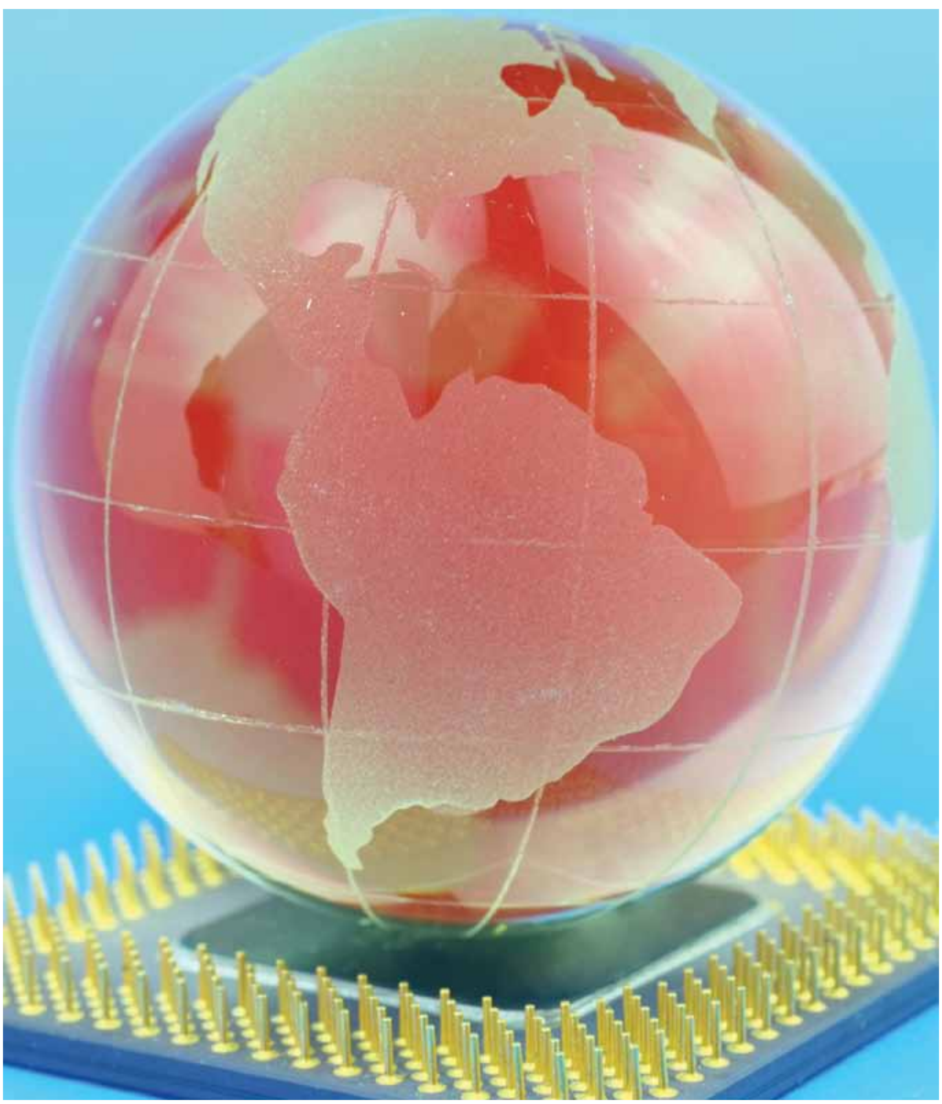
Ms. Fernández Boll explains that the program is similar to that of Harvard Business School in that it trains students for excellence in general business leadership and management. In keeping with the mission of the Universidad del Austral, the program emphasizes ethics across all fields of study. "We are always focused on ethics. There is no class devoted to ethics specifically; rather it traverses every class and subject. The debate is permanent."

There is, likewise, a focus on ethics when it comes to granting scholarships for students, says Mr. Blasco. "We want to identify not merely the students with the best grades but those with the best values. We believe the region needs more investment in virtues, to make the business world better, and we're trying to give scholarships to those who have the best conjunction of values and professionalism."

Aside from its focus on ethics, Ms. Fernández Boll says the IAE's strength and uniqueness comes from its position as a globally reputable school situated in an emerging market, specifically one that has been racked by various kinds of crises over the decades. Students in the program, she says, learn a great deal about managing companies in the face of volatility, inflationary problems and political risk, subjects that are no longer the province of emerging market managers only but are relevant to managers the world over – a fact that augments the global value of the school's graduates.

Center for Entrepreneurship

That talent for navigating emerging, volatile, politically risky markets – a talent fostered at the IAE Business School and embodied by what Mr. Juliá has done at Taurus Americas and Parque Austral – is on full display at the IAE's Centro de Entrepreneurship, which promotes entrepreneurship at the school and across the region with courses, contests and a growing investment and business development network.



Silvia Torres Carbonell, Executive Director of the Center, had a successful career as a businesswoman and entrepreneur before she began teaching at the IAE in the 1990s. A board member at Endeavor, an international organization supporting entrepreneurs with an Argentine branch in Buenos Aires, she has spent the last two decades both training entrepreneurs and trying to create a more conducive ecosystem in which they could thrive.

"Argentina has always ranked high in entrepreneurial attitude and activity," she says, "but very low in terms of environment and ecosystem. We've faced many crises and have had to be creative, but a lot of those problems prevent entrepreneurs from going beyond."

In Argentina, many of those problems are rooted in governmnet, she says. "The ecosystem has improved since I started. We are much more connected with Silicon Valley and Boston and other centers of en-

trepreneurship, and some venture capitalists have established themselves here, but those improvements are in spite of the government, not because of it."

One of the center's most important programs for fostering entrepreneurship is its annual business plan contest. Open to entrants from around the country (not only IAE students), the contest's winners are awarded help in developing their business plan, including free consultancy, free legal advice and even free office space at Parque Austral for 1 year. They are also put in touch with the center's angel investor network, Club de Business Angel, of which Ms. Carbonelli herself was the founder and is currently a member.

Such angel investors, she says, along with the increasing amounts of venture capital investors entering the country and region, are an essential component of entrepreneurship at the center and across the region. "Investment is critical," she says. Without it, I can push entrepreneurship as much as I want, but it won't work." She says that about 250 full-fledged businesses have emerged from the contest and the Center for Entrepreneurship, and that entrepreneurial activity is on the rise. "Every year I see more and more students interested in entrepreneurship," she says, including social entrepreneurship and what she calls intrapreneurship. "Even if you don't start a new business, you still need to be entrepreneurial in all you do."

IAE's Centro de Entrepreneurship promotes entrepreneurship at the school and across the region with courses, contests and a growing investment and business development network.

For now, her job remains cultivating the right ecosystem region-wide in which her protégés can prosper. "I think Latin America has huge opportunities nowadays," she says. "It is a special moment for our continent, but we have to make a lot of efforts because sometimes our politicians aren't acting according to those opportunities. It's a problem, but we have to keep working with an entrepreneurial attitude nevertheless. And that's something that the developed world, perhaps, can learn from us."

'Euro Debt Crisis Turns Investors Toward LatAm'

An Interview with Andres Jacobus, Alpha Institutes CIO Summit Panelist

President and CEO at FINSER Corp. (an SEC-registered investment advisor) and the CIO at CONFISER Simi Fund, Andres Jacobus has over 25 years' experience in the global asset management business in LatAm. Currently FINSER International has over US$400 million in AUM from a diverse group of individuals and corporations, including a publicly traded REIT, a reinsurance company, a petrochemical company and a retirement fund for the Catholic Church. Andres holds a B.S. in Mechanical Engineering from Northeastern University, an MBA from ESCP EAP (France), and a Specialization Degree in Entrepreneurial Engineering. He is also a member of New World Angels, a South Florida Venture Capital group and holds an NASD series 65. Andres divides his time between New York City, Miami and LatAm.

With America and Europe stagnant, will investors seeking growth turn towards Latin America? How can Latin America compete with Asia for growth seeking investors?

As markets like India and China get overheated, there is going to be a tendency to come toward an easier market. It is the same time zone; we have the same culture. LatAm should recover at a faster pace than other parts of the world because of stronger macro fundamentals and limited structural imbalances. Of course there are a few countries that will fall behind, but with negligible consequences. Higher growth is projected in many of the commodity exporting countries; average GDP growth in 2011 was 5%, CPI (inflation) 6%, and Debt-to-GDP 45%.

Labor cost and tax incentives for foreign investments in LatAm are comparable to Asia, making it an attractive region for so-called "maquilas" or twin factories or in bond industry. Mexico is a perfect example of this where more than 1.3 million Mexicans work in 3,000-plus maquila factories for US parts.

There is, of course, risk of currency fluctuation, but it is somewhat contained (nothing like what happened back in the early '90s or a possible "bubble" from China). In addition, there has been low to no impact from the housing crises in US or Europe, and there is generally low exposure among LatAm banks to European debt.

What are the best ways to invest in Latin America (ETFs, long-only managers, HFs, PE, RE)?

The best ways for foreign investors to access LatAm markets is via an ETF (like the EWZ in Brazil for example, an index traded fund), or multi-strategy funds with a reputable manager. Only after a great deal of experience has been achieved, the investors could begin to look at long only or individual stock selection.

What are the challenges of investing in Latin America (compatible fund structures, taxes)?

There needs to be improvements in the following:

- Transparency: information presented under internationally accepted accounting practices and audited by reliable and well-respected firms
- Local exchanges with internationally accepted regulations
- Stable and open currency exchange mechanism
- Ease of currency conversion and repatriation of capital
- Reasonable fiscal policies for investors
- Ensuring safe custody of assets, either locally or via Euroclear/Cedel
- Market capitalization

In addition, legal structures must always be evaluated with appropriate counsel in order to best guarantee (1) easy exit when desired or needed and (2) the confidentiality of the investor, a key issue in many countries, especially for the personal safety of the individuals. You don't want your affairs to be public knowledge for security purposes. It is always best in business to be under the radar with respect to who earns what.

And issues like double taxation treaties must always be evaluated in order to determine the best jurisdiction for establishing the investment or special purpose entity that will handle the local investments.

How has the investment infrastructure improved in Latin America?

We have seen the start of MILA – Mercado Integrado Latinoamericano or Latin American Integrated Market – in Chile, Colombia and Peru, creating an economy of scale that will certainly attract international investors. Many world-renowned financial institutions and fund managers are setting up offices in the region (Blackstone partnering with Brazilian Patria, for example). Uruguay and Panama are becoming well-respected international financial centers, and Chile, Mexico, Peru, Brazil and Colombia have "Investment Grade" credit ratings.

The banking system in most LatAm countries is well-capitalized with a healthy credit. Overall LatAm banks have performed better so far in 2010 with 9 of the 10 largest returning positive price performances, with Credicorp (+61%) and Banco De Chile (+60%) leading the group. In Asia returns are weaker with 3 banks showing negative returns. In fact only the 2 Indian banks in the sample, State Bank of India (+41%) and ICICI (+29%), have strong double-digit returns. Agricultural Bank of China, up 18% since its initial public offering earlier this year, saves the year for China as results are fairly dismal otherwise.

By total market capitalization the 10 largest Asian banks dwarf LatAm banks by a ratio of over 3 to 1. ICBC (Industrial and Commercial Bank of China) by itself has a largest LatAm banks. However, remember "Too Big to Fail?" But beware that bigger is not necessarily better. Institutions have less room to maneuver in these volatile markets.

What are the opportunities in Latin America beyond raw materials?

There is strong interest in new and high-technology production mechanisms, which brings into the region much investment in the industrial areas. There are great opportunities in the agriculture and construction sectors.

The European Investment Bank has established an investment fund for LatAm of EUR 2.8 billion specifically for infrastructure development, agro-industry, mining and services. Special emphasis is given to projects that contribute to environmental sustainability (including climate change mitigation), like biofuels for example.

Less than 10 years ago, fixed income bonds in countries like Argentina (after the default of 2002), Colombia or Brazil were trading at considerable discounts. Now, with the exception of Argentina and Venezuela, most country debt trades at premium levels. Still with coupons about 7% or 8%, yields are far more attractive to investors than T-Bills. And the yield spread for most countries has contracted, making it very attractive.

Keep in mind that consumption is going to be the most important driver of Latin American economies, making this an attractive area for investors. A rise in consumer spending, coupled with low inflation and a young population is creating the perfect environment for robust growth. The population of Brazil is about 190 million of which approximately 50 million are considered middle class. This means that people will eat better and by better cell phones!

Many Asian countries are investing in the region's commodity sector. For example, China has established alliances with Brazilian partners in the steel and oil industries, or the Germans in the automobile industry in Brazil and Mexico. Export of commodities has been increasing on average 20% per year, and higher prices of commodities are positively impacting the region. Commodities include not just oil and basic minerals but food (fishing industries, fruits and vegetables, cattle, grains, wine). In Chile, copper is the biggest export, but the country is also known for its wine, agriculture, fishing and tourism. And Argentina is the 5th largest wheat exporter in the world.

Lastly, Tourism is becoming a high source of income in many countries. For example, you have world-class ski resorts in Chile and Argentina and in seasons that complement, not compete with, Europe or North America. Many high-end hotels are opening in LatAm (Four Seasons, Ritz, Aman, etc.). Eco and adventure tourism in other areas are strong.

How does the VC organization you belong to, New World Angels, view LatAm?

We have seen many extremely interesting new ventures originating in Latin America, especially in professional services, internet and social media. Each year, Florida International University's Eugenio Pino and Family Global Entrepreneurship Center hosts the "Americas Venture Capital Forum." It is a 2-day event where not only do you get a broad view of what is going on in the region, but a great number of ventures seeking capital get the opportunity to present their business models. Last year presenters received in total about $25 million in capital for their projects, an indication of investor interest in the region.

What is the state of alternative assets in LatAm?

Institutional assets in LatAm are growing at an average of 20% annually for the past 3 years. According to the Capgemini/Merrill Lynch World Wealth Report, LatAm investors place 47% of their portfolios in cash or fixed income instruments. There is a need for exposure to a world of investment option opportunities, but there is a lack of knowledge among investors and also local managers of alternative asset investment products as investment instruments for diversification of portfolios. Plus, the number of fund managers located in LatAm is still small.

What do you see happening in LatAm in 2012 and beyond?

I see several developments:

- The MILA initiative will provide a good market capitalization for the region.
- Brazil continues to be a strong investment interest, but let us not forget Mexico.
- US capital markets will continue to be a reference.
- We will probably see more LatAm ADR programs trading in international stock exchanges, as well as the MILA.
- Most likely we will see many new issues or IPOs coming out of the LatAm region.

Event Information

The Alpha Institutes CIO Summit will take place on October 18th, 2012 in New York City. For more information or to register visit: http://www.alphainstitutes.com/main/bbs/board.php?bo_table=2_01

The JOBS Act and Its Implications

Behind the Curtain of Hedge Fund Advertising

In April of this year, President Obama signed into law the Jumpstart Our Businesses and Startups (JOBS) Act, a widely supported measure intended to help small businesses grow by making it easier for them to raise money. In the alternative assets community, the big news was the act's provision repealing the prohibition of advertisements by hedge funds. For the first time, US hedge funds will be able to publicly advertise and disclose information about their activities in various media, including magazines, newspapers and – long the most controversial issue – websites.

It is still far from clear how these loosened restrictions will play out. Currently the US Securities and Exchange Commission (SEC) is reviewing the act and will release its interpretation on July 4.

And yet, regardless of the act's final form, the consensus among those in the hedge fund industry worldwide, including in LatAm, is that it marks a watershed moment.

New Era

"It will revolutionize how investment managers will market their funds" in the US, says Victor Rodriguez, CEO of LatAm Alternatives, a third-party marketer, fundraiser and consultant for alternative asset managers interested in expanding into the region. "Now hedge funds will have the ability to show their audience not only what a hedge fund really is but to educate them about the potential downsize protection with noncorrelated risk-adjusted returns. This will trigger a side effect where more investors might call their advisors to consider allocating 15% to 20% of their funds to alternatives."
Mr. Rodriguez notes that, though most LatAm funds are outside the scope of the SEC's jurisdiction, LatAm regulators tend to follow the lead of those in the US, and he expects to see a domino effect of lessened restrictions throughout the region. "Hopefully it will mark the beginning of a new era in the US, and it will be followed by other regions."

Richard Heller, a partner at Thompson Hine in the firm's Corporate Transactions and Securities practice group, agrees that this provision of the JOBS Act will be a game changer, allowing emerging managers to garner attention in an increasingly crowded market.

"Dodd-Frank was, in my opinion, an impediment to the emerging manager," he says, referring to the US law passed in the wake of the 2008 financial crisis that attempted, among other things, to regulate the hedge fund industry. "Congress did not understand that of the 7,000 or so funds that are out there, with US$2 trillion in assets, maybe 200 are the George Soros size, while the rest are struggling to make a living with 2 or 3 people in a room. And when Dodd-Frank came out, some of the potential emerging managers said, 'Forget it, I'll just stay at home and invest for myself.' I think, to a certain degree, these JOBS Act regulations are an attempt to get those potential managers to come out and play."

The consensus among those in the hedge fund industry worldwide, including in LatAm, is that the passage of the JOBS Act marks a watershed moment.

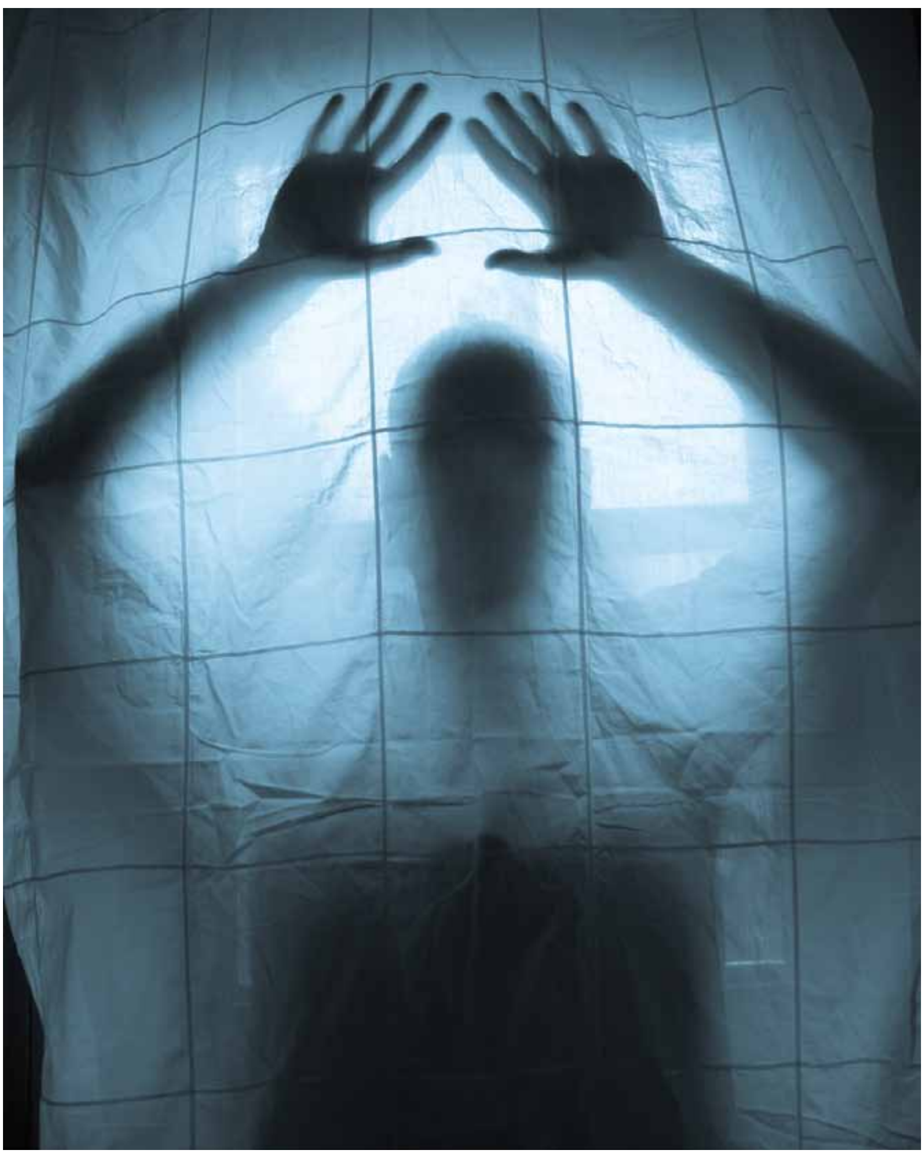
Uncertainty

There has been some discussion as to whether the JOBS Act will allow hedge funds to publish their returns, but Jaye Scholl, regional director of the Hedge Fund Association and vice president of Hedge Fund PR with 30 years' experience covering the SEC, finds it unlikely.

"I don't think they'll be allowed to publish returns and information on how to subscribe to funds. I think it will be limited to the information in ADV parts 1 and 2," she says, referring to the 2-part form that investment advisors must fill out to register with the SEC and state securities authorities in the US. But even allowing that much information will be an immense change, especially to funds' web presences, she says. "This should have a huge impact on websites.

What's in the ADV will be permissible on websites; in fact, the SEC wants it there."

Mr. Heller stresses, however, that the final shape of the law is far from clear, and there are still limitations that the act doesn't touch. "The JOBS Act does not change the Investment Advisers Act of 1940, which includes specific criteria as to what you can and cannot say," he points out. As to the negative consequences of the deregulation, such as a possible increase in fraud, he says that those, too, are unpredictable and depend on the SEC's interpretation. "The problems will be unknown until we get the rules on July 4. But generally I think implementing the various aspects of this bill is not going to be as simple as people think." He suggests that there could be a problem "with potential fraud coming from foreign entities, which are harder to regulate."



Effects in LatAm

The JOBS Act may well spur discussion of enacting similar rules and regulations in LatAm, a prospect Mr. Rodriguez welcomes. "Hedge funds are still relatively new in LatAm," he says, "and they are somewhat taboo because of fears about unscrupulous activity, so there is basically no regulation. But again, countries are opening up to the industry because they understand the possibilities of transparency with risk-adjusted noncorrelated returns."

Mr. Rodriguez thinks the growth of the industry and an increasing awareness of the benefits of alternative investments will benefit the region as a whole. "LatAm funds, including institutional investors and pension funds, will be able to convince local regulators to allow them to conquer more fully their local regions. They'll point to the US, an economy coming out of the crisis where people are going more and more to alternatives, and they'll say, 'It's time you allow us to go after alternatives so we can find better noncorrelated returns.'"

As things stand now, certain high-quality hedge funds have emerged in recent years, their success rooted in their managers' solid pedigrees and reputations. "You are seeing a great deal of talented new emerging managers. You have excellent examples not only in Brazil, but in Chile, Colombia and Peru as well. Without the credentials it is too difficult to prevail. This is compelling because it shows that the industry is really getting the best degree of managers out there." Freer advertising, however, will allow other emerging managers, especially midsize ones, to take their shops to the next level. "It's going to benefit everyone," he says. "Everyone will enjoy the party, but the middle guys will enjoy it most."

He agrees, however, that potential fraud is a problem that should be on everyone's radar, and against which it is everyone's task to be vigilant. "If there's any downside, it's the potential schemes. When you start to see these opportunities, you need to be more aware of potential unscrupulous marketing activities. We at the Hedge Fund Association are paying a lot of attention, and it's important for people to use companies such as LatAm Alternatives to help them do due diligence on who they are dealing with, to make sure a manager is well known and has strong ties."

On top of increased public and government awareness of the benefits of alternative investments and increased vigilance against fraud, there is one more change which Mr. Rodriguez hopes to see: namely, an increase in philanthropy on the part of successful LatAm managers.

"Hedge fund managers, investors and service providers in the alternatives investment are blessed," he says. "We will have to remember how to give back to society; whether it's money or time, we have to promote charity and show our audience that we the hedge fund professionals really do care about our community."

Bloomberg Aptitude Tests Scores a Home Run

As financial sector recruiters have looked increasingly to foreign markets for fresh talent in recent years, they have faced 2 basic challenges. First is the logistical challenge of merely discovering such talent from far-flung places, including many emerging markets, on limited budgets. Second is evaluating that global mix of potential employees in such a way that the truly talented, regardless of the particulars of their culture, mother tongue or college-level education, rise to the top.

A few years ago, Bloomberg hired Michael London to run Bloomberg Institute and address these challenges. Previously the manager of corporate strategy at Kaplan, Mr. London oversaw the creation of the Bloomberg Assessment Test (BAT), a financial aptitude test that, in just its second year, has grown precipitously into one of the most important tests in the industry, and essentially the only one of its kind.

"We've been really impressed," Mr. London says of the test's growth. "We can't prove it, but it seems to be fastest-growing of all the major tests. We've only been offering it 16 months, and have had 40,000 take it; we expect 50,000, even 75,000, to take it this year. Based on my sources, the CFA and GMAT have about 150,000 each, and we imagine we'll be larger than both of them in our 3rd year."

BAT has been a boon for employers, business and finance schools, and aspiring financial sector workers alike. According to Mr. London, part of its uniqueness and value derives from the way it illuminates aptitude and creative thinking, as opposed to mere factual knowledge. "For students and young professionals in their early 20s," he says, "it's more about their ability to do and solve rather than how much they know. A big investment bank isn't hiring the person who knows the most about investment banking out of college. They want the next great thinker."

The test's 11 sections focus on analytical and verbal skills, but by de-contextualizing analytical questions so that they are not dependent on finance-specific knowledge, potential financial talent from other disciplines can be assessed.

"Sometimes we find that these young financial superstars don't have the aptitude of non-financial superstars from top-level liberal arts schools. We're measuring them equally. We're measuring aptitude and it's translating into predictability of who's going to be successful in the workplace, and I don't think that's ever been done."

Eric Saucedo, of Tricap Partners & Co. in New York, sums up the response of much of the financial community to the BAT, noting how it quantifies the intangible: «Unfortunately, the interview process is very much an art and not a science. But the BAT gives us a very good indication as to what candidates will feel relatively more comfortable with a highly quantitative and stressful job on Wall Street.»

Test results are stored in the BAT database, which employers can access for a fee. This allows recruiters to find top talent from among the swelling pool of BAT takers around the globe. Recruiters even have the option of prioritizing certain sections of the test when ranking scores, so that results can be weighted toward certain aptitudes.

Mr. London says the BAT's reception among employers has been enthusiastic. "It's been a home run," he says. "Employers love it for a couple of reasons. First, we started this at a time when people in recruiting were getting pressed on their expenses, and often these 20-somethings were not being recruited in the most cost-effective way. So it's been a cost-saver."

"Second, people are becoming more forensic about how they are hiring people, and we give them the analytical tools to see the differentiation among people. So it's just what people want and the timing is perfect. Students need jobs and the community that hires them is looking to be smarter and more cost-effective."

He emphasizes, too, that the test levels the playing field for global talent. "It's a test that can be equally fair to all people regardless of where they live and what they've studied, and that's particularly appealing to the employer community." The test is given only in English, the lingua franca of global finance, though Mr. London says he has been amazed at some of the high scores that non-native-English speakers have earned.

> *"We're measuring aptitude and it's translating into predictability of who's going to be successful in the workplace, and I don't think that's ever been done."*
>
> *Michael London, CEO at Bloomberg Institute*

So far, the BAT has been most popular in the US, India and the U.K. But it has also made headway in LatAm, catching on among the generation coming of age amidst the region's economic growth and financial maturation.

"We see LatAm as a growing market," Mr. London says. "Obviously there are far more people going to college and grad school in LatAm than 5 years ago, and a lot of those markets are becoming financial hubs. And a lot of our clients are looking for people from those places, from both a diversity and a geographic perspective."

Universities across the region are also seeing the BAT as a means to connect their students to the global job market. "For the most part," he observes, "LatAm schools seem less skeptical and more enterprising. These schools are asking if they can integrate our test into their curriculum, or require people to take it. They realize that if we have more students taking this than anyone, they'll appear on top. So we've been impressed by the savvy of the global community."

Bloomberg Institute and the BAT are still in their early stages. In the near future, in addition to continually renewing and improving the test – which his staff of 100 financial practitioners and education professionals already does on a regular basis — Mr. London says the institute plans to offer more preparatory materials and to improve its revenue structure. He also notes, however, that BAT prep services will no doubt be attractive to third parties. "When I was at Kaplan," he remarks, "if I had known that 40,000 people were taking a brand new test, we would have been prepping for it right away. At Bloomberg, we've been smart and haven't had a lot of press, but our numbers are staggering, and as the success becomes more well known, everyone will be prepping."

Private Equity in Latin America K-12

The world has long recognized the increasing complexity of a global economy, with the interdependency of different economies and the long presence of multinational companies. We also learn to appreciate various cultures and always seek to learn about the many ethnic, governmental, religious and even culinary differences present around the world. The education sector and K-12 schools in particular have similarly embraced the success of international schools, as a growing number of school districts and individual schools in K-12 have tried to take global learning to the next level. Specific components include foreign language proficiency, curriculum with global perspectives and the use of technology to build global cultural competency.

Private-equity investors have capitalized on this opportunity to fund such networks of schools as The Avenues (LLR Partners, Liberty Partners), World Class Learning Academy (Sovereign Capital), Nobel Learning Communities (Leeds Equity Partners), Nord Anglia (Baring Private Equity Asia), Cognita (Bregal Capital), Kroton (Advent International) and Bahcesehir Koleji (The Carlyle Group) to name a few. In LatAm, certain funds have targeted single countries and individual schools; however, nobody has successfully addressed the opportunity for a LatAm network of private K-12 schools.

Now New York-based merchant banking firm Tricap Partners & Co. is doing just that. Santa Maria Academies is the only network of private college-preparatory schools focused specifically on the LatAm K-12 student. The school's vision is to develop future generations of exemplary citizens of LatAm and the world. Its curriculum and programs are tailored to the needs of the international student and guided by common standards that are at the core of its commitment to academic and personal excellence. The schools inculcate key academic objectives while providing an educational experience of global relevance, developing second- and third-language fluency and an overall educational experience that prepares its students for an increasingly global society.

> *"For Latin America to continue to grow and improve for the long term, it must have a strong educational backbone, and the Santa Maria Academies provide Latin American K-12 students with a unique opportunity to participate in a school which promotes cross-cultural literacy and a committed focus on an increasingly global society."*
>
> *Jack A. Smith, Partner, Tricap Partners & Co.; Chairman and CEO, Santa Maria Academies*

"Latin America has shown phenomenal progress the last few years from an economic standpoint and with the growth of a continuously emerging middle class," said Jack A. Smith, a partner at Tricap Partners & Co. and the Chairman and CEO of Santa Maria Academies. "For Latin America to continue to grow and improve for the long term, it must have a strong educational backbone, and the Santa Maria Academies provide Latin American K-12 students with a unique opportunity to participate in a school which promotes cross-cultural literacy and a committed focus on an increasingly global society."

Through high academic expectations and a structured environment, the Santa Maria Academies maintain a balance among challenging academic, athletic, artistic and extracurricular programs. "In addition to prizing intellect, the Santa Maria Academies insist upon and foster integrity, high ethical standards, leadership, mutual respect, tolerance and teamwork, issues that are important in of themselves but even more so when talking about overall international integration and cooperation," added Scott B. Sucher, another partner at Tricap Partners & Co. active with the Santa Maria Academies. Mr. Sucher explained that, in addition to strong academic environment, the Santa Maria Academies are focused on three main strategies:

- Second language proficiency. Students are required to reach second- and third-language proficiency, and they are required to do a semester at another network school.
- Global collaboration. Students, teachers and even administrators collaborate

across schools on projects, assignments, athletics, music and the arts.

- Technology advancement. Led by the experience of management and members of the board of directors, the Santa Maria campuses are networked for student communications.

In addition to building new schools, Santa Maria Academies is acquiring, financing, expanding and integrating existing schools with competitive advantages based on location, reputation and commitment to academic excellence, said Eric Saucedo, a partner at Tricap Partners & Co. "Unlike similar ventures, we identify schools that have a long and rich history of academic excellence, and once a school forms part of the Santa Maria Academies, it is connected by ethos and technology and forms part of a single school, a single student body, a single faculty, a single curriculum and a single vision," he said.

Tricap Partners & Co. has put together a management team at Santa Maria Academies comprising senior executives with experience in business, education and technology. Led by Mr. Smith, who founded The Sports Authority and has worked with many private equity-backed companies throughout his career, the group is experienced in Latin American business and education and brings exceptional hands-on operational experience with early-stage companies. Above all, they have a unique passion for education and its role in the continued development of Latin America.

"Like any good company or transaction, one of the toughest parts of this transaction has been putting together a balanced management team from both business and academia that can come together and build a successful company and network of schools, but that's why we have Jack, because he has built a phenomenal management team, starting with Marcelo Hernandez in Chile, who serves as the company's president, because there is nobody better that Marcelo when you're talking about Latin America K-12 education," said Mr. Sucher.

Mr. Sucher explained further that the Santa Maria Academies network of schools presents a wide array of benefits and opportunities for not only students but teachers and proprietors of schools that look to become part of the network. "Mixing outstanding academics with exceptional extracurricular activities that often include regional and international travel opportunities, Santa Maria Academies is a road to success for all parties involved," said Mr. Sucher. "For teachers, we provide opportunities for transfers and visiting instructorships, enhanced career growth through unique experience with a network of schools, and for schools looking to become part of the Santa Maria Academies, we ensure the preservation of a school's legacy, we accelerate capital projects through access to increased investment, and we can give owners a certain level of liquidity if that's something they want. So we see it as a win-win for everyone."

Post-Crisis Trends in Offshore Investment Structures

In the immediate aftermath of the financial meltdown in 2008, offshore financial centerss came under intense scrutiny as governments – led by the newly-elected Obama administration – rushed to tighten banking regulations. For a short while, offshore financial centerss became synonymous with tax havens, blamed for contributing to the global economic collapse and costing governments millions as wealthy individuals and corporations dodged tax collectors.

According to Rolf Lindsay, Partner at the Cayman Islands based law firm Walkers, this was a misrepresentation of the typical role of the tax neutral offshore financial center, which is primarily to provide an efficient forum to raise capital which can then be deployed anywhere in the world. Those investments, he underscores, are still taxed according to the rules of the relevant jurisdiction and distributions made to investors are taxed in their home jurisdictions. But the absence of an additional layer of tax in the offshore center makes it a more cost-effective location to raise and deploy capital.

The rhetoric has since softened considerably as politicians realized that when it comes to the real areas of concern – issues of transparency, regulatory cooperation and the management of systemic risk – offshore financial centers already had robust systems in place. With that came the realization that it was onshore banking, particularly in the US, that needed tighter regulations to avoid system abuse. “It was a sobering thought for many that [Bernard] Madoff would not have been able to do what he did had he been in the Cayman Islands,” says Lindsay.

In addition, after the initial post-crisis outrage, the perception of offshore banking improved as governments in stricken Western economies saw the role they played in raising the capital that was used to buy up distressed debt and ultimately stabilise the banking system. This helped improve people’s understanding of the benefits that offshore financial centres can offer local economies, by improving access to global capital and stimulate growth.

With this awareness, experts say the jurisdictional element becomes less of an issue, provided that the relevant controls to prevent money laundering and exchange information across borders are in place. As these controls have been tightened since 2008, there are fewer places in the world now that could be considered real tax havens, which is less to do with the level of local applicable taxes and more to do with bank secrecy laws and the level of cooperation with regulators. Traditional ‘havens’ like Switzerland are coming under increasing pressure to comply with international regulations, as new financial reforms such as the Dodd-Frank Act in the US and the Alternative Investment Fund Managers Directive (AIFMD) in Europe change the way banks and investment firms operate.

In the US, the Foreign Account Tax Compliance Act (FACTA), which requires US citizens to declare information about offshore holdings exceeding a certain amount and foreign financial institutions to provide the IRS directly with details of accounts held by US citizens, is another example of the additional controls that have been developed post-crisis. However, according to Lindsay, while these may be more stringent reporting requirements for some US-

Rolf Lindsay, Partner at the Cayman Islands based law firm Walkers based investors, the information required to be gathered is typical of the controls already used in established offshore financial centres to prevent money laundering.

Emerging Markets

The relationship between offshore financial centres and emerging markets has traditionally been quite different to that in the developed world. China, for example, which has seen enormous flows of investments from places like the Cayman Islands over the last decade, has long recognised the benefits of international capital to its econmy. Meanwhile, another emerging giant, India, has attractive tax agreements with Asian financial hubs like Singapore and Mauritius, which acts as a catalyst for global capital entering the region.

Latin American states, on the other hand, continue to pose tough restrictions of the movement of capital, due to a history of capital flight and tax avoidance among the wealthiest segments of the local population. Measures to prevent tax avoidance and money laundering are important and justified, though in their current state, also present obstacles to legitimate foreign investment which could bring considerable local benefits.

At the same time, Lindsay says emerging markets, and Latin American countries in particular, are a hot destination for capital when it comes to institutional investors based in offshore financial centres. A lot of large, international private equity funds, for example, are increasingly focusing their portfolios on the high-growth countries of Latin America as a means of reducing exposure to more traditional markets. Meanwhile high-net worth individuals within Latin America continue to favour offshore banking as a means of protecting against political instability, even though more recently this has begun to change as growth and confidence in the region rises.

"It was a sobering thought for many that [Bernard] Madoff would not have been able to do what he did had he been in the Cayman Islands."
Rolf Lindsay

The rise of emerging markets could also potentially create new offshore financial centres in developing regions. In Latin America, Uruguay's relative political stability and relaxed immigration laws has given the country a growing reputation as a financial hub for individuals and corporations operating in some of its larger neighbours. It is also an increasingly popular retirement spot for North Americans.

However, Lindsay thinks the new wave of controls and regulations will make it increasingly difficult for new offshore jurisdictions to get up and running. Not only are costs in traditional offshore financial centres now extremely low, but the experience of dealing with complex legal proceedings in the wake of the 2008 crisis means the courts in places like the Cayman Islands are now far more sophisticated and prepared to deal with future problems. Given the uncertainty that still exists in the global economy, the importance of this expertise cannot be underestimated.

E-learning's fate could be similar to that of mobile phones and mobile banking in LatAm and other emerging markets: spreading rapidly across all corners of the region, precisely because the previous generation of infrastructure, supplies and methods is underdeveloped.

Public awareness of the profound changes happening in the realm of e-learning has reached a tipping point. The recent announcement that Stanford University and the Massachusetts Institute of Technology would offer free courses online to anyone in the world, for instance, set off a flurry of commentary in the mainstream media regarding the paradigm shift we're living through. That shift, though initiated largely in the US over the last decade, is occurring in emerging markets such as LatAm, too, and it signals not merely a change in the medium of educational content delivery but a profound reorganization of the structures and methods of education itself.

You Say You Want a Revolution: E-Learning Arrives in LatAm

"The quality of education online continues to improve," says Daniel Black, Managing Partner at the Wicks Group, a New York-based private equity firm targeting small- and mid-cap companies in education, information and media, "and the data are suggesting that a combination of online and in-person education is better than either one without the other."

As technology develops, he say, people are interacting"not only synchronously but asynchronously" with educational material and each other. "You now have 1,000 students interacting with instructors and content on their own terms. There's a power shift away from instructor-led teaching, and that's going to open up a whole new set of opportunities in education."

Nor is e-learning confined merely to online courses for adults and continuing education, as it was in its fledgling days. Such online courses, many provided by universities, Mr. Black says, "have been the pioneers of nontraditional education. They've been pushing online capabilities, and their success is starting to bleed over into other parts of their institutions." That more comprehensive approach was attempted before, of course, early last decade, when some online-only university programs tried to enter the market, but the trend didn't catch on. "Those early pioneers got shot," Mr. Black explains, "and the guys who followed up had better technology and a better business plan."

"The evolution is taking place right before our eyes," he adds. "From a technological and services perspective, we're still in the early days. The question now is: Who is going to enable and manage this evolution?"

Little Fish, Big Pond: Moodle and Moodlerooms

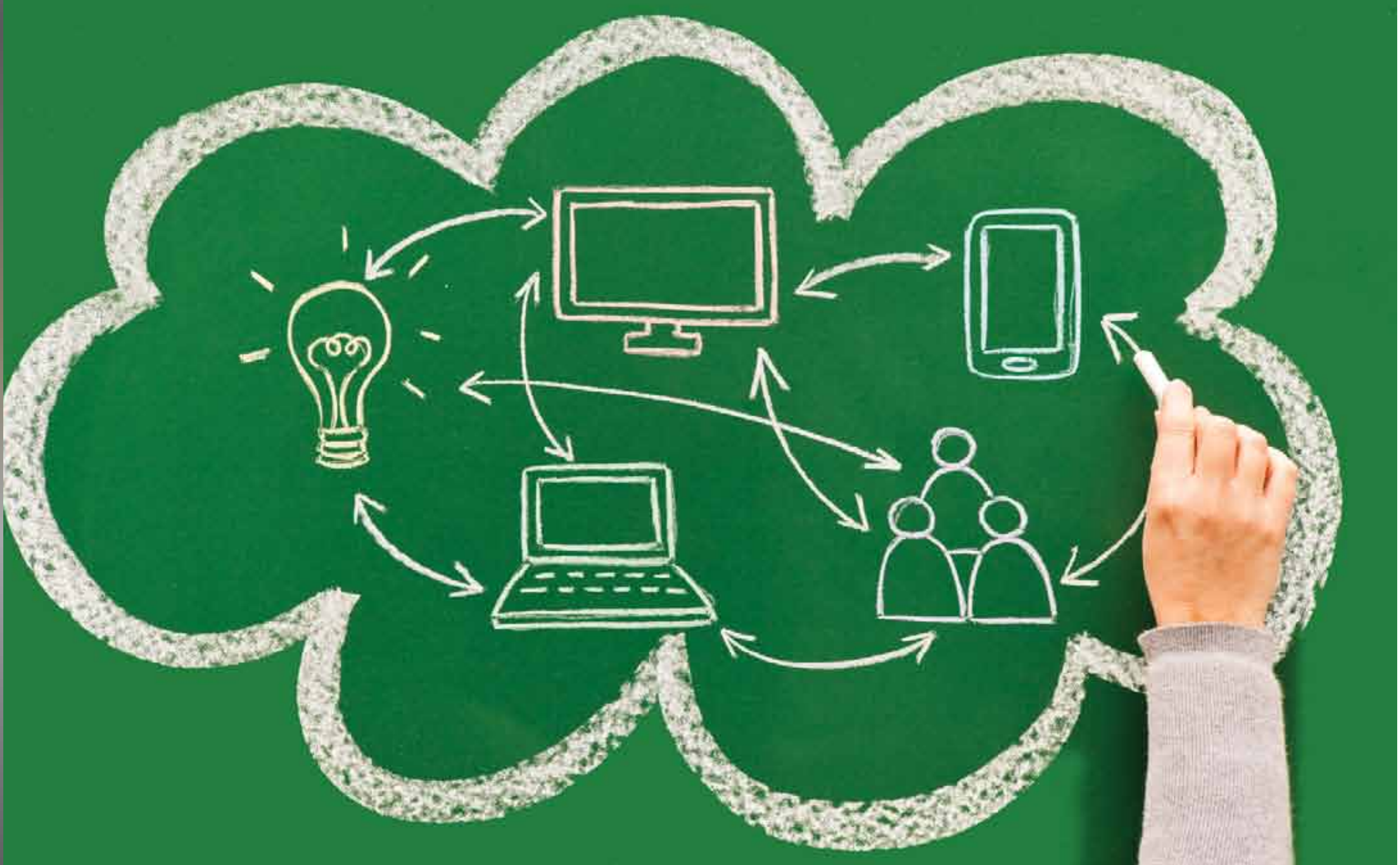
For Lou Pugliese, CEO of Moodlerooms, a Baltimore-based learning solutions provider, smaller-sized companies such as his are defining e-learning's bleeding edge. "As we're moving toward Generation 2 systems, we're starting to see small startup players emerge on the marketplace who are successful because they are nimble and can create and re-create e-learning systems in Generation 2 model that large, less nimble organizations might not be able to," he says.

Moodlerooms has seen rapid growth since it began in 2006, utilizing the Moodle software platform to provide learning solutions to clients across sectors. Moodle is an open-source, freely downloadable learning management system (LMS) that increasing numbers of institutions are utilizing to create online learning environments. As it is flexible, cheap to maintain and develop and part of a worldwide network of users and developers, many companies and institutions are turning to Moodle over proprietary options. "We're starting to see organic encroachment of open-source products into the proprietary space," Mr. Pugliese explains, saying that his company has "added significant value to software and services for institutions globally who are looking to migrate from current proprietary platforms to open source, both for economics and flexibility." A map on Moodlerooms's website shows LatAm, and particularly Mexico and Colombia, accounting for a large share of the Moodle sites worldwide, on par with the US, Europe and patches of Southeast Asia.

Knowing Our Technology

Mr. Pugliese agrees with Mr. Black that the e-learning revolution is changing the very nature of student-teacher and student-content interaction, and that it is up to the market to meet the demand. "In the '90s," he says, "e-learning was a convenient way to store content. For the first decade, LMS's were used as an administrative tool. What's wrong with the current design is that the category we created had a lot to do with the management of instruction and not instruction itself and its outcomes. The transition in this market is happening very quickly, moving from management to learning and the ability to track students and to understand their performance and create adaptive environments."

Fueling this structural change in education has been a greater understanding of what



education technology is capable of. "What we failed to realize early on in e-learning management is that software does a great job of listening, of understanding what students are doing online. It tells us not only how they are performing on tests but how they are interacting with each other and connecting with course materials and faculty members and their general engagement in their course of study. E-learning platforms can correlate a mountain of data against performance indicators. We're still in the early stages of looking for nonadministrative applications for this intelligence to understand how students can better learn and faculty can better teach."

Increasing Education's Reach

As cheap, more flexible and often open-source solutions continue to enter the LatAm market, many experts believe that e-learning's fate could be similar to that of mobile phones and mobile banking in LatAm and other emerging markets: spreading rapidly across all corners of the region, precisely because, in many places, the previous generation of infrastructure, supplies and methods is underdeveloped or doesn't exist at all.

According to Stormy Byorum, Executive Vice President at Stephens and Co-Head of the firm's International Group with extensive experience in the private education sector in LatAm, e-learning has the potential to increase access to education for the most needy. "It can get its tentacles out to the very best educators in the world and deliver it at a fraction of the cost. If you overlay that with crowded cities and non-optimal roads in many places, you have a real opportunity to reach hundreds of millions of people."

But the relationship of mobile telecom and e-learning is not merely one of analogy. According to Mr. Pugliese, the 2 sectors will thrive off one another. He sees an opportunity for partnerships between the telecom sector and the e-learning industry. "As broadband and wireless become more prevalent and mature, we're starting to see telecom companies that want to partner with e-learning providers, providing the necessary transport, with LMS providing content and learning delivery.

Big Fish, New Pond: Pearson Education

But even as small, nimble companies are sprouting up to join the e-learning revolution, Mr. Black says the large companies that have dominated educational content provision and services for decades – such as Pearson, McGraw Hill, etc. — are starting to morph and retool. "Pearson, in my view, has been the most aggressive in transforming their business and have had a better view to the future than other players in the sector," he says.

Hernan Moyano, Business Development Director focused on LatAm at Pearson Education, sees his company as a proactive risk-taker within an often sluggish and timid – if very promising – industry. "It is a blaring industry taking baby steps," he says. "The results are journal articles; Youtube videos with less than 500 views; several books on the secret of success with the word 'e-learning' on their covers; government's promises, dreams and more voices, all of them collapsing for lack of ambition, appetite for risk, investment and the patience to await returns on those investments. "Nevertheless," he adds, "it's an industry with a big future, within a young continent with little access to education, which makes it attractive and destined for success, sooner or later."

It [e-learning] can get its tentacles out to the very best educators in the world and deliver it at a fraction of the cost. If you overlay that with crowded cities and non-optimal roads in many places, you have a real opportunity to reach hundreds of millions of people.

Pearson's aggressive expansion into e-learning, he says, is not a radical change of direction for the company, but follows logically from what it has always done. "Pearson's expansion plan," he says, "is fully related to its mission to change the lives of people through education." Currently Pearson offers e-learning solutions across the board, including content and educational materials; course design and syllabi; institutional design; courses and simulators such as Mymathlab, Myeconlab and other products from the Mylabs suite; content repositories; learning management systems; and administrative software.

As Pearson continues its metamorphosis into an e-learning leader, Mr. Moyano says its geographic focus and project selection "have to do with the viability of the projects and the flexibility demanded of local businesses and efforts," and that their expansion follows 2 general models.

"One model is to create awareness and offer public and private entities assessment tools, content, technology and certification," he says, mentioning a handful of exemplary Pearson-led businesses such as eCollege, Frontier, Pearson Publishing and Edexcel, among others. "It's an education-provider model that goes beyond mere branding and doesn't drag its feet for lack of ambition, investment and risk-taking." "The second model is complementary and has to do with a move toward the delivery of education. Acting as partners, and using e-learning platforms, we hope to bring education to all parts of the world, creating social mobility and value for people, communities, markets and, of course, shareholders. We will do it on our own, or through co-branding, or by providing back-office services to other institutions joining this effort to create an industry."

Ecuador

From Artisans to Entrepreneurs through the Development of Social Enterprise

In Ecuador, social and economic indicators are trending upwards, inviting opportunities for international and local investors. With substantial oil reserves and a rich agricultural terrain, an 8.37% decrease in overall poverty in the last 5 years, an annual modest but increasing growth rate of 3.2%, and a GDP per capita of US$3,700, economic trends point to a promising investment climate.

However, despite these external success indicators, poverty and unemployment are still evident throughout the country. In Ecuador, there are currently 14.5 million people living in a geographic area roughly the size of the US state of Colorado; 4.5 million of them are employed or actively looking for employment. Twenty-eight percent of the overall population still lives at or below poverty levels, and this is exacerbated in the rural areas where 50% of the population still find themselves in this situation.

Rural women, who are often the key providers of their families, have a very difficult time finding long-lasting and sustainable income-generating opportunities. The effects of this are particularly disturbing when one considers that in many households, this income often goes toward the education and health needs of the children, and therefore toward family mobility and the eventual movement out of poverty and exclusion.

Fortunately, there is a group of pioneering international organizations working on the ground in Ecuador to foster local development opportunities for rural Ecuadorans. NESsT, an international organization with a permanent presence in Ecuador, develops sustainable social enterprises that work to overcome barriers to employment and sustainable income for marginalized populations throughout the region. Utilizing a hybrid model, NESsT takes a long-term, tailored approach building the capacity and providing varied financial instruments to grow its portfolio of high-impact social enterprises. NESsT believes that social enterprises create a more just and productive marketplace by extending access to fair employment, sustainable income, basic services and universal rights.

The key component of the business model is to move the women from the role of marginalized garment producers to proactive entrepreneurs whose productivity and engagement constitute the main driver in the success of the business.

Texsal, a NESsT Enterprise, is an association of women artisans who began producing handicrafts and clothing over 35 years ago in the area of Salinas de Bolivar, Ecuador. Since then, thanks to changes in land ownership, as well as financial support received from several funders, the Salinas de Bolivar region has become an outstanding model of community development. Texsal began with 15 women weaving wool and alpaca clothing items. Over the years, the association grew steadily and today, there are almost 300 members. One-third of the women are actively selling their works to tourists in the marketplace, and generating a steady income that goes toward enhancing their independence and improving their living conditions.

With the support of NESsT, Texsal has been able to diversify its product offerings and attract and secure a new target market, mainly an upper middle class following from Quito. The enterprise's line of homemade alpaca garments are produced with high-quality materials and incorporate design elements that preserve Andean culture. The articles of clothing blend traditional and modern aesthetics and are very appealing to upper middle-class Ecuadorans. The demonstrated ability to meet orders and satisfy the preferences of this market has led to the growth of the enterprise and to slowly building the capital needed for reinvestment.

For Livia Salazar, director of Texsal, the possibility of increasing the number and improving the quality and price of the garments sold is allowing this group of 300 women to increase their self-esteem and their ability to make decisions. Tailor-made trainings offered by NESsT and experts in this trade are permitting the women to professionalize their skills and to foster a sense of permanence and pride that is having a life-changing impact on the women and their families, while also maintaining true to their indigenous culture.

The key component of the business model is to move the women from the role of marginalized garment producers to proactive entrepreneurs whose productivity and engagement constitute the main driver in the success of the business. One strategy used is to organize "business rounds" between these local entrepreneurs with prospective buyers and clients which allow Texsal to measure the acceptance of its products, and serve as opportunities to train the entrepreneurs in negotiation and reaching prospective clients.

This type of tailored and ongoing capacity support guided by a business plan and supported by growth capital is critical for the development of investment-ready scalable social enterprises. By recognizing these needs, and by working with stakeholders to develop these types of support mechanisms, investors committed to social impact are sure to have a healthy pipeline while working toward overcoming structural poverty in Ecuador.

Author Biography

This is the 4th in a series of 6 articles by NESsT on social enterprise and impact investing in Latin America, leading up to the Social Enterprise World Forum - Fórum Mundial de Negócios Sociais 2012, October 16-18, 2012, Rio de Janeiro, Brazil. SEWF is the premiere global event focused on building a social enterprise movement worldwide. SEWF2012 will focus on the growing field of impact investing, including over 1,000 delegates from 30 different countries. For more information and registration details, visit www.sewf2012.org. See you in Rio!

Education PE in LatAm 101

Private equity investment is on the rise in LatAm, with global fund managers attracted to the region's generally low prices, strong macro fundamentals and increasingly business friendly regulatory environments. One of the big stories in the region has been the expanding middle class, which is steadily growing and number and purchasing power in such countries as Brazil, Mexico, Peru and Colombia. Many PE funds have been tapping those demographics by investing in industries that serve this rising consumer class, and one of sectors garnering the most attention is education.

Sam Shah, Head of Global Education Services at Credit Suisse, speaking specifically of Brazil, sums up the general situation in the region: "The main theme is not dissimilar in many respects from what you find in other emerging markets and which makes education so exciting. You've got an emerging middle class that recognizes the wage premiums tied to a better education, and as disposable income increases, there is significant demand for better education. But many of these governments recognize that the public sector alone is ill-equipped to satiate the appetite for education, so they're viewing the private sector as a critical partner to educate the middle class. There's a perfect storm of demand coupled with supply supported by supportive governments." Robert Lytle, co-head of the education practice at the Parthenon Group with a focus on global private education markets, concurs, seeing the increasing demand of the middle class as the basic engine of the education sector's growth and development. "Anywhere you have rising income, you have a rising, insatiable demand for education services," he says, noting that parents generally want to place their children in the best schools they can afford. "For very poor parents," he says, "this typically means they want to withdraw them from their public school and move them into a private school; a step above them, the desire is for a bilingual school; then a full-English school but with a lot of non-native English instructors; and then an English school with native English instructors. We see that dynamic all around the world."

"There's a perfect storm of demand coupled with supply supported by supportive governments."

Sam Shah, Head of Global Education Services, Credit Suisse

K-12 and Post-Secondary

Mr. Lytle estimates that he and his firm have been involved, at some point or other, with most of the recent PE transactions in the LatAm education sector. And from their perspective, he says, "K-12 private schools and post-secondary schools, especially universities, tend to be where the best opportunities are. Most of our clients would agree."

The rise in income, he says, is the basic reason why. "The simplest thing is to look at growth and income, adjusted for purchasing power parity," he says, speaking specifically of post-secondary participation. "As income rises, attendance rises as well." This means an increased demand for seats, "and we're not aware of any country in the world, with the possible exception of the UAE, who can afford these seats on its own. So governments are turning to capital markets and private enterprise in one way or another to do it."

"Income stratification is secondary," he adds. "As long as income is rising generally, you know you have the right dynamics, and now it comes down to having the right regulatory structure and hunting for the right options."

Mr. Lytle expects to see growth in both K-12 and post-secondary for years to come. "Just about everywhere in the world, you're looking at 10 to 20 years of growth. You have a growth market with 10 to 15 years of underlying secular demand and tuition price points tied to employability. In every country we've been in, you can get the cost structure in line and have a profitable growing enterprise."

He notes that private K-12 and post-secondary schools tend to be cash-flow positive businesses, with positive working capital from Day 1, and that both types of schools have fairly high barriers of entry. "Getting the permission to run a university, and even a K-12 school, takes real effort, and that plus location and reputation dynamics creates a barrier." Moreover, he adds, "any university is a good scale investment from a PE fund perspective, as is a small chain of K-12 schools."

Regarding returns, he says they tend to be reasonably similar throughout the world, with a

"You really don't have a lot of for-profit players in the industry, and education assets tend to be less aggressively managed than in other sectors. So it's an industry that's going through a substantial restructuring, and we think we're in the first or second inning of that restructuring."

Daniel Black, Managing Partner, Wicks Group

couple of isolated exceptions. "In India, for instance, demand so far outpaces supply that you have virtually no marketing costs, and that can add a few points to the bottom line. But in general you'll find that tuition price points and costs tend to adjust themselves to the local market, and as long as you run efficiently, schedule well, and are careful about your facilities and capital utilization, the returns tend to be about the same profile."

"Put those things together," he says in sum, "and it starts to look very attractive for a PE investment."

Language and Specialized Education

Investing in K-12 and post-secondary schools is not suited to every fund manager, of course. As Jim Bland, principal at NCP & Company, a Chicago-based private growth equity firm, the nature of such schools precludes certain investor types. "Part of the concern around K-12 investment," he says, "is the typical hold period. A fund like ours has a discrete time period for investing and harvesting, and if you're starting a school de novo, it takes a long time to start and establish a reputation in the market, and that's tough given our time horizons."

Mr. Bland agrees with Mr. Lytle that growth and barriers to entry are fundamental. "We're growth investors looking at areas with high growth and high barriers to entry, and education lines up well with those parameters," he says. But his firm is focusing more on small companies providing specialized content and services; among current investments are three education-specific companies: Career Training Academy Inc., Collaborative Learning Inc. and

Language Stars

Language Stars is a US-based company, launched in Chicago, that provides foreign language teaching services for young children, including serving as an outsourced language provider for K-5. "A lot of schools are cutting languages, and what we offer works well with cutbacks, as we're a better alternative at a cheaper price," he says. The company is growing fast, and though it has yet to enter foreign markets, Mr. Bland expects that, as emerging markets open up to the world, there will be high demand for the particular service it provides. "There's a global aspect to early language skills, and the research is becoming more mainstream regarding the ease in learning a second language earlier in one's life."

Dismantling the Textbook Paradigm

Education Growth Advisors is another fund focused on growth investing in the sector. As Managing Partner Chris Curran puts it,

> *"Though we're not at the bottom of the food chain, there is a food chain, and it's toward the lower end that we see the value."*
>
> *Daniel Black, Wicks Group*

"We felt there was a need for a fund focused on growth equity in education, based on our recognition that there's been scarcity economics at play in the asset classes that need the most capital to really have an impact." His firm's focus has been in large part on the small companies that are defining a new wave of education content provision in the region. "Our filter for strong market opportunities," he says, "starts with anything that may be disruptive to the traditional textbook paradigm, which has been being dismantled pretty dramatically in the last 5 years."

The opportunities deriving from this shift include e-learning companies and companies offering new assessment alternatives. "There's been increased success around the changing nature of assessment," he says, "not just among the major players but the top 50 players in the market. Some of that growth is regulation driven, some of it demand driven. And some of it has to do with global human capital competition and optimization, where the best way to make advancements in your learning systems as a country is to measure, assess and understand where the baseline strengths and weaknesses are occurring."

Deriving from such opportunities are others in domestic companies providing translation and localization services to local markets. "A big part of the psychometrics and science of assessment is around that contextual balance. You can't talk to rural kids in the Amazon about urban planning when constructing math questions. Content must be relevant to the user."

Mr. Curran points to the Brazilian textbook and e-learning delivery market as being particularly ripe for investment, noting that entry into the market is simplified by the centralization of education regulation in the country. "There are some compelling opportunities for publishers and tech and service providers who will be able to underwrite that evolution into the next generation of the textbook in Brazil and LatAm. Brazil is the largest purchaser of textbooks in the world as the sole source procurement agency for all its schools and education agencies."

Finally, Mr. Curran points to the opportunities deriving from education infrastructure development in the region. "There is staggering growth in Brazil, as there is in China, in terms of turn-key and greenfield school development. It's entrenched in local politics and regulatory issues around building and development, but there are a lot of opportunities for construction and design companies that work with both the development and implementation of schools and school buildings as well as the networks and hardware going into those schools."

For Mr. Curran and Education Growth Investors, success in equity means having intimate contact with emerging companies in the sector. "We've found that, for our investing to be well informed in the education space, we really have to work with smaller venture-backed and growth-oriented companies in the emerging seminal layer of the tech and services realm, so we do a lot of consulting work with such companies looking for future growth and who need advisory services around channel optimization, product maximization and joint ventures, etc."

Transforming Companies

While many PE funds are investing growth capital in the region, others, such as the Wicks Group, are finding valuable opportunities in certain well established companies. "We look for underperforming and undermanaged assets to buy," says Daniel Black, Managing Partner at the firm, "and then focus on operational improvement and implementing best practices to drive performance and create a substantially better business that we can sell up the food chain. Though we're not at the bottom of the food chain, there is a food chain, and it's toward the lower end that we see the value."

He explains that the firm's target includes businesses that are generally decent but have yet to be maximized. "We don't want to buy broken businesses but ones that haven't been run with best practices and a lot of focus. We're not investing in growth stage; we want a little growth and a lot of process improvement, including looking for opportunities the prior owner didn't see, such as utilizing a product in a new market."

The firm applies a broad definition of the concept of education, as implying any context "where knowledge is being transferred from source to use." They are interested in opportunities across the sector and see a "broad tail wind behind knowledge-based education businesses," Mr. Black says, "with growth over time for all of them."

Mr. Black sees his firm as helping companies adopt a new ethos and enter a new age of education. "You really don't have a lot of for-profit players in the industry, and education assets tend to be less aggressively managed than in other sectors. So it's an industry that's going through a substantial restructuring, and we think we're in the first or second inning of that restructuring."

Regulation

According to Mr. Shah, of Credit Suisse, investing in education in emerging markets is less a question of the regulatory environment and more a function of demand. "Many of these markets have no reliance on government funding," he says. "It's mostly a cash play and a consumer discretionary item. These markets are enticing for investors because there is a relatively simple approach to selling in these markets. Advanced countries like the US tend to be overdeveloped, overcomplex, overwrought."

Nevertheless, he says that working well with governments is essential for any business and investor. "It is the most important factor to the sustainability of any education business, at least one that's directly tied to education provision, i.e., teaching students. It's vital that you maintain a very strong direct dialogue with regulators because ultimately they can make or break you."

"It is the most important factor to the sustainability of any education business, at least one that's directly tied to education provision, i.e., teaching students. It's vital that you maintain a very strong direct dialogue with regulators because ultimately they can make or break you."

Sam Shah, Credit Suisse

Branding

Mr. Shah also mentions branding as being fundamental to success. "This market is about growth, it's about branding, it's about capital efficiency. Obviously you want to buy a business that can grow, because you're putting in growth capital. You want to make sure they're more efficient spenders of that capital than other opportunities, because that will dictate what absolute quantum of growth they can achieve.

But ultimately, given that it is a consumer discretionary item, people will always gravitate toward and ultimately pay more for the better and more established brand, the brand with the best pedigree and track record of delivering the outcomes parents are looking for, like getting their children into a good school or improving their test scores."

The Intangible

Mr. Shaw adds that there is a further, more intangible secret to success in the market, rooted in the investor's motives for entering it. "The sector should appeal to those who have not only a business but a philanthropic approach to investing, because when you buy an education asset, it's not just income-generating but critical to the community and ultimately changing children's and people's lives. So you have to be passionate about delivering on 2 purposes."

The Truth About Nationalization

James Knight is Director of Pionero Partners, a LatAm-based strategic advisory consultancy

Evo Morales's May Day present to the Bolivian people this year, the nationalization of electricity firm Transportadora de Electricidad (TDE), caused some discomfort, especially in Madrid, coming shortly after the Argentine government's YPF expropriation. TDE was 99.94% owned by REE, the Spanish electricity operator, and lack of investment was cited as the reason behind the move. Would the dominos of the old colonial power start to fall in South America? This is an easy conclusion to jump to. However, I don't believe it's the right one. First, 2 events do not constitute a trend. They are simply 2 points that can be linked on a graph. Second, circumstances and implications are very different.

The Bolivian premier pulls a rabbit from the hat every Workers' Day. This time round the announcement was more subdued. TDE represents only 1.5% of REE's operations, and talks are ongoing to reach a fair valuation on assets. On the same day, Morales hot-footed it down to the Margarita gas field (which, incidentally, supplies 7 million m³/year to Argentina) to deliver another speech stressing the excellent partnership with none other than Antonio Brufau, Repsol's Chairman. This was after Morales had «nationalized» the hydrocarbons industry in 2006.

In Argentina, almost as startling as the manner of the expropriation is the fact that until it happened the administration had no direct stake in one of the country's key strategic assets. This is not the norm across the continent. And there may be good reason for that. At the time of YPF's 2-stage sale of 98% of its value to Repsol in 1999, which was perhaps inspired by too much heady imbibing of neoliberal doctrine, the firm had a value roughly equivalent with Petrobras, of around US$15 billion. The Brazilian supercorp, which employs a public-private mix whereby the state retains a controlling strategic interest but company shares are traded on the NYSE, is now worth US$136.31 billion. Go figure.

The point is, state participation is almost to be expected, and therefore accommodated. In Chile – an OECD, free-market-endorsing member – Codelco, the world's largest copper producer, is 100% state-owned. Mexico's Pemex is another nationalized behemoth, and Venezuela's PDVSA is well-known as a chavista machine. In countries where regulatory institutions are generally weaker, the easiest way to exert influence is through direct involvement. But the most successful firms are those that keep day-to-day political interference to a minimum, while control of strategic direction is clear.

If we were to play a game of 'Where next,' Ecuador is an obvious candidate, due to its administration's populist credentials. However, no South American leader will have failed to notice the bounce that Morales and Fernández de Kirchner found after expropriating. Therefore, companies operating in countries with low-polling leaders should perhaps shore up their government relations departments. Peru's President Humala, who fought an election campaign that played on populist sentiment, has been a friend to the private sector so far, but might consider reclaiming part of the mining sector to try and staunch his falling ratings.

If more corporate raids are on the cards, what does this mean for existing or new market entrants? Partnerships, is the most likely answer. The treasuries of many Latin American countries cannot afford to actually develop the assets and resources they have expropriated. Hire the best local law firm you can afford, with a public-private specialty. If you are prepared to offer some kind of technology transfer, and/or a strategic plan that offers clear benefits in terms of local investment, jobs and legacy, with a strong CSR element, you will get a hearing. And where past contract breaches have pushed up insurance premiums, and/or the need for investment is acute, there will be room to negotiate on pricing.

The treasuries of many Latin American countries cannot afford to actually develop the assets and resources they have expropriated.

Argentine Corporate Bond Liquidity

By Katherine Wegert in New York and Clara Agustoni in Buenos Aires for Debtwire Latin America PLUS

Dries Up as Regulatory, Refinancing Risks Rise

Secondary market liquidity for Argentine corporate bonds has dried to a trickle amidst President Cristina Kirchner's increasingly interventionist stance in local economic affairs. From all accounts, the remainder of 2012 promises to be a difficult year for Argentina, with a wave of corporate defaults expected in 2013, several sources said.

The European financial crisis predictably weighed heavily on all Latin American assets, but those from Argentina consistently underperformed the rest of the region. Trading volumes of Brazilian and Venezuelan corporate bonds, for example, slumped 50% and 40% over the same period. According to data from the Emerging Market Traders Association (EMTA), however, Argentine corporate bond trading dropped from nearly US$5.4billion in 4Q10 to US$1.5 billion in 4Q11, down 72% year-on-year.

That trend shows no sign of abating this year. Reflecting the lack of liquidity, the bid-ask spreads on several Argentine corporations remains unusually wide, even for highly respected credits like candy maker Arcor. The company's US$200 million 7.25% bond due in 2017 was recently quoted at 105.84/107.96 bid/ask, a far cry from the tighter 1/2 point spread seen last year.

Other, more liquid, benchmarks like IMPSA's US$390 million 10.325% 2020s are trading over 2 points wide, double where they were last year.

Argentina's heavy hand in the local economy has deterred investors from taking on exposure. For months, investors have erred on the side of caution, skeptical of Kirchner's agenda and role in domestic policymaking. Those suspicions turned into outright fear in April after the administration unilaterally expropriated a majority stake in oil and gas giant YPF, triggering a massive selloff in Argentine securities and raising serious questions about which firms would fall next into the lap of the central government.

The market for Argentine corporate bonds is small and the expropriation of YPF has made trading in some credits, like Petrobras Energia's 2013s and 2017s, come to a standstill, a market source said. "Hedge funds and real money accounts have been selling positions, but the lack of liquidity has made it difficult," the trader said.

Investors mindful of Argentina's woes are taking steps to dump their holdings and protect their funds from potential losses. There's a sense "the government is trying to plug holes with chewing gum," a portfolio manager said following a recent trip to Buenos Aires. "We're hedging all the Argentine debt we have in our portfolio for an eventual fall in prices."

Since winning reelection in October 2011, Kirchner pursued an expanded role for the Central Bank, which investors worry will make the institution a proxy for the government's policies. Kirchner has pushed for tighter regulation of the financial markets, credit creation, payment systems and a number of other jurisdictions that fall under the Central Bank's umbrella. She has also placed restrictions on imports and US dollar purchases from Argentine citizens.

Such measures are becoming burdensome for Argentine corporations, especially those with US dollar-denominated debt that already find refinancing opportunities hard to come by, analysts said. Fueled by loose monetary policy in the developed world, the EM high-yield debt market has been open to dozens of Latin American companies this year. Yet the pipeline from Argentina has practically dried up.

Arcor tried its luck in the debt capital markets in March, but came up empty-handed. The company sought to reopen its existing US$200 million 2017s, but ran into new regulations that put the deal on ice. The local securities regulator is forcing new issuers to ditch traditional book building and sell new bonds through Dutch auctions, making the issuance process more complicated for everyone involved.

In the meantime, Argentine corporations will have to rely on expensive short-term bank debt to finance their operations since long-term funding isn't available in the cross-border markets. Firms like Arcor and real-estate developer Raghsa are expected to experience "high funding risk" going forward, Moody's said, while companies like Edenor, Transener and IEBA may face short-term cash shortfalls and potential defaults.

The central government has previously acted as a cash cow for several provinces and firms, but that avenue is drying up...

Debtwire Latin America PLUS

Debtwire Latin America PLUS provides actionable intelligence on event-driven equity in addition to the distressed and high-yield markets in Latin America. With an on-the-ground team of journalists based in Sao Paulo, Buenos Aires and Mexico City, Debtwire LatAm PLUS closely tracks special situations throughout the LatAm market, providing real-time coverage of primary equity issuance, and alerting subscribers early-on to restructuring events and key credit situations.

The central government has previously acted as a cash cow for several provinces and firms, but that avenue is drying up, too, a market source said. "There's concern that Argentina is short on dollars and that the administration is losing control of the foreign exchange rate," he said. State and local government are being squeezed, so issuers won't be able to rely on them to the same extent to cover debts and maturities.

While the "official" cost of a US dollar in Argentina has only increased 2% to 4.42 Argentine pesos since the beginning of the year, the rate on the black market has soared 22% to 5.02 Argentine pesos. The cost to move US dollars out of the country has become more expensive, another market source said. That rate can range anywhere from 5.63 to 6 Argentine pesos depending on the instrument. Meanwhile, capital flight nearly doubled from US$400 million a month in January and February to almost US$1 billion in April, according to private estimates. The Central Bank will disclose the official second-quarter capital flight figure in August.

Currensee: The Next Step in Forex Trading

Foreign currency exchange (Forex) has gained popularity worldwide in recent years, including in LatAm, as investors have been drawn to the market's massive size and liquidity, the speed and flexibility of Forex transactions and the possibility of earning strong returns during times of volatility.

Now Currensee, an online trading platform, is attracting a new generation of investors to Forext trading by increasing transparency and amplifying their exposure to global managers and markets.

Originally a social network for Forex traders to share information and collaborate with each other in real time, Currensee more recently launched its Trade Leaders Investment Program, whereby investors can select highly qualified traders from around the world to manage their portfolio from a single account.

According to Currensee CEO Dave Lamont, Currensee is an important development for the market in several respects, starting with the transparency it brings. "What's unique is that our customers can give one another permission to view their actual trading activity and performance," he says, "allowing them to collaborate based on real information. There's a level of transparency beyond any alternative investment I know of."

Second, it gives investors "diversification along two axes," he says. On the one hand, Currensee investors can choose from a diverse array of managers from various markets. "We're finding emerging managers from all of the world – China, Japan, Vietnam, Russia – people that normal investors could never find on their own." They can then build their portfolio of these managers in a single account, with each account-owner choosing and easily adjusting the assets they want each of their traders to manage and the terms and limitations under which they want them to trade.

On the other hand, it gives investors diversification across asset classes, which Mr. Lamont sees as an increasingly valuable prospect for a generation of investors disaffected with sluggish global stock markets. "From 2000 to 2010," he points out, "the S&P 500 went down 3.7%. If you're the average person with all your money in stocks and bonds, you lost." Moreover, he says, "the stock market is manipulated by big players and algorithmic traders on a daily basis. The foreign currency market is so much bigger: US$4 trillion a day, with 24-hour trading. We're not going to get together and move the euro today, but we could get together and move the price of a small-cap stock."

"The beauty of Forex trading," he says in sum, "is that the returns are in no way correlated to the stock market, so it's a true alternative investment."

Finally, Currensee distinguishes itself by the quality of the managers it selects for its Trade Leaders Investment Program. "There is extremely careful due diligence done on each of the traders we present to the trade leader program," he says. Some traders are recruited from the Currensee social network, while others are hand-selected top firms around the globe. "We have a team of financial analysts who view their drawdowns, their risks, their trading personalities and styles; we test them for months with our own capital." Less than 1% of applicants are accepted, and they distinguish themselves, Mr. Lamont says, primarily by their discipline. "The trade leaders we select might use a little bit of leverage to their advantage, but not 50-to-1," he says, referring to the maximum leverage traders may use according to new US regulations, down from 100-to-1. "Anyone who uses that much leverage is absolutely going to lose; they may not lose that day or month, but they will eventually. You can't start a fire every day and not get burned. We're looking for people who have very strong money management discipline, and that discipline is really what separates professional traders from amateurs."

While 50-to-1 leverage might be too high for Currensee Trade Leaders, Mr. Lamont still appreciates the value of stricter regulations in general. "The more regulation there is in the US, the better it is, to some extent. We might not agree with every single regulation, but the fact that there's a higher bar for people really creates the conditions for the Forex market to be a true alternative asset class."

Ultimately, he thinks people will turn increasingly to Forex trading and Currensee. "The playing field is much more level, and the market more liquid, in foreign currency trading. And people are interested because they see how currency and the world economy are intertwined, that there is a value to currency, and they are interested in knowing how to make money from that. One of the powers of Currensee is that we bring the foreign currency market to people who haven't had experience trading it before."

"We think the education sector has tremendous opportunity in Mexico. The government is doing a lot, but the population is demanding services from the private sector." Roberto Terrazzas, Fund Manager, Nexxus Capital

Mexico Raises the Bar

Education PE Opportunities

The previous issue of ALI highlighted investment opportunities and developments in Mexico, showing how, in spite of its strong ties to a sluggish US economy, Mexico's macro indicators continue to be strong and bolster alternative asset classes across the board. A large and predominantly young population – more than100 million people with an average age under 25 – with increasing purchasing power has fueled this growth, while regulatory reforms have helped free up capital for investments, particularly in private equity.

According to Roberto Terrazzas, a fund manager at Nexxus Capital, Mexico's first and most seasoned native PE fund, education is one of the main sectors thriving off of this macro health. "We think the education sector has tremendous opportunity in Mexico. The government is doing a lot, but the population is demanding services from the private sector. The GDP per capita in Mexico has been growing, as well as discretionary income, and we believe they will continue to grow. And as long as they grow and inflation stays low, the macroeconomic side will support the education sector."

Education hits Nexxus' sweet spot, he says. "We like education because it fits into the space we're interested in: Mexican companies in fragmented markets that sell services or products to the end consumer in the middle segment of the socioeconomic spectrum."

Since its inception in the early 1990s, Nexxus has raised 5 funds, the 5th of which, Nexxus V, they are investing currently. Investing exclusively in mid-cap Mexican companies that they believe can be expanded to world-class status, they have targeted such industries as consumer goods, consumer credit, fast food, fitness and health care.

With Nexxus III, raised in 2007, they invested successfully in Harmon Hall, the largest chain of English-teaching schools in the country, with over 100 schools in 60 cities. The firm bought 60% of the company, while co-investors included the German development bank, DEG; the IFC; and Great Lakes Partners, part of HSBC. According to Mr. Terrazzas, education is one of the sectors they are most interested in for Nexxus V.

Nexxus is well-positioned in Mexico as perhaps its most highly reputed PE firm in a market that's far from cluttered. "The PE penetration in Mexico is ridiculously low," Mr. Terrazzas says. "The reality is that there are only 5 or 6 groups doing transactions in Mexico. There are not that many companies that are well established in this [education] sector, so the sector is very fragmented."

Entering and consolidating fragmented sectors is central to Nexxus' strategy. They have been successful so far, Mr. Terrazzas explains, with a model whereby they create a holding company to consolidate disparate companies within a single sector. Nexxus's preferred exit strategy is an IPO, as they did with Harmon Hall last year. "There is a tremendous opportunity" when it comes to taking companies public, he says. "Whenever you have a nice vehicle – a company with a growth story and a growth future – you can get good attention from public investors." Nexxus tends to maintain stakes in the company after the IPO, in order to continue raising money.

Mr. Terrazzas says that, within the education sector, Nexxus is more interested in specialized education than universities or K-12. He sees e-learning as no doubt the next frontier in education, but notes that many of the businesses pioneering e-learning in Mexico are either too big or too small for their investment taste. He also sees it, however, as a fragmented sector that could be consolidated, and says that it is on his firm's radar.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Top Brazil Real Estate Investment Funds Provide Stellar Returns

Vernon Budinger, Principal & Jason Smith, Portfolio Manager

Fundos de Investimento Imobiliários (FIIs) represent one of the fastest-growing asset-backed security (ABS) markets in Brazil. In this paper we look at the returns for the best and worst performing FIIs and FII market sectors over the last 12 months. We then analyze the returns to understand the key factors that are driving their strong performance. Finally, we discuss the outlook for FIIs given the current state of the financial markets and some of the underlying economic trends that we are monitoring. We do not see a combination of positive trends that will produce returns like we have seen over the past year.

FIIs are similar to real estate investment trusts in the United States, and they are an attractive investment sector for ABS investors who want Brazil real estate exposure. The market has grown to roughly R$14.6 billion in size (Source: Uqbar Orbis Database) and is relatively liquid compared with other ABS markets. Data is so accessible that investors can pull price quotes off Yahoo Finance for about 30 FIIs. The funds offer investments in diverse sectors such as office buildings, schools, hospitals and residential developments. The 3 largest deals are over R$1 billion (US$500 million) in size. FIIs generally provide the same tax advantages as the underlying collateral; real estate investments are often exempt from the Brazilian income tax.

FIIs are one call that we did not get right last year. In our paper, "Is the Market for Brazilian Real Estate Investment Funds Cooling Off?" (September 6, 2011), we outlined the weakness in real estate sales for the second quarter of 2011 and expressed concern about the ability of the FII market to continue to register returns at the pace seen in 2010.

However, FIIs have come back with a vengeance in most sectors in 2012. The best-performing sectors, such as hotels, hospitals

Exhibit 1 - Top 10 for April 2012

Operação	Tipo de Imóvel	Rentabilidade
RB Capital Prime Realty I	Residencial	10.33
Shopping Pátio Higienópolis	Varejo - Shopping Centers	9.92
Hospital da Criança	Hospitalar	8.32
Rio Bravo Renda Corporativa	Escritórios	7.76
Brazilian Capital Real Estate Fund I	Escritórios	5.4
Europar	Logística	4.36
Memorial Office	Escritórios	4.25
CSHG Logistica	Múltiplos	3.44
Torre Norte	Escritórios	3.17
Kinea Renda Imobiliária	Escritórios	2.98

Exhibit 2 - 10 Worst for April 2012

Operação	Tipo de Imóvel	Rentabilidade
RB Capital Desenvolvimento Residencial II	Residencial	-8.92
RB Capital Agre	Residencial	-7.43
Hotel Maxinvest	Hospedagem	-6.34
Panamby	Múltiplos	-5.68
Torre Almirante	Escritórios	-4.31
BM Brascan Lajes Corporativas	Escritórios	-2.74
BM CENESP	Escritórios	-2.37
JS Real Estate Renda Imobiliária	Não Aplicável	-2.2
Caixa TRX Logística Renda	Múltiplos	-2.2
CSHG Brasil Shopping	Varejo - Shopping Centers	-1.93

Exhibit 3 - Sector Total Return for April 2012

Sectors	Contribution to Total Return	Number of Issues	Sector Weight	Sector Return
Escolar	0.040	3	2.54%	1.58
Escritórios	1.084	21	59.99%	1.81
Hospitalar	0.053	2	1.82%	2.94
Industrial	0.022	1	1.58%	1.39
Logistica	0.039	3	2.06%	1.90
Múltiplos	0.050	6	7.73%	0.65
Não Aplicável	-0.013	8	5.63%	-0.23
Residencial	-0.046	4	2.29%	-2.03
Varejo - Lojas Individuais	-0.010	1	0.52%	-1.86
Varejo - Shopping Centers	0.199	8	14.27%	1.39
Grand Total	1.319	58	100.00%	1.32

Source: Orbis

and retail shopping centers, have generated returns rivaling those seen in high-performing equity markets in previous years.

We ran a performance attribution to understand the factors driving the recent returns. Three major factors contributed to the FIIs' robust performance: a strong real estate market, property owners' ability to increase revenues and the large drop in interest rates over the last 9 months. While we see some of the trends continuing, we don't see these same factors driving excess returns in the FII market in the coming months.

Performance Review

As reported by Uqbar on May 13, 2012 in Orbis, the FII market turned in a strong performance during April that added to the even more spectacular performance in the first quarter of 2012. The liquid FIIs were up 1.32% on average in April, but the returns ranged from up 10.3% to down 8.92%. Uqbar gives 1st place in April to the FII Shopping Patio Higienópolis (SHPH11) with a total return (dividends and price change) of 9.92%. Other FIIs had higher returns but they were driven by technical factors (bad pricing). The top 5 funds turned in total returns of 5% or more for the month. Heady numbers, given that the Brazilian stock market declined 4.17% and Interfinance Deposit Certificates (certificado de depósito inferfinanceiro, or CDI) returned 0.67% for the month. See Exhibits 1 through 3 below.

The RB Capital Residential Funds have been suffering through 2012 and this underperformance continued in April. Hotel Maxinvest lost some ground in April after performing well through the first quarter of 2012. Residential and Não-Aplicável (contains some FIIs backed by pass-through securities of residential loans, Certificados Recebíveis Imobiliários or CRIs). We are concerned about the weak overall performance of the Residential and Residential-linked FIIs. (See Exhibit 3)

Looking at sector returns for April, Logística (Storage and Shipping Centers) and Escritórios (Office Buildings) performed the best. Hospedagem (Hotels) and Varejo – Lojas Individuais (Retail – Individual Shops) performed very poorly; both sectors only have one FII each that performed poorly.

Editor's Notes: See the translation key for the sectors at the end of the article. Our methodology for calculating weighted average returns differs from Uqbar's approach. Latin America Structured Finance uses the market value of the FII to weight its return. We realize that it would better to compound the weighted returns for each time period. However, we feel that our current approach is better than using unweighted returns because the dominance of FIIs backed by office buildings and shopping centers, which represent 60% and 14.3%, respectively, of the liquid market.

Year-to-date returns as of April are even more impressive. The weighted average return for the liquid FIIs was 13.93% versus 8.93% for the BOVESPA and 3.14% year-to-date for CDI. Uqbar published the following comments in its May 11, 2012 FII Rankings analysis in the Orbis service:

Shopping Patio Higienópolis (SHPH11), managed by Rio Bravo Investimentos DTVM, closed the first four months of 2012 as rankings leader, driven by 42.5% increase in its price. The fund, which has a 25% stake in the underlying venture and its current expansion, had year-to-date net income as of March of $ 5.0 million according to their monthly trial balance.

In second place is the FII Projeto Água Branca (FPAB11), managed by Coin DTVM, with a 24.4% increase in the price of their shares. The fund has in its portfolio the buildings New York and Los Angeles in the neighborhood of Agua Branca in Sao Paulo. These fixed assets are valued at U.S. $ 72.9 million on the balance sheet of the fund for the month of March.

At the other end of the spectrum, 6 FIIs registered negative year-to-date total returns as of April. Shopping Mais Largo 13 seems to like the basement as it is one of the worst performers every month. The RB Capital Residential deals have also been performing poorly recently.

The Hospedagem (Hotels) turned in the best sector total return for April YTD, 22.62%. Note that this sector only has one FII, Hotel Maxinvest. The hotel sector was followed by the Hospital FIIs with a return of 19.73% and Varejo - Shopping Centers (Retail Shopping Centers)

Exhibit 4 - Top 10 Returns Year-to-Date

Operação	Tipo de Imóvel	Início	Fim	Rentabilidade
Shopping Pátio Higienópolis	Varejo - Shopping Centers	Dec-12	Apr -12	45.94
Projeto Água Branca	Escritórios	Dec-11	Apr-12	27.91
Hospital Nossa Senhora de Lourdes	Hospitalar	Dec-11	Apr-12	24.04
CSHG Brasil Shopping	Varejo - Shopping Centers	Dec-11	Apr-12	23.48
Hotel Maxinvest	Hospedagem	Dec-11	Apr-12	22.62
RB Capital Prime Realty 1	Residencial	Dec-11	Apr-12	19.07
Memorial Office	Escritórios	Dec-11	Apr-12	17.65
Kinea Renda Imobiliária	Escritórios	Dec-11	Apr-12	17.26
Square Faria Lima	Múltiplos	Dec-11	Apr-12	16.02
CSHG Real Estate	Escritórios	Dec-11	Apr12	15.83

Exhibit 5 - 10 Worst Returns Year-to-Date

Operação	Tipo de Imóvel	Início	Fim	Rentabilidade
Mais Shopping Largo 13	Varejo - Shopping Centers	Dec-11	Apr -12	-3.81
RB Capital Agre	Residencial	Dec-11	Apr-12	-3.16
RB Capital Desenvolvimento Residencial II	Residencial	Dec-11	Apr-12	-1.87
Caixa Cedae	Escritórios	Dec-11	Apr-12	-0.45
RB Capital General Shopping Sulacap	Varejo - Shopping Centers	Dec-11	Apr-12	-0.13
TRX Realty Logística Renda 1	Logística	Dec-11	Apr-12	-0.12
BB Renda Corporativa	Escritórios	Dec-11	Apr-12	1.2
Hospital da Criança	Hospitalar	Dec-11	Apr-12	2.11
Floripa Shopping	Varejo - Shopping Centers	Dec-11	Apr-12	2.86
CSHG Recebíveis Imobiliários BC	Não Aplicável	Dec-11	Apr12	2.89

Source: Orbis

Exhibit 6 - Sector Total Returns for 2012 YTD

Sectors	Contribution to Total Return	Number of Issues	Sector Weight	Sector Return
Escolar	0.21	3	2.7%	7.75
Escritórios	8.48	18	60.7%	13.97
Hospedagem	0.38	1	1.7%	22.62
Hospitalar	0.38	2	1.9%	19.73
Logistica	0.20	3	2.2%	9.33
Múltiplos	0.88	4	6.7%	13.16
Não Aplicável	0.31	8	6.0%	5.19
Residencial	0.11	4	2.4%	4.44
Varejo - Galerias	0.07	1	0.1%	82.49
Varejo - Lojas Individuais	0.05	1	0.5%	9.65
Varejo - Shopping Centers	2.86	8	15.1%	18.89
Grand Total	13.93	53	100.00%	

Exhibit 7 - Top 10 Performing Funds

Fund Name	Type of Property	Total Return
BB Progressivo	Escritórios	59.58
Hotel Maxinvest	Hospedagem	56.16
Brazilian Capital Real Estate Fund I	Escritórios	50.18
Shopping Pátio Higienópolis	Varejo - Shopping Centers	41.29
Projeto Água Branca	Escritórios	39.93
Torre Norte	Escritórios	39.35
CSHG Real Estate	Escritórios	38.02
Torre Almirante	Escritórios	37.97
Edifício Almirante Barroso	Escritórios	37.45
GWI Condomínios Logísticos	Logística	33.87

Exhibit 8 - Ten Worst Performing Funds

Fund Name	Type of Property	Total Return
Panamby	Múltiplos	-35.68
Mais Shopping Largo	Varejo - Shopping Centers	-30.31
RB Capital Agre	Residencial	-18.66
Hospital da Criança	Hospitalar	-15.38
Hospital Nossa Senhora de Lourdes	Hospitalar	-13.01
Floripa Shopping	Varejo - Shopping Centers	-9.14
CSHG Recebíveis Imobiliários BC	Não Aplicável	-8.18
West Plaza	Varejo - Shopping Centers	-3.95
REP 1CCS	Varejo - Galerias	0.03
BC Fundo de FII	Não Aplicável	3.18

Source: Orbis

with 18.89%. Varejo – Galerias contains only one FII and its year-end price was very low, apparently a marking error. See Exhibit 6.

FIIs have achieved stellar returns over the last 12 months. The 12-month total return for the 44 FIIs traded in the market came in at 30.55% for the year as calculated from Orbis data. (Orbis calculated the returns; we calculated the market weights.) An investment in CDI earned 11.20% while the BOVESPA dropped -9.87 over the same period. BB Progresso was the top fund over the last year with a return of 59.58%. Thirteen funds of the 43 liquid funds earned over 30% for the 12-month period.

These numbers are heavily skewed by the returns on FIIs backed by office buildings, which account for almost 62% of the market and returned 38.73% for the year. The median total return for the year was a still exceptional, 18.36%. The returns are evenly distributed as the absolute performance of the negative funds was in the neighborhood with the biggest gains. We are concerned with the large dispersion in performance, as this puts a question mark on the sustainability of the positive returns.

The market-weighted 12-month dividend yield for the FIIs was 7.25%, with the Residential FIIs turning in 16.43% (total return of only 9.00%). Only 2 sectors turned in a higher dividend yield than CDI: Residential and Hospitals, with the latter earning 11.80% in dividends over the year. We are concerned with the low general level of the yields since many investors look to the FII market more for income than for appreciation.

Performance Analysis

We picked Shopping Patio Higienópolis to use for the performance analysis. It is very liquid and has been performing very well since September 2011 as the FII has appreciated almost 50% while the BOVESPA has been flat to down.

The FII's strong price appreciation is being driven by three major factors:

- Appreciation of real estate in Brazil that increased the value in the underlying property
- Increases in revenues for the underlying property that flow through to fund's

dividend income

- Lower swap rates due to the Banco Central's aggressive easing

Property Value Appreciation

MSNBC announced that São Paulo, Brazil, was the world's 10th most expensive city in 2011. In an impressive performance, the city jumped 11 places in the index from its spot in 2010. Monthly rent for a luxury 2-bedroom apartment is US$2,397 a month. A gallon of gasoline costs US$6.32 and a daily international newspaper costs US$9.59. Rio de Janeiro jumped 17 spots to the No, 12 spot in this list. (http://www.cnbc.com/id/43729279/The_World_s_Most_Expensive_Places_To_Live_2011?slide=2)

According to the website AgenteImóvel (www.agenteimovel.com.br), real estate values increased 16.7% in São Paulo in the 52 weeks ended May 11. Prices for the most expensive real estate in São Paulo increased 31% over this period (a 4-bedroom apartment in Vila Nova Conceição).

Growing Revenues

The top shopping centers and office buildings successfully increased revenue and income from various sources. These increases in the revenues flow through to the dividends for the FIIs. Shopping Patio Higienópolis' February operations report from manager Rio Bravo Investimentos DTVM Ltda. announced that rent increased 11.66% in February 2012 from the same period last year. Revenue from parking increased 23.46% for the same period. Revenues from the shopping center's portion of store sales increased 12.21% relative to 2011. In February 2012 the fund distributed R$4.34 per fund share, 46.62% above the distribution for the same period last year.

Changes in the Terminal Capitalization Rate

The Dividend Discount Model (DDM) is one of 3 popular approaches for valuing REITs and REIT-like investments such as FIIs. The DDM uses the Terminal Capitalization Rate (cap rate) to determine the price for the forecast stream of cash flows.

Exhibit 9 – Sector Total Return

Sectors	Contribution to Total Return	Number of Issues	Sector Weight	Sector Return
Escolar	0.22126	2	2.24%	9.89
Escritórios	23.92489	15	61.78%	38.73
Hospedagem	1.03528	1	1.84%	56.16
Hospitalar	0.28520	2	2.12%	-13.48
Logistica	0.54947	3	2.40%	22.85
Múltiplos	1.51364	5	8.50%	17.81
Não Aplicável	0.10499	4	3.95%	2.66
Residencial	0.06943	2	0.77%	9.00
Varejo - Galerias	0.00003	1	0.10%	0.03
Varejo - Lojas Individuais	0.08928	1	0.60%	14.85
Varejo - Shopping Centers	3.32513	7	15.70%	21.17
Grand Total	30.54821	43	100.00%	

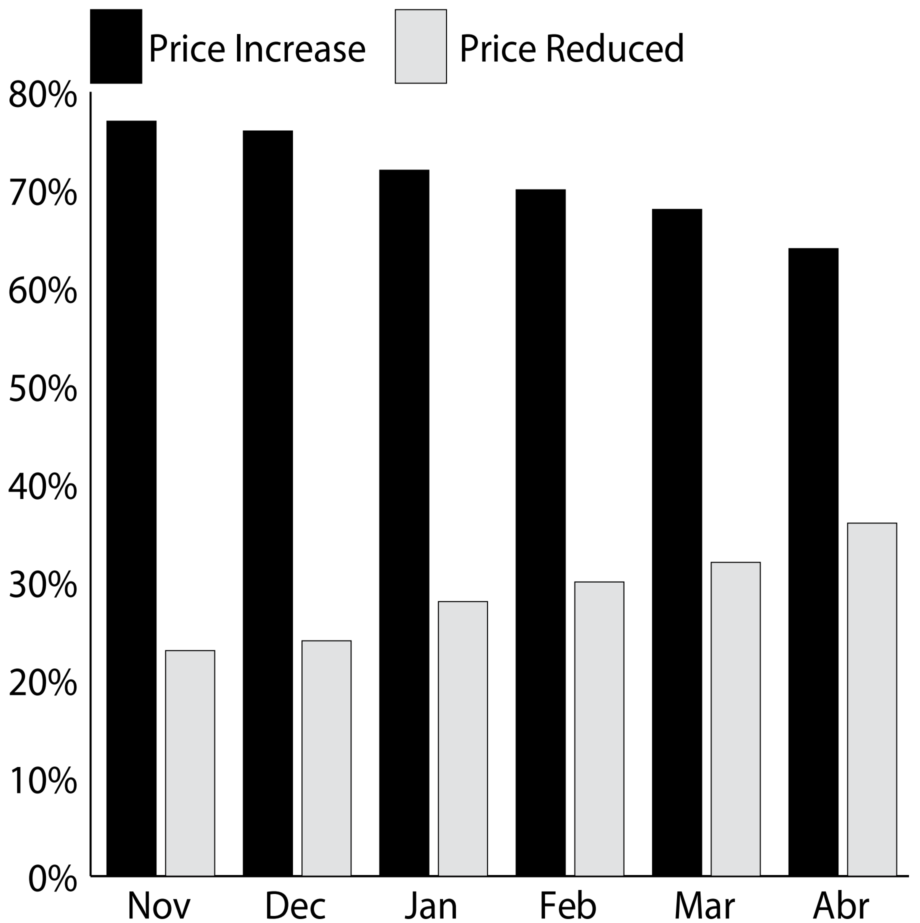
Exhibit 10 - Total Dividend Yield by Sector

Row Labels	Sum of Cont to Div yield	Count of Rentabilidade	Sum of Weight	Sector Yield
Escolar	0.20643	2	2.24%	9.23
Escritórios	4.12809	15	61.78%	6.68
Hospedagem	0.19762	1	1.84%	10.72
Hospitalar	0.24967	2	2.12%	11.80
Logistica	0.19240	3	2.40%	8.00
Múltiplos	0.60130	4	7.42%	8.11
Não Aplicável	0.40307	4	3.95%	10.21
Residencial	0.12673	2	0.77%	16.43
Varejo - Galerias	0.00255	1	0.10%	2.60
Varejo - Lojas Individuais	0.05501	1	0.60%	9.15
Varejo - Shopping Centers	1.09026	7	15.70%	6.94
Grand Total	7.25312	42	100.00%	

Exhibit 11 – Price Increase by Apartment Size

Neighbourhood	1 Bedroom Apartment	4 Bedroom Apartment
Vila Nova Conceição	13%	31%
Jardim Europa	6%	3%
Jardim América	256%	16%
Ibirapuera	0%	45%

Exhibit 12 - Price Reductions Versus Price Increases For São Paulo Real Estate



The cap rate is a function of the SELIC or the risk-free rate. Given the Copom's decision to start aggressively cutting SELIC in August 2011, we would have expected FII prices to increase because the cap rate declines with the reductions in SELIC. We can use the DDM to evaluate these changes.

The DDM arrives at the theoretical price by discounting the per share dividend payout by the cap rate reduced by the growth rate of the dividends. However, the equation can be reversed to solve for the cap rate implied by the market price.

Price = Dividend / (Cap Rate – Growth Rate of Dividend)

The 5-year average dividend growth rate for Shopping Patio Higienópolis was 4.93% in August of 2011 (Source: Orbis) and the 12-month dividend payout was R$26.70. The price per share was R$417. Given the known growth rate, the value per share, and the dividend, we can estimate the cap rate that market had been using for the FII.

R$417 = R$26.70 / (i – 5%)
Note: We rounded the growth rate to 5%.

The cap rate that solves this equation is 11.4%, or about 91.2% of the CDI rate of 12.5% in August 2011.

Note: Since real estate sometimes receives preferential tax treatment, it is not surprising that the cap rate would be less than CDI.

We then use the same numbers, but drop the CDI from 12.5% to 9.0% to reflect the current market environment and calculate a theoretical price for today's valuation.

R$831.74 = R$26.70 / ((9.0%*91.2%) – 5%)

The current price of US$628 (4/30/2012) is not that surprising given a theoretical price of R$831.74. The higher theoretical price says that, all things equal, we would have expected the actual price to be higher given the drop in CDI and the current 12-month payout of R$32.47. Investors clearly have increased the cap rate as a function of the CDI rate or they have dramatically increased the growth rate. To be conservative in estimating the new cap rate, we are going to use a new growth rate of 6.0% (the actual 5-year rate is 8.4%, but this would be a very optimistic number and drive up the cap rate even further).

R$628 = 32.47 / ((9.0% * 124%) – 6%)

As a result, we can see that things are not all completely rosy in the market for FIIs in Brazil. In reality, investors are increasing their cap rates to compensate for increased risks.

Breaking Down the Future

Looking forward, we feel that FIIs could continue to appreciate, but we doubt that they are going to earn the high returns that we have seen over the past year. First, how much more can property values go up? AgenteImóvel tracks the number of offers where the price has increased versus the offers with price decreases. This number has been declining recently for the São Paulo market. Equity prices for real estate companies, such as Cyrela Brazil Realty, have declined dramatically over the last month after appreciating significantly since September 2011. Bloomberg reported that "Brazil Builders Plunge as PDG Profit Tumble Deepens Slump" on May 15. MRV lost more that 15% and PDG lost 9.8% when both builders joined a slew of other Brazilian developers and homebuilders in reporting lower earnings. Bloomberg highlighted that, as of the date of the article, PDG was the worst performer this year in the BOVESPA Index.

We doubt that the property owners will be able to continue increasing dividends and maintain the same pace of revenue growth. Brazil's economy has been slowing dramatically; industrial production has been disappointing for over the past year, GDP growth has been stunted and consumers' credit lines are tapped out.

There is definitely price appreciation left from further interest rate cuts, although the market is already forecasting cuts as low as 7.5%. Still, another 150 basis points of cuts is not going to drive price changes like 350 basis points in cuts since August 2011. If we leave the inputs the same to the dividend discount model and reduce the cap rate by 1.5%, the theoretical price could be roughly 50% higher. However, we see the Banco Central halting rate cuts at 7.5% and this will put an end to the declining cap rates.

We feel that investors should be cautious about adding large positions in the FII given the economic headwinds and the current historically high valuations in the Brazil real estate markets. We are also concerned about the current low dividend yields and the large disparity between the best- and the worst-performing deals. We do not see these last 2 developments as signs of a screaming bull market.

Author Biography

LatAm Structured Finance is an investment advisor specializing in Latin American asset-backed securities. We use our proprietary technology and experience to identify unique investment opportunities and to protect our clients from risks embedded in complex structures. Vernon Budinger is an investment professional and a CFA with more than 28 years of experience. Prior to forming LatAm Structured Finance, Vernon worked at Western Asset Management and spent the last 3 years working for Western in Brazil where he evaluated Brazilian structured finance.

Education and Democracy:

An Interview with Susan Segal, Chair of the Americas Society

ALI: What are the current needs for education development and investment in LatAm? Where do you see the best opportunities?

SS: It's in everything. There's no place, in my opinion, where there isn't room to make huge advances in education. It starts with early childhood, making early childhood education more accessible. Children who can't afford to go to school are disadvantaged from the get-go; it also prohibits or makes it difficult for mothers to get jobs. Elementary school and K-12 are also critical investments – inspiring kids to want to go to school, getting them there, the quality of schools, teaching teachers how to teach, getting computers into students' hands and inspiring them to study math and science.

ALI: How would you characterize the relationship or division between states and NGOs, on the one hand, and for-profit players? Can LatAm governments do it on their own?

SS: It's public sector meets private sector. There is enormous space for public-private partnerships in education in terms of training, adapting schools, scholarships, getting computers into schools – you can go on and on. There is an enormous mismatch between job openings in these countries and kids' qualifications to fill them. That's true in the US, too, but countries like Mexico and Brazil have huge demand for qualified workers, and you've got to produce those qualified workers, starting early on, with public-private partnerships across the board.

If you talk to President Santos [of Colombia]; if you talk to Dilma [Rouseff, of Brazil], who has a plan for 100,000 scholarships for students to study in the US for a year; if you talk to Chileans and Peruvians, everyone knows that the key to inclusive growth and good jobs is education. And every single one of them will say that there is a place where the public and private sectors can work together. Education may be the policy domain of the public sector, but they recognize the role of the private sector. Capital is capital. Where it comes from doesn't matter.

ALI: What do you see as the role for e-learning in the education sector in LatAm?
SS: There's an incredible opportunity for online education, but the fact of the matter is that you've got to start really early; and though, yes, there's a lot of social media now, there's still a huge gap in access to computers for people who have no money versus those who do. It used to be that children, at 5 or 6 years old, went to school and learned to read and write. But now kids know how to pick up an iPad at 1. So before many children are even 5, they are disadvantaged, and that's a huge gap we need to fill.

A second big area for online education is in teacher training because you have to get teachers up to a certain level. Teachers can't teach computers if they don't know how to work them.

ALI: What is university attendance like in LatAm? Are most LatAm students choosing private schools?

SS: More kids are going to university than ever before in LatAm, but it's still at a small level, and it varies country by country. The interesting thing in LatAm is that most of the very good universities right now are public. The University of Sao Paulo is spectacular, Monterrey Tech is spectacular. The problem is that the kids who get into those schools generally come out of private secondary schools, so the public sector is essentially paying for their university education. There is something wrong with that, and it needs to change.

ALI: To what extent are LatAm governments prioritizing education?

SS: Education is one of the top priories of almost every country. It's critical for a democratic society. The big buzzword now in LatAm is "inclusive growth." Well, you can't have it without education. To create the right kind of quality jobs, you need education. It also reduces crime. LatAm leaders know that in today's world, if you're not educated, you fall behind very quickly.

ALI: What's the main driver for the growth in education investment in LatAm?

SS: People wanting a better life for their children.

"Education may be the policy domain of the public sector, but they recognize the role of the private sector. Capital is capital. Where it comes from doesn't matter."

(I Can't Get No) *Satisfaction*

Last April the Argentine government decided to nationalize 51% of the largest oil company operating in Argentina, YPF. The controlling stake (51%) will be nationalized from the holdings of the Spanish company Repsol, that will continue to own 7%. The balance will remain held by a local Argentine shareholder, Grupo Ezkenazi, and publicly traded in New York and Buenos Aires. In this process, the Argentine government has not complied with the rules for expropriation under Argentine law and the bylaws of the company, approved by the Public Registry of Commerce and the Securities Commission of Argentina.

Javier Canosa - Canosa Abogados – Argentina

Did this come as a surprise? No, it had been on the news for a couple of weeks that the Argentine government would seize the shares of the majority shareholder (Repsol). Few people knew which day it would occur, but it was clear that the decision had been made awhile ago.

The law that decided the nationalization declares that such a move is necessary to preserve the sovereignty over Argentina's national oil and gas resources. However, if one digs a little bit deeper, it is clear that the real decision is based on the current public deficit.

It is an important decision, nevertheless, because it shows that when the need for cash is dire, there are virtually no limits, and manners do not matter.

Previous crises of the public deficit were resolved in the same manner: in 2008, by means of the seizure of the pension funds; in 2010 by snatching the reserves of the Central Bank, followed by an amendment of the bank's charter to allow the government to use the bank's funds at its discretion; in 2011 by implementing restrictions to purchase dollars, and imports in general; and in 2012 with the seizure of the largest private oil company.

How will the government keep the band playing? No one knows. We are experiencing a complex cocktail of high inflation, dramatic slowdown of the economy and low interest rates.

The government could go on and print more pesos, and further restrict the purchase of dollars (as it has been doing for the past four weeks when the dollar controls tightened), but the system could not go on like this forever.

What can we expect for the coming months? More regulation, more taxation, probable mandatory repatriation of declared funds held overseas and possibly more expropriation of profit-making companies.

This saga has not ended yet, and it promises to have all the makings for a great drama.

Author Biography

Javier is a partner in the BA firm Canosa Abogados. Javier's practice concentrates on corporate law issues, advising several national and foreign companies in various corporate matters, including investment vehicles, corporate management, directors' duties and responsibilities, audits, risk detection and distribution, documents, policies and corporate contracts, and design and implementation of a suitable corporate form for each business.
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Florida Law Threatens Investors in LatAm

Pedro Martins

"The restrictions will not go into effect unless and until Congress passes, and the president signs, a law permitting states to independently impose such sanctions against Syria and Cuba." -

Rick Scott

The Freedom Tower is a building located in Miami, Florida, that was used by the government in the 1960s to assist recently arrived Cuban refugees and, for that, has become a memorial to Cuban immigration to the United States since then. On May 1, however, the building attracted special attention from all over the world when Florida Governor Rick Scott signed House Bill 959 in such a symbolic place for Cuban refugees.

As another measure taken to strengthen the state's campaign against the Cuban regime, the new Florida law prohibits agencies or local government entities from hiring companies engaged in business operations in Cuba or Syria for contracts worth more than US$1 million, also forbidding Florida state pension funds from investing in such companies.

Supporting Rick Scott's action, several sponsors of the bill have emphasized that the new law is targeted at companies that support oppressive regimes, such as Cuba and Syria, which are on the US list of state sponsors of terrorism. But the law has raised great concern, especially from Brazilian and Canadian investors.

Although almost 200 foreign companies could fall into one of the two categories mentioned by the bill, the most affected investor seems to be the US subsidiary of the Odebrecht Group, one of the largest Brazilian enterprises, acting in the engineering, construction, chemicals and petrochemicals markets all over the world.

Based in Coral Gables, Florida, Odebrecht USA is one of the biggest contractors of Miami-Dade County and has secured major projects with investments of more than US$2 billion: the North Terminal at Miami International Airport, the Adrienne Arsht Center for the Performing Arts, the American Airlines Arena and the Stadium at Florida International University.

Over the past months, Odebrecht USA has been negotiating a US$700 million deal to build a complex of hotels and office and retail space on airport grounds, that may generate about 5,000 jobs during construction and about 10,000 jobs afterwards.

However, the deal is threatened by the new law due to its parent company's business activities in Cuba. Since 2010, the Odebrecht Group is engaged in the expansion of the port of Mariel, the biggest infrastruc-

ture project in Cuba in 50 years, with an investment of almost US$ 1 billion, 70% of which is funded by the Brazilian government through the Brazilian Development Bank (BNDES). Moreover, the group has recently announced a contract with a Cuban state-owned company to expand the sugar industry in the country.

Since Brazil has not signed investment protection treaties, what could have granted Odebrecht recourse to some international standards of protection such as fair and equitable treatment and international arbitration, its only course of action is to hope the new law is never enforced domestically. Fortunately, Odebrecht — as well as any investor affected by the law — has some arguments at its disposal.

The main argument against the bill is that it is unconstitutional, since it interferes with the federal government's exclusive power to set foreign policy. Such understanding is supported by the 2000 case Crosby v. National Foreign Trade Council, in which the Supreme Court considered unconstitutional under the Constitution's Supremacy Clause a Massachusetts law that prohibited local government agencies from buying goods and services from companies conducting business with Myanmar (at that time, Burma). According to the Supremacy Clause, if the federal government is acting in pursuit of its constitutionally authorized powers, when a conflict arises between federal law and either the state constitution or state law, federal law must prevail as the supreme law of the land.

The main argument against the bill is that it is unconstitutional, since it interferes with the federal government's exclusive power to set foreign policy.

Therefore, since the new Florida law would conflict with the federal government's foreign affairs and foreign commerce powers, the state would be barred by the Supreme Court decision from enacting a bill targeting companies doing business in a given foreign country.

Beyond the legal arguments, local players have demonstrated concern that the law would damage Florida's business climate, encouraging foreign companies to invest in other states. Some may even say that states could enact laws that would benefit companies doing business in Cuba, as a way to strengthen their ties with the island and increase their exports.

Indeed, Miami Herald columnist Andres Oppenheimer believes that if the new law is enacted, it will “encourage other U.S. states to pass foreign policy and trade laws [creating a U.S. foreign policy] dependent on local constituencies that push for their own economic agendas ahead of the national interest.”

Such discussion is especially relevant since President Barack Obama has been less harsh on Cuba than his predecessor, George W. Bush, allowing an increasingly cultural exchange and reducing the number of restrictions previously imposed.

Curiously or not, although House Bill 959 states that it will take effect on July 12, in the signing letter Rick Scott wrote that “the restrictions will not go into effect unless and until Congress passes, and the president signs, a law permitting states to independently impose such sanctions against Syria and Cuba.”

This means that Odebrecht USA and other investors that may be affected by the law may continue to sleep well for a while, since the actual effectiveness of the law now rests on Congress’ (and Obama’s) decision to confer states the power to enact laws regarding foreign policy. But investors should also consider that such effectiveness may also rest on Rick Scott’s willingness to chase his re-election in 2014 by enforcing the new law, which was largely acclaimed by the growing Cuban community in Florida.

Author Biography

Pedro Martini is a lawyer based in Belo Horizonte, Brazil. He graduated from the Federal University of Minas Gerais – UFMG, Brazil where he was president of the Brazilian Association of Arbitration Students – ABEArb; vice president at Moot Alumni Association – MAA; coordinator of the study group on International Trade Law at UFMG; professor coordinator of the course on International and Domestic Arbitration offered by the Center of International Law Studies – CEDIN; member of the Editorial Board of the GEArb - PUC-MG Academic Journal.

Fostering the Future

Montessori Education in LatAm

Montessori education is a widespread and well-known early education method. Developed by the Italian doctor-cum-pedagogy theorist Maria Montessori in the early 20th century, it spread from Italy to most corners of the globe over the next 100 years, becoming particularly popular in the US as one of the most successful alternative education models of recent decades. Designed to foster autonomy, creativity and spontaneity, among other characteristics often lacking in traditional school settings, Montessori education has garnered attention not only from progressive-minded parents but anyone who values healthy development and innovation, including entrepreneurs and business managers. A recent blog post on the Harvard Business Review website, for instance, is entitled "Develop Leaders the Montessori way." Articles in the same publication as well as others have shown that successful innovators and business leaders often draw on Montessori's ideas – and that many, indeed, went to Montessori schools.

But as Montessori education has become viable, reputable and successful in the US and elsewhere, there are few Montessori and Montessori-inspired schools in LatAm. South of Mexico, there is only one official center for training Montessori teachers: the Fundación Argentina María Montessori (FAMM), located in Parque Austral, the technology and business park in Pilar, Argentina, just outside the city of Buenos Aires.

Founded by Constanza Carballo and Marisa Canova de Sioli, both Argentine education professionals trained in Montessori methods, with the help of a generous grant from a private group based in Singapore, the Fundación has held Montessori training workshops for teachers from around the world, mostly from South America, with 75% coming from Argentina. Both Ms. Carballo and Ms. Canova de Sioli work for free, and they use tuition revenue to pay for rent and expenses. With the little money that they have been able to raise so far, they offer scholarships for students to attend training courses, all of whom must be involved in a socially beneficial project of some kind. FAMM's current space is a single large room on the ground floor of an office building, designed to simulate a Montessori preschool – an oasis of imagination and play amidst the more corporate (if progressive) feel of the Parque.

And yet, according to Ms. Carballo and Ms. Canova de Soli, the Parque is in fact a perfectly apt location for FAMM. "The Parque invited us because of the innovative character of Montessori," Ms. Canova de Soli says. "As Montessori has extended around the world, people have been interested in researching its efficacy and seeing the data. Our intention is to do that research here, and that research into innovation gives us a synergistic relationship with the Parque."

Bucking the Trend

Yet the hospitality and support that they find within the Parque and the community of the Universidad del Austral, one of LatAm's best, does not extend to their country as a whole. "In Argentina education is undervalued," says Ms. Canova di Soli, "even as economists, neuroscientists and many studies have shown that in order to create a healthy person and society, investment in early education is where you see some of the best returns."

According to Jorge Basaldua, an author and professor of education at the Universidad del Austral who works closely with FAMM, this lack of support for socially beneficial, private projects such as the FAMM arises, in part, from Argentina's tax system. "In Argentina there is a problem with education distinct from what you see in the US or Chile, for example," he explains. "In those countries, there are tax laws allowing companies and individuals to donate portions of their income for charitable purposes, including education. Here there are no such laws, so it's very difficult to get the money together for a school, a kindergarten or a university."

Finding the Funds

It has been difficult, then, for FAMM to raise the money to meet its current needs and realize its vision, including providing more scholarships to visiting trainees and expanding the space to include a functioning classroom where trainees can apply their knowledge. Instead, Mr. Basaldua says, FAMM must rely on the generosity of private donors. "You usually need a big private donor to found the school" – like FAMM's founding donors in Singapore – "and smaller donors to help complete the job," he explains. He estimates that FAMM needs about US$1 million for its near-future development needs.

Complete Human Beings

Ms. Constanza, Ms. Canova de Siolia, and Mr. Basaldua see FAMM as providing vital training to teachers – and Montessori schools in general as providing vital care for children – to face the challenges of the world with behaviors and habits that will lead to better innovation and creativity. "Almost every school says that they want to form well-integrated people, but here we offer the possibility of making it a practical reality, not just an idea," says Ms. Canova de Sioli. "By fostering in the children a proactive attitude and autonomy," Ms. Carballo concurs, "we are giving them the tools to be complete human beings. Our situation as a region is vulnerable, and these children will need these qualities when they are adults."


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