

ALTERNATIVE LatinInvestor

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Retail Special Issue



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to the “Other America”

Inaugural Column:
Structured Finance

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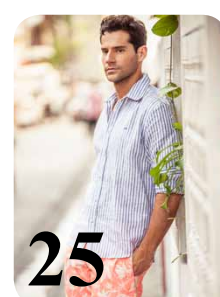
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While ALI's focus is on the LatAm region, we are all investors first and foremost, and specifically alternative asset investors. Our industry has suffered more trials and tribulations than most due to a historic lack of transparency, as well as misunderstanding by the general public and much of the popular media. The Madoffs of the world have not helped our reputation, but only furthered the plausibility of alternative assets' being the evil root of all economic woes. It is with great pleasure, then, that I see, if not a revolution or violent paradigm shift, then an evolution of our industry, in two respects.

Funds are now looking to do what's best for the fund, their investors and the industry. Case in point: the latest, shocking move from hedge fund legend Louis Bacon. Unable to match previous returns, he's giving back 25% of his US\$8 billion fund or urging investors to re-invest in other smaller vehicles. "I am more comfortable taking down the size of the fund than increasing the size of the positions in order to give clients an adequate return given the fees they are paying and the return they are hoping for or expecting," he stated. From all of us here at Alternative Latin Investor, we applaud you, Mr. Bacon.

Secondly, we are genetically coded to fear what we don't understand, and I'm sure we can agree there is a huge amount of misconceptions about the alternative asset industry. President Obama's JOBS Act will, to some degree, bring us out from behind the curtain. With the ability to advertise, market, be interviewed in media, and have a more substantial web-presence than a simple splash page, the industry will become part of the information age, rather than hiding from it. This, of course, will have no bearing on the public's ability to participate in these vehicles: accreditation of investors must still be verified. But their limited participation in no way inhibits our responsibility as an industry to educate.

Along these lines, this issue of Alternative Latin Investor examines the due diligence required when evaluating a fund manager, and takes an in-depth look at the JOBS act and its implications for the hedge fund industry, based on our two-part webinar series in which we spoke with the top experts on the subject.

While we can do little about the state of our global economy, we can do much to improve the practices, success and perception of our industry, and I'm supremely happy to see that we finally are.

Saludos,



Nate Suppaiah
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Hedge Fund Marketing: Understanding the JOBS Act

In the Latest Installment of the ALI Webinar Series, Four Hedge Fund Industry Experts Discussed the Benefits of a Legislative Landmark



As part of its ongoing series of webinars on topics of critical importance to the alternative asset community, ALI recently hosted a two-part webinar on the JOBS Act, a landmark piece of U.S. legislation that many expect will have an enormous effect on hedge funds both in the U.S. and abroad.

The first segment of the webinar, “Understanding the Jobs Act,” featured Richard Heller, a partner at the law firm Thomson Hine, where he heads the firm’s investment management group, and Victor Rodriguez, CEO of the third-party hedge fund marketer LatAm Alternatives and head of the LatAm chapter of the Hedge Fund Association (HFA). Mr. Heller and Mr. Rodriguez explained relevant features of the JOBS Act and speculated as to what effects it will have on the hedge fund industry in LatAm and worldwide.

The second segment, “Putting the Jobs Act to Work,” featured Mitch Ackles, CEO of Hedge Fund PR and Global President and Spokesman of the HFA, and Andrew Saunders, Director of Capital Introduction at Direct Access Partners. Mr. Ackles and Mr. Saunders discussed in more concrete terms the ways in which hedge funds can market and advertise effectively.

Over 100 listeners tuned in for each one-hour segment of the webinar. The discussions were moderated by ALI’s Editor in Chief, Nate Suppaiah.

Understanding the JOBS Act

Mr. Heller began the first segment of the webinar by giving a basic explanation of what the JOBS Act entails, particularly as it pertains to the alternative asset and hedge fund communities.

The Jump Start Our Business Startups Act was signed into law by President Obama in April of this year, with broad bipartisan support in both the U.S. Senate and House. The basic purpose of the Act is to make it easier for small companies (or what the Act calls “emerging growth companies”) to raise capital. Two important ways in which it does this are (1) by making pre- and post-IPO compliance easier for such companies and (2) allowing for crowd funding, whereby

companies will be able to collect small contributions from large numbers of investors via internet-based portals.

A third provision of the Act, of particular importance to the hedge fund community, is that hedge funds will now be able to advertise and perform general solicitations, including posting private offering documentation on their websites for public viewing. The ALI webinar panelists focused particularly on the meaning and consequences of this measure.

After the JOBS Act was signed into law, it was sent to the U.S. Securities and Exchange Commission for review. The SEC

“The JOBS Act offsets Dodd-Frank to an extent. There is US\$2.5 trillion in AUM in the hedge fund space, but there may be 6 or 7 thousand funds. As we saw in the first half of this year, most of the money is going to the very large funds, like Paulson and Soros, but there are thousands of small funds out there managed by two or three guys or gals struggling to make a living, and who now have the added burden of compliance with Dodd-Frank.”

~~~~~ *Richard Heller* ~~~~~

has announced it will release a definition of general solicitation August 22nd; however, never the less, there is much speculation as to what the Act’s final form will be. Indeed,

all four panelists stressed that the consequences of the Act on the hedge fund industry cannot be fathomed until it is clear what hedge funds will and will not be able to do. Nevertheless, based on what we do know, there is a broad consensus that the signing of the JOBS Act marked a watershed moment for the hedge fund industry.

## A Boon for Emerging Managers

All four panelists agreed that the JOBS Act will have the greatest effect on emerging managers, including both small and midsize managers looking for increased exposure and AUM, as well as start-ups. Indeed, Mr. Heller sees the Act as a kind of counterbalance to the Dodd-Frank Act passed in the immediate wake of the global financial crisis of 2008 and 2009, which he believes increased the onus on small and midsize managers by burdening them with regulatory red-tape. Dodd-Frank compels managers with between US\$25 million and \$100 million AUM to register with states, and managers with over US\$150 million AUM to register with the SEC.

“The JOBS Act offsets Dodd-Frank to an extent,” Mr. Heller explained. “There is US\$2.5 trillion in AUM in the hedge fund space, but there may be 6 or 7 thousand funds. As we saw in the first half of this year, most of the money is going to the very large funds, like Paulson and Soros, but there are thousands of small funds out there managed by two or three guys or gals struggling to make a living, and who now had the added burden of compliance with Dodd-Frank. When they threw in an exception for 3c1 and 3c7 managers to take advantage of under the JOBS Act, it was an attempt to level the playing field.” 3c1 and 3c7 are sections of the Investment Company Act of 1940 that had previously exempted hedge funds from registration requirements.

Mr. Rodriguez agreed, saying that the Act gives hope to small and midsize managers who want to raise AuM and increase their profile, while for larger funds, who are less in need of raising capital, it will help grow their brands. “The first ones to jump on the bandwagon will be the smaller managers,” he said. “I think the big ones will be thinking slowly how they will benefit and go to the

next level. They already have large AuM and waiting lists of willing investors.” He also expects to see more consolidation and M&A activity in the hedge fund space, and expects the JOBS Act to fuel that growth.

Larger funds may also utilize this added potential for exposure to advertise a change of direction. “You will see people doing strategic things to take their funds to next level,” Mr. Rodriguez said. “This includes the large funds, who will take strategic steps to show that they not only have brand recognition in industry but can cross over into alternative investing. Those companies who have been doing long only over last thirty years can use advertising to start entering alternative assets space.”

### ■ Transforming the Industry

presents an excellent opportunity for such marketers to seize. Managers will become more serious about marketing, and third parties will be able to work closely with internal marketing teams, he said.

Mr. Rodriguez noted, however, that it will also mean more competition in the space, with more funds and third-party servicers sprouting up, while very large funds aim to grow and consolidate the sector. “These smaller marketing companies need to find their niche,” he advised. “In our case, the focus is on LatAm.”

### ■ The LatAm Effect

The JOBS Act promises to have a large effect on investment worldwide, far beyond its jurisdiction within the U.S. The most immediate and obvious effect it will have

demonstrating to LatAm regulators that allowing advertising, general solicitations, and crowd funding can – if done responsibly – increase transparency and the overall health of the industry.

“There will be reciprocity,” he said in response to an audience-member’s question about what to expect beyond U.S. borders. “The fact that funds should come here will probably start activism abroad,” with the U.S. hedge funds saying, in effect, that other countries “should open their markets to them as well. And I think the continent that will benefit most is LatAm.”

He emphasized that the growth of the LatAm hedge fund industry is several steps behind that of the U.S., and that any post-JOBS Act changes will be part of a larger learning process. “In LatAm, people are

*“The Act promises not only to increase the exposure and fundraising capabilities of emerging managers, but to fundamentally restructure how individual hedge funds and third-party services operate.”*

*Victor Rodriguez*

The Act promises not only to increase the exposure and fundraising capabilities of emerging managers, but to fundamentally restructure how individual hedge funds and third-party services operate, Mr. Rodriguez added. There will be what he calls “an institutionalization of the business” at the middle and smaller end of the market, as asset managers hire the staff necessary to spearhead comprehensive marketing strategies that have been much more limited in the past, and reevaluate the ways in which, and the extent to which, they can utilize third party services.

Mr. Rodriguez understands this well. As the CEO and one of the founding partners of LatAm Alternatives, a third-party hedge fund marketing firm that acts as a consultant to foreign hedge funds operating in LatAm as well as local LatAm hedge funds, he believes the Act has its pros and cons for third-party marketers, but that ultimately it

on foreign fund managers is that – barring an unlikely prohibition by the SEC – they will be able to advertise directly to U.S. audiences. Mr. Heller said that he expects this to be the biggest change for foreign managers.

Mr. Rodriguez agreed that the ability of offshore funds to market in the U.S. represents an enormous opportunity for the global industry. “The U.S. is the most important alternative investment market in the world,” he said, “so it gives these foreign managers hope that they can be part of the global mainstream. They will be able to go pitch their funds in the U.S., create onshore vehicles in the U.S. and market themselves, offering documents on the internet, showcasing their edge – and this is very important.” But he also thinks the JOBS Act will have more indirect but no less important and tangible effects on the global and, in particular, LatAm hedge fund industry, essentially by

copying what they are doing in the U.S., with regulation and rules of engagement, so you will see changes. And these changes will create a landscape of opportunities for evaluating asset allocation and moving traditional investment toward alternatives. Basically, it is up to local legislatures to determine how to create the legal structures for these managers to exist.” This will take time, and he expects that the regulatory repercussions of the JOBS Act will not arrive in LatAm until 2014.

### ■ Transparency and Education

The theme of educating investors, regulators and the public was central to both Mr. Heller’s and Mr. Rodriguez’s view of the JOBS Act’s ultimate effect. As Mr. Heller pointed out, the hedge fund industry has been all but opaque to the investor public and general public for years, and most of the news that they do hear has to do with

wrongdoing. “This act will allow education and transparency,” he said. Even if you are not an accredited investors but want to learn about the industry, it will give you the opportunity.”

But both panelists stressed that, with the added transparency and greater contact between asset managers and the investor public, there are concerns which the SEC should address in its revision. “The biggest concern articulated by the SEC,” said Mr. Heller, “is how to prevent fraud. Clearly, there needs to be limits. It’s critical to define with particularity who an accredited investor is and for that accredited investor to be able to prove they’re accredited. We’ve had a check-the-box system in the past and that has to go away. I don’t know to what granularity the SEC will drill down, but that has to be a concern.” Mr. Heller added that SEC regulation of the private companies hosting online crowd funding portals will be very important as well.

He noted, too, that there are many effective laws already at place, particularly at the state level and in the Investment Companies Act, and that fraud will remain a concern regardless of the SEC’s regulations are. “As with all laws, the people who want to comply will comply no matter what the cost, and those who want to commit fraud will do so, and should get caught.”

## ■ Due Diligence

When the SEC announces its rules, U.S. hedge funds and foreign hedge funds that wish to market in the U.S. will find themselves in a vastly altered context, and their operations and strategies will have to change accordingly.



And yet certain fundamental aspects of the current business will remain unchanged.

For example, Mr. Heller pointed out that the increase in the exposure of fund managers and the information available to prospective investors, far from alleviating the need for due diligence, makes it all the more important. “The JOBS Act will allow single family offices in particular the opportunity to take a look at managers and strategies that are out there, and for those managers to post offering literature on line,” he said. “But the due diligence component for single family office will need to increase. You want to ensure that you learn as much as you possibly can about the manager before you make the investment, not only for family offices but for accredited investors as well, and that will be difficult.”

## ■ The Successful Manager

Along the same lines, Mr. Heller concurred with all four of the webinar panelists that certain qualities that have always distinguished the best managers from the rest of the pack will only grow in importance as the post-JOBS Act hedge fund market grows. “You have to have a strategy that is compelling and a pedigree of merit,” he said. Mr. Rodriguez agreed, emphasizing the importance of having an impressive team. “You don’t even need an office or a business card. The most important thing is having a strong team, and then thinking outside the box and having a plan.”

Mr. Rodriguez added that, in the current climate, it is essential for emerging managers to offer managed accounts. “We are in market dislocation mode,” he explained, “and people are saying we’re going to fall apart, and the only way for you to survive within this context as a small business is to understand that you need to have managed accounts. It’s the only way to have transparency right away; you might be exposing secrets, but it will bring in revenue.”

Mr. Rodriguez spoke of other intangible qualities that separate the best from the rest, beginning with transparency and forthrightness – a theme that was taken up

at length in the following segment of the webinar.

“Accomplishment is everything,” he said, “and you need to say what your accomplishments have been, but you also have to be honest, show your failings, discuss how you will tweak your strategy and approach capital preservation.” Routine, regularity, and commitment are key, he said. “People tend to overestimate what they can accomplish in one year but underestimate what they can accomplish in ten. The bottom line is what are you going to do when you have these new tools, and it has to do with routine, discipline, study and using common sense, because common sense doesn’t fail.”

*“There is a perception of hedge funds in public that isn’t true,” he said. “Not everyone is flying around on a private jet.” Indeed, hedge funds are, in most cases, far more beneficial to the economy and society than people realize. “Hedge funds provide liquidity when others don’t. After the financial crisis of ’08, the lenders were hedge funds when banks stopped doing it.”*

~~~~~ Mitch Ackles ~~~~~

■ Part II: Putting the JOBS Act to Work

In the second segment, Mitch Ackles and Andrew Saunders focused on the practical question of how hedge funds – and espe-

cially the emerging hedge funds poised to be most affected by the Act – should utilize the newly granted advertising and general solicitation freedoms.

Mr. Ackles, CEO of Hedge Fund PR and President and Spokesman of the Hedge fund Association, began the segment by expounding on some of the points made in the first. He said that he, too, expects the greatest effect to be seen with emerging and start-up managers, and that this is a positive development in line with the HFA's own goals. "We think there is great value in advertising, and the HFA has been promoting the idea," he said. "We believe hedge funds should enjoy the same free speech as others providers of financial services, we believe it's a step in the right direction after so many years of hedge funds not being able to advertise."

He added that the HFA also expects that the JOBS Act will have global repercussions. "Hedge fund industry is global, has been for many years, just like Wall St. and Finance. We anticipate that LatAm funds, in Brazil and other countries, are looking at this and will be advertising on a global scale, and managers who are forward-thinking are already thinking about strategies."

He seconded the point that Mr. Heller and Mr. Rodriguez made in the first segment regarding the importance of improving the hedge fund industry's reputation with the investor public. "There is a perception of hedge funds in public that isn't true," he said. "Not everyone is flying around on a private jet." Indeed, hedge funds are, in most cases, far more beneficial to the economy and society than people realize. "Hedge funds provide liquidity when others don't. After financial crisis of '08, the lenders were hedge funds when banks stopped doing it. And they provide a lot of other benefits beyond just to investors: they employ people, rents space, spend in broader economy, create jobs."

He said he hopes and thinks the JOBS Act will ultimately allow hedge fund managers to be more comfortable with their role and willing to identify with it and be vocal in public. Indeed, he said it was essential for the hedge fund industry generally and individual managers to be proactive when it

comes to PR. Summing up the moral of the webinar's second part, he said:

"If you don't get your message out there as a manger or investment firm, then that message is crafted for you. If you're not part of that conversation, you're shaped by that conversation. This is an opportunity to speak up for your firm and brand, and we think that is one strong benefit of the JOBS Act."

■ One of Many Tools

Mr. Saunders, Head of Capital Introduction at Direct Access Partners, and Mr. Ackles agreed that advertising should be seen as one tool inside a larger toolbox of a mar-

"Marketing is a process, a core business function, and advertising is a tactic that comes off of that. My hope is that [in the wake of the JOBS Act] managers will begin to view marketing in a more formal, institutionalized and traditional way."

~~~~~ *Andrew Saunders* ~~~~~

keting strategy. The other tools include those that have been allowed and utilized by hedge funds before, such as conference appearances; those that have been allowed but under-utilized, such as appearances in the media; and increased web and social media presence. But as with any marketing push, it is important that these tactics grow out of an overarching marketing strategy; that their effect be measured; and that there be significant follow-through to transform mere contacts into strong investor relations.

"You have to do a lot of work now before spending 'silly money' on advertising," Mr. Saunders insisted. "A lot of people think there is a natural market for their product, but they haven't done any pre-market intelligence necessarily that you would do with another product. You have to get the messaging right. You can use professionals to help break down what you do, how it's different, what the added value is. Marketing is a process, a core business function, and advertising is a tactic that comes off of that. My hope is that [in the wake of the JOBS Act] managers will begin to view marketing in a more formal, institutionalized and traditional way."

### ■ Voice, Message, Audience

Mr. Saunders said that in developing a marketing plan, including for advertising, it is essential that fund managers, their marketing staff and whatever outside consultants they might seek define the three classic elements of effective advertising: voice, message, and voice.

Crafting your message and voice comes down to an age-old mandate, he said: "Know thyself." This includes not only what a manager's strengths and weaknesses are and what he or she has to offer, but what the manager needs out of investors. For example, if a fund has a certain lifespan, it will need certain investors to fit into that lifespan.

The new rules will also give hedge funds the opportunity to advance specific ideas or strategies that differentiate them from the pack. "Hedge funds can focus on specific trades, specific ideas. Often these managers are very intelligent people focusing on an idea, and they may now able to write a white paper and put more market push behind idea, that strategy, by advertising it in a financial publication."

### ■ Knowing the Audience

But once the manager and marketing team know what their message is and requirements are, "it all comes back to who's your target audience," Mr. Saunders said.

Mr. Ackles agreed, saying that the managers will benefit most from the new advertising

de-regulation if they focus on the audience they “know to be qualified.”

“I believe that those who are smart are going to approach it surgically,” Mr. Ackles added.” This means, for example, placing advertisements in focused, niche trade publications and media, instead of the broader mass media. He noted that there are such publications geared specifically toward family offices, pension funds, endowments, etc., and that most publications and other media outlets will provide prospective advertisers with demographic information, “which is vitally important.”

Mr. Ackles emphasized another important part of advertising and marketing: measuring its effect. “All advertising has to be measured in order to succeed,” he said. **Striking a Balance**

Both Mr. Saunders and Mr. Ackles stressed, however, that it will be important for managers to toe a delicate line between being informative and slipping into over-exposure. “Hedge funds are a luxury product,” Mr. Saunders said. “Investors seek access to portfolio managers. They are demanding of manager time. If they see a manager on TV all the time, they might be dissuaded from thinking they’re being treated with white glove treatment they expect.”

In this respect, Mr. Ackles said it will be important for managers to hire staff specifically for marketing. “Running a hedge fund is two-fold: it’s running a portfolio and running a business. You need staff to handle things for you. As an investor, you want to make sure the manager is watching portfolio, so the manager needs infrastructure in place to handle those aspects.”

## ■ Transparency & Consistency

Both panelists stressed the importance of transparency and consistency in providing investors with information, saying that it is in the interests not only of the public and the industry as a whole but of individual managers themselves to be as forthright as possible about their strategies and performance and as consistent as possible in the manner in which they report to investors.

Mr. Saunders mentioned how amazed he is in the lack of overlap in the data contained in proprietary hedge fund databases, and recommended that, as soon as the details of the new reality are known, managers “get their numbers out there.”

Consistency, Mr. Ackles added, is key, and managers should focus on demonstrating consistency and transparency instead of trying to demonstrate consistently stellar returns.

“You need to be consistent and tell the truth,” he said, “and then you don’t have anything you need to remember. If a manager has a complete line going up, they’re probably not real. There are going to be bad months. But you need to be consistent in your reporting, report to the databases you know to be the most prominent, and realize that reporting to one is not all. If you report on a specific day, you want to make sure you do so regularly.

“If I were an allocator of an endowment, a family office, accredited investor, and I noticed a big difference in dates, that’s a red flag. There are legal counsels who actually don’t want managers to report, and it really has been an impediment to raising capital for a lot of smart people.”

## ■ Web Presence

One of the primary ways to get information out there, of course, is via the internet, and the JOBS Act ought to have a huge impact on managers’ web presence – though much will depend on the SEC’s rules.

“When you’re allowed to speak more freely and do more brand management like every other industry,” said Mr. Saunders, “the low-hanging fruit is the website. It should be more engaging informative, a bit more contemporary – not just a splash page with a picture of a mountain and contact info. You should use it to discuss performance and discuss specific ideas, participate in conversations.” He recommended thinking creatively of interactive features.

Mr. Ackles added that most investors use Google as their primary search tool, and that managers need to stake out a prominent place among its search results. And they

need to create websites that give a sense of uniqueness and identity. There are companies emerging that can provide such services to managers, he said.

Mr. Ackles also spoke of the growing importance of having a social media presence. “There are more managers on Twitter and LinkedIn now, and investors as well, which offer many different ways for managers to approach investors. But you still need to be surgical with your ads, the perception of how they look and what’s included. They need to be top-drawer and sophisticated, not get-rich-quick schemes.

## ■ Execution

Ultimately, apart from the impression managers make on current or prospective investors from a distance – whether through advertisements, information on websites, media appearances, etc. – it will be essential to forge personal relationships. In that respect, the JOBS Act will not change the fundamental name of the game. If anything, it will make it all the more important.

“Investors need to know you are investing alongside them, doing your own cooking,” said Mr. Ackles. “There’s still going to have to be face-time, onsite visits. There is no replacement for the follow-up. Your internal people raising capital still need to close that circle by following up with inquiries, keeping investors informed, asking for second meetings.”

Mr. Saunders agreed. To bring investors on board, he said, “you need to respond to info requests, tweak your documentation – that’s what’s going to push it across the goal line. Advertising can be valuable for branding, generating a phone call, some comfort, but it’s all about the execution of bringing that client on and embracing a new partner. “A lot of people are looking for silver bullets, but it’s all in the execution.”

# The Failed States Index

James Knight

Everyone loves a table. What better way to try and capture in a nice, juicy round number the multitude of influences that make up the fabric of a nation? The Failed States Index remains an extremely useful way to see at a glance the kinds of pressures – social, political, economic and military – acting on countries and how they try and handle them. How do the South American results break down?

Most encouraging is the large, inverted triangle of yellow that makes up the Southern Cone (see map). Uruguay, Chile and Argentina are ranked at 154, 151 and 145 respectively, which classifies them as ‘stable.’ They rank comfortably below (and on this axis, the lower the score the less ‘failing’ a state is judged to be) their continental neighbors and beat countries including the UAE, Slovakia and Costa Rica, all of which have seen vast capital inflows in recent years and been feted at various times as the darlings of their respective regions. The US comes in at 159, out of 177 states, with Finland occupying the bottom spot. In South America the range varies widely, with 102 places separating the most and least stable states (see table).

The temperature is taken across a range of 12 indicators that include demographic





weakness as states, enabling access to vast quantities of raw materials with little or no scrutiny or debate, due to weak institutions, an easily controlled form of political and business clientelism, little or no viable political opposition and/or civil society, and the lack of a free press. This vacuum can create the kind of stasis that increases the certainty of outcomes, which the market likes. However, it does not lay the foundations for long-term wealth creation.

It's too simplistic to say that Argentina is a 'better' place to do business than Colombia on the basis of its position in this index. Perhaps the more pertinent question should be: If Argentina is so 'stable,' why isn't it doing more to attract investors? But the difficulties of doing business in Argentina are also partly due to the complexity of its competing interest groups, consisting of powerful unions; a Machiavellian and interventionist political leadership at the federal, provincial and local levels (often from competing parties); relatively open media; and active environmental and social welfare NGOs. I would argue that dealing with these factors is, if not necessarily easier than dealing with an absence of them, the product of a (relatively) sophisticated culture that has developed to the point where grievance and redress are accepted parts of the political and

business process. They may not always be resolved satisfactorily or to Western legal standards; however, they are at least (usually) resolved without the use of brute force.

## ■ Fragility remains

This, unfortunately, is not always the case elsewhere on the continent, and this index is a timely reminder of the security challenges that many countries face between competing interest groups. This includes countries considered investor-friendly right now, and investors need to be aware that their own interests may become flash points. Peru's much-vaunted US\$50 billion pipeline of mining projects is hampered by what is happening in Cajamarca province, where the US\$5 billion Conga gold project, majority-controlled by Newmont Mining, remains on hold since November 2011. In July, 5 people died in environmental protests, and the ongoing standoff between police and local communities threatens to destabilize the situation further. In Bolivia, Evo Morales nationalized Canada-based South American Silver Corp.'s operation, following the death of a protestor and the taking of hostages by indigenous groups.

Colombia has made huge efforts to rebrand itself in recent years from the 'narco-state' tag that dogged it for much of the 1990s. While it is the highest-placed country in the index, it is trending steadily downwards and was one of the top 10 movers this year. However, the danger remains that unsatisfied terrorist and criminal groups, a hangover from the war against the FARC and drug-trafficking are now finding rich new pickings with the flood of foreign capital and personnel going into the country.

Finally, the weakness of Paraguay's political institutions was brutally exposed by the ease and speed with which President Lugo was impeached. It was certainly no coup, but the constitutional leeway and lack of due process that enabled the express toppling of a democratically elected leader was startling.

It is easy enough to enact a series of pro-business reforms that can move a country up another oft-quoted investment metric, the UN's Doing Business rankings. But the Failed States Index reminds us it's quite another thing to create the social conditions that enable stable, sustainable investment to take place. Therefore, the fragility of the states nearer the top of the list needs to be remembered.

## Author Biography

James Knight is a LatAm-based journalist and consultant with ten years' experience of working in and with emerging market countries. He is Director of Pionero Partners, a locally-based risk and strategic advisory consultancy serving international clients. Prior to his current role he acted as an advisor to Chinese clients on various LatAm projects and previously worked at Barclays Bank plc. He has acted as a strategic consultant to the World Bank and the United Nations, while his investigative and analytical skills were honed with journalism for Reuters, The Economist, Africa Confidential and BBC Online covering business, investment and conflict. He holds an undergraduate degree from Cambridge University.

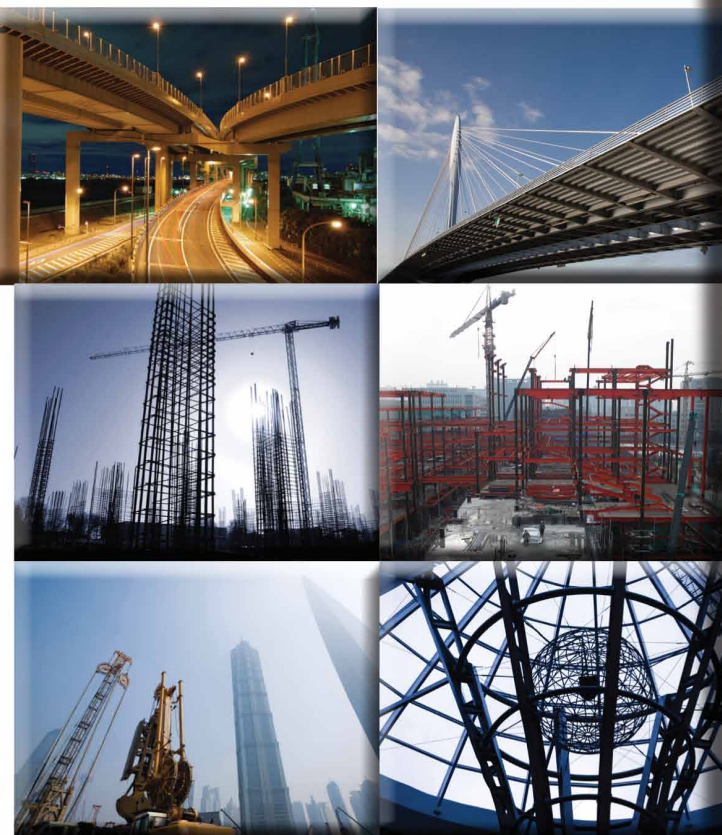


## HOW LATAM PERFORMS

| Failed States Index 2012 | Country Ranking |
|--------------------------|-----------------|
| Colombia                 | 52              |
| Bolivia                  | 67              |
| Venezuela                | 82              |
| Peru                     | 99              |
| Guyana                   | 104             |
| Suriname                 | 105             |
| Paraguay                 | 107             |
| Brazil                   | 123             |
| Argentina                | 145             |
| Chile                    | 151             |
| Uruguay                  | 154             |

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Public-private partnerships to fund infrastructure projects

**Subway expansion in Santiago, Chile and Sao Paulo**

New "Metrobus" bus rapid transit (BRT) system in Asunción, Paraguay

**Concessions in Peru: Challenges for the next five years**

Rodoanel Norte highway in Sao Paulo, Brazil

**Bioceánico Aconcagua rail corridor, Argentina**

Santos-Guarujá tunnel, Brazil

**Transnordestina railway, Brazil**

Petrobras' 2012 investment plan

**Itaipú-Villa Hayes transmission project, Paraguay**

Hydro Aysén hydroelectric dam (Chile)

**Antucoya copper project, Chile**

Desalination plant in Antofagasta, Chile

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# Argentina

*Ladrillos.* Bricks. While real estate is probably the *least* alternative investment in Latin America, and specifically in Argentina, it is inescapable and critical. Over the past year, the investment climate in Argentina has suffered a series of blows that significantly affect this core area.

## Currency Restrictions

■ Emily Sarah Hersh

### ■ Currency Controls

Following re-election in October 2011, second-term President Cristina Fernandez de Kirchner instituted a series of controls stemming capital flight from the country. On Oct. 31, restrictions were enacted to stop capital outflows, assist domestic manufacturers and restrain the sliding value of the peso. These controls required individuals to seek authorization from the federal tax agency for any foreign exchange purchase demonstrating that funds were obtained legally. Most applicants were routinely denied with little explanation.

In July, Argentina's central bank formally banned people from buying dollars for the purpose of saving, confirming the de facto policy in place. Existing dollar-denominated mortgage payments and travel abroad are permissible reasons for foreign currency purchases. These steps to stem capital flight and ease downward pressure on the peso exacerbate fears and have stoked a vibrant set of black market transactions designed to evade them.

### ■ Parallel Currency Market(s)

Argentina's measures to limit capital flows have been a limited success. The peso has fallen 5.6% so far in 2012 and is currently at 4.5457 to the US dollar. According to the Central Bank, investors withdrew US\$1.6 billion from Argentina from January through March 2012, compared with US\$3.3 billion in the final 3 months of 2011. This capital moves via unofficial routes and transactions that use the purchase and sale of dollar-denominated instruments abroad and locally. The following 3 rates are the most commonly encountered classifications for investors and academics alike:

The official rate: Also known as the white rate, this is the rate announced by the Central Bank of Argentina. This is the rate at which authorized importers can buy dollars to import goods, or that individuals who receive approval from AFIP (the tax



agency) can buy dollars for travel. The current reality is that fewer everyday people can access dollars at the official rate. If you are a foreign investor, this is the rate you will receive if you use your ATM card to withdraw pesos, bring money in officially through a bank or use your credit card. Conversely, Argentines will face this rate when they use their credit cards to pay for goods or services overseas.

**The blue rate:** Also known as the unofficial, black or parallel rate. This is the exchange rate given by casas de cambio and other unofficial buyers and sellers of currency. This rate varies between cambios and rises and falls according to sentiment and government crackdowns. During the last week of May and the first week of June, the rate reached a high of about 6.15 pesos to the dollar on new restrictions on travelers to access dollars. The following week it fell to 5.9 as the market calmed and the government pressured cambios to lower rates. This is the rate most individuals and small-to-medium businesses face when converting pesos. It is also what savvy tourists and travelers do when they bring cash down to Argentina to exchange outside of a bank.

**The blue chip swap rate:** This is the rate implied by a legal operation whereby Argentines can buy sovereign bonds or securities in pesos in Argentina and sell them abroad for dollars. This bond swap is sometimes referred to as Boden, or bonds issued following 2001 that are paid in dollars. This rate is typically higher than the blue rate and is primarily accessible by large businesses with access to the national and international securities markets. This rate can also be used by broker houses and legal offices to assist clients in large transactions. While this exchange is legal, it is frowned upon and closely monitored by the government. It is also inaccessible to the majority of individuals who lack sufficient capital.

For investors, this adds a layer of complexity and risk to any transaction. Funds brought into Argentina at the official rate will essentially lose 30% of their value crossing the border, but to go through an alternative route will involve a third party and raise transaction costs. The risk is inherent in the fact that changing policies and a shifting currency environment have the potential to decrease the value of any investment quickly and unexpectedly.

## ■ “Pesification” Looming?

The underlying fear that perpetuates Argentina’s love affair with the US dollar — and, by extension, the prevalence of real estate as an investment — is the risk that, as in 2001, an economic crisis will convert savings and holdings into pesos at a rate that dissolves wealth by a significant factor.

While the government repeatedly makes statements assuring that there will be no forced conversions of dollar accounts to pesos and that all dollar obligations will be honored, history does not offer reassurance. In May, Senator Anibal Fernandez commented that “Argentines will have to start thinking in pesos,” and Interior Minister Florencio Randazzo noted that it would be a “significant cultural advance [if] the Argentine economy reference is the peso.”

Rumors persist that Kirchner will pass legislation that makes the use of the peso obligatory in all transactions as part of her “cultural war” against Argentina’s dependence on the dollar. In June, the government enacted a sweeping overhaul of civil and commercial laws to allow debtors to “free themselves” of foreign currency debt by paying “the equivalent amount” in pesos. The Justice Minister denies this will extend to all contracts, but the fear remains.

## ■ Additional Considerations

In addition to currency market interventions, the Argentine government recently nationalized YPF, the country’s largest oil company. The government has passed measures forcing banks to lend long term at unofficially low rates and continues to restrict imports. Protests have increased in frequency and participation, and friction between the labor unions and the government is high.

## ■ Real Estate Market

In response, Argentina’s residential real estate market has frozen up over June and July. Owners are holding their properties to hedge against depreciation of the peso and are unwilling to sell unless in hard currency. Investors seeking to acquire properties must navigate a maze of restrictions and then take on the risk inherent in the market. The

residential real estate market is almost exclusively in dollars and transactions occur in cash. Mortgages represent a negligible portion of the market and construction fell 5.9% from March to April, down 3.8% from the past year.

Sales of new and used homes in Buenos Aires fell 25% in March from a year ago, and estimates suggest that sales fell 30% in May and 35% in June.

While opportunities still exist in commercial projects, many investors have made the decision to sit out and invest elsewhere — not a bad decision, considering the lower risk and higher return.

### Author Biography

Emily Sarah Hersh lives and works in Buenos Aires, Argentina, and serves as Managing Partner of DCDB Group, a US-based financial advisory and consulting firm. She holds a dual bachelor’s degree in economics and international political economy from Tulane University and a master’s degree in international economic relations from American University.

At DCDB, Emily works directly with business owners to create financing structures and facilitates fund formations designed to appeal to investors in Latin America. She has structured public/private joint ventures that incorporate tax credits and economic development bonds, as well as created fund-specific deal flow structures including due diligence in both the GreenTech and AgroTech fields.

Emily is fluent in English and Spanish, and shares her colorful view on Argentina on her controversial blog notparis.com under the pseudonym Bianca Fernet. In her limited free time, she enjoys cooking everything, drinking wine in good company and traveling. She has experience in Latin America, the US, Asia, the Middle East in petroleum and Islamic Finance, the Forex market, the derivatives market and sovereign funds.

# Retailers Shift Focus to the 'Other America'

■ Mario Capizzani, Felipe Javier Ramirez Huerta & Paulo Rocha e Oliveira

Asia-Pacific may currently be the world's dominant growth region, due primarily to the sheer number of inhabitants currently of working age. However, the strongest long-term growth prospects are offered by Latin America and the Middle East, whose burgeoning populations of younger inhabitants will soon join the labor force.

In the case of Latin America, the growing middle class and increased purchasing power in many countries are opening up new markets in the retail sector.

In their paper, "Retail in Latin America: Trends, Challenges and Opportunities," IESE's Mario Capizzani, Felipe Javier Ramirez Huerta and Paulo Rocha e Oliveira analyze these opportunities on a country-by-country basis, mindful of the significant differences that exist between the countries that make up the continent.

## ■ Urban Explosion

One-third of the world's population, roughly 2.6 billion people, live in cities in emerging

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**Original document:** Retail in Latin America: Trends, challenges and opportunities - 2012

markets. By 2030, the numbers of emerging-market urban dwellers are forecast to increase by another 1.3 billion. To put this in context, cities in developed markets will only add roughly 100 million new residents during the same period.

*The region is expected to remain the fastest growing in this sector over the next 5 years.*

This unprecedented growth in urban populations will fundamentally change the competitive landscape, as the emerging middle class in these new markets pushes up consumer demand.

Some 26 million households in Latin America joined the middle class during the 1996-2010 period. However, the authors point out that this rosy picture masks a complex underlying reality.

While these newly minted middle-class consumers may be much better off than their parents, their status is often tenuous, with insecure jobs and poor access to education for their children.

## ■ Small Still Beautiful

Traditionally, most consumers' needs in the region have been met by small retailers.

While a growing portion of emerging customers are attracted to large supermarkets, most of the large chain formats lack a key element: the emotional proximity and feeling of community that comes from personal relationships with shopkeepers or store per-

## Different Formats per LatAm Country

| Format                                                                         | Brazil                                                                                    | Mexico                                                               | Argentina                                                                             | Colombia                                                                      | Chile                                                                 |
|--------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------|----------------------------------------------------------------------|---------------------------------------------------------------------------------------|-------------------------------------------------------------------------------|-----------------------------------------------------------------------|
| Big Scale Commerce                                                             | -Discount Stores<br>-Hypermarkets<br>-Big Supermarkets<br>-Wholesalers<br>("Atacadistas") | -Warehouse<br>-Hyper/Megamarket<br>-Big Supermarkets<br>-Retail Club | -Discount Stores<br>-Hypermarkets<br>-Big Supermarkets<br>-Wholesales                 | -Hypermarkets<br>-Big Supermarkets                                            | -Discount Stores<br>-Hypermarkets<br>-Big Supermarkets<br>-Wholesales |
| Small Supermarkets:<br>-Small independent<br>-Self Service<br>-Less than 6 POS | - Supermarkets Self Service<br>(Small Supermarkets and Mercadinhos)                       | - Supermarkets Self Service                                          | - Supermarkets Self Service                                                           | - Supermarkets Self Service<br>"superetes"                                    | - Supermarkets Self Service                                           |
| Traditional:<br>-Small Independent<br>-Front and attendance                    | - Mercearias / Mercadinhos                                                                | - Grocery Stores                                                     | - Grocery Stores (Almacenes) Todo Suelto                                              | -Small Stores<br>-Medium Stores                                               | - Grocery Stores                                                      |
| "Street Format"<br>- Limited Infrastructure                                    | - Feira Livre                                                                             | -Tianguis<br>-Wheel Market                                           | -Neighborhood Ferias<br>-Mobile Ferias<br>-Exchange Club<br>-Door to Door<br>-Vendors | -Public Markets (Abastos)<br>-Square Wholesaler<br>-Mobile Ferias<br>-Casetas | -Ferias<br>-Street Vendors                                            |
| Specialists                                                                    | -Acougue<br>-SacoÃŁo<br>-Padaria                                                          | -Butcher Shops<br>-Creameries<br>-Fruit<br>-Poultry                  | -Butcher shops<br>-Bakery<br>-Green Grocer                                            | -Butcher Shops<br>-Frutiver                                                   | -Butcher Shops<br>-Bakery<br>-Green Grocer                            |
| Convenience                                                                    | -Gas Stations<br>-Bancas / Barracas                                                       | - Gas Stations<br>- Estanquillos                                     | - Maxikioskos<br>- Convenience Gas                                                    | -Gas stations<br>-Tobacco Store                                               | -Gas                                                                  |

## Consumer Preferences in LatAm

sonnel. Personal relationships are usually the deciding factor for preferring certain outlets over similarly priced competitors.

For now, the need for credit is not a factor in drawing consumers away from small-scale stores. Although they may come up short on small purchases, consumers often rely on informal credit, by which small retailers allow their regular customers to make up the difference the next time they shop. This saves them from the embarrassment of having to remove purchases at the time of payment.

|                   | "Staples"                                                                                                                                                                    | "Secondary"                                                                                                                                                                                                | "Luxuries"                                                                                                                                                                                                                                                                                                            |
|-------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Packaged foods    | Rice, beans, dry pasta, oil, salt sugar, tomato sauce, cookies and snacks for kids (value brands)<br>Br: flours (wheat, manioc, corn), canned fish (Class C)<br>Col: lentils | Sweet and salty snacks, some canned food<br>Mex: cereal, snacks<br>Arg: salty snacks, sweets, candy<br>Ch: dressings, mayonnaise                                                                           | Canned foods, chocolate candy, cookies (leading brands), cereal<br>Arg: tuna, olives, "alfajores"<br>Br: condensed milk, cake mix<br>Ch: heat of palm<br>Col: salty snacks (adults)                                                                                                                                   |
| Perishable foods  | Fruits and vegetables, eggs, bread, margarine/butter<br>Arg: jelly, cold cuts<br>Mex/Br Class C: yogurt                                                                      | Cold cuts, meats<br>Arg/Ch: sausages<br>Br: yogurt, cheese, chicken<br>Mex: ground hamburger meat<br>Ch/Col: margarine, chicken<br>Value brand sodas (Arg, Col),<br>Br: powdered drink mix<br>Arg/Br: beer | Frozen foods, ice cream<br>Br: frozen lasagna, fried potatoes, hamburger patties<br>Br/Mex: ready to eat pizza<br>Mex/Col: seafood<br>Coca-Cola<br>Arg/Col: wine<br>Mex: tequila, rum<br>CR: Gatorade sports drinks<br>Ar/CR: tang powdered drink<br>Leading brands in detergent and softener<br>Br: furniture polish |
| Beverages         | Coffee, juice concentrate<br>Col: chocolate bars<br>Br: value brand sodas<br>Mex: powdered drink mix<br>Arg/Ch: tea                                                          |                                                                                                                                                                                                            |                                                                                                                                                                                                                                                                                                                       |
| Cleaning products | Powdered laundry detergent, bleach, disinfectant<br>Br/Col: bar laundry soap<br>Mex: softener, steel wool<br>Arg: floor cleaner                                              | Softener<br>Arg: multi-purpose cleaners, air freshener<br>Col: liquid dish detergent                                                                                                                       |                                                                                                                                                                                                                                                                                                                       |
| Personal care     | Toilet paper, soap, toothpaste, sanitary napkins, deodorant, family shampoo, sanitary napkins<br>Mex: diapers<br>Arg/CR: conditioner, cotton                                 | Leading brand shampoo (Arg, Br), conditioners                                                                                                                                                              | Leading brands, perfume<br>Br: personal shampoo, facial lotion<br>Ch: make up<br>Mex: body lotion                                                                                                                                                                                                                     |

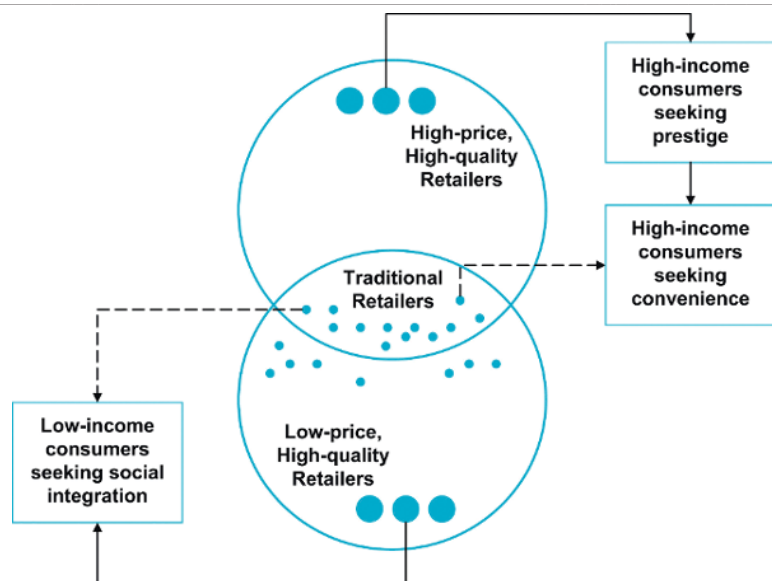
Sources: IBOPE Solution, BAH analysis

## Going Global

Of the emerging-market retailers in the region that have achieved impressive economies of scale, many — particularly those in Brazil, Chile and Mexico — are rapidly becoming world-class players in their own right.

Not only are they well-equipped to compete with the global giants in their home markets, some are even becoming competitive in other markets. Such retailers are now able to tap into global expertise, often hiring reverse expats who have spent time in affluent markets gaining valuable knowledge and experience.

Online retailing is also expanding rapidly, nearly tripling in size over the past 5 years



to generate sales of US\$12 billion in 2010. The same year saw Latin America top internet retailing growth globally, achieving a 24% increase.

The region is expected to remain the fastest growing in this sector over the next 5 years.

## Women Leading the Way

Another important factor in the region's retail growth is the changing status and buying power of women.

Brazil, for example, has experienced a significant influx of young women joining the labor force. These women, in their early 20s and 30s, are characterized by their interest in advancing their careers and investing in

their education. They work long hours and many learn second languages.

In Mexico, too, more women are joining the work force, with an increase from 14.7 million in 2005 to 16.3 million in 2009, a growth of 10.4%. Nevertheless, women still only make up 35% of the Mexican work force.

Across all of Latin America, over the past 2 decades the economically active female population has doubled and their employment levels appear to have become more resilient.

Historically, when the region has seen economic difficulty, female employment has tended to take the brunt of the impact. However, this was not the case in the 2008-09 downturn.

Indeed, over the past 2 years, sales of women's clothes in Latin America have grown faster than men's clothing sales. Given such resilience, the sector represents an enticing opportunity for retailers.

## A Burgeoning Middle Class

Favorable economic conditions in recent years have propelled many Brazilians into the middle class, which now represents close to 50% of the population.

Brazilian demographics are changing steadily as life expectancy continues to rise while fertility rates decline, all of which influence consumer habits and expenditure.



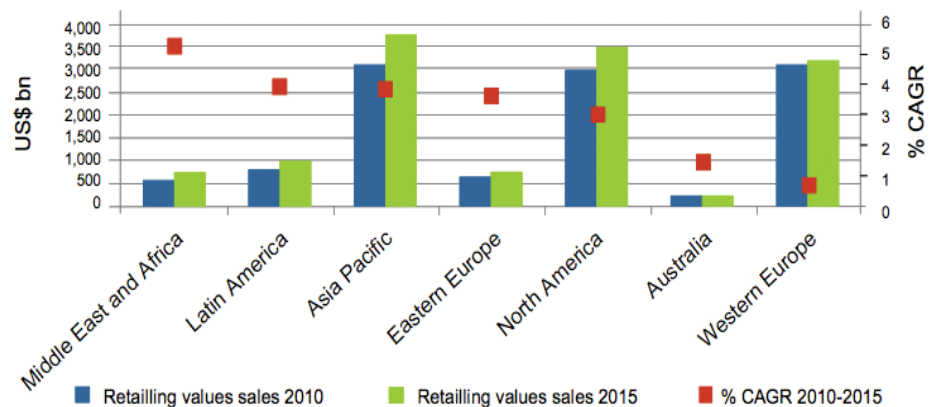


Many elderly people are receiving income from their pensions, as well as getting help from their families. As a result, they, too, have greater purchasing power.

By 2015, emerging-market cities will account for 30%, or \$2.6 trillion, of the total global consumption of clothing and household items. These cities are already some of the fastest-growing markets for luxury goods in the world.

A younger working population, meanwhile, portends higher levels of interest in goods such as textiles and consumer electronics. And as these workers set up their households and start their own families, new opportunities will no doubt arise in markets for houseware and for baby and children's products.

**Figure 3.1**  
Emerging Markets Lead Forecast Retail Growth



The piece you have just read is an overview from a study called “Retail in Latin America: Trends, challenges and opportunities” published in 2012 by Mario Capizzani, Felipe Javier Ramírez Huerta and Paulo Rocha e Oliveira – students at IESE Business School in Spain.

# *Emotional Intelligence:*

## Martin Butler on the *Art of Being Chosen*

**Modern retail is undergoing a paradigm shift, fueled by the forces of globalization and technology. And yet those who will succeed in this brave new retailing world are not necessarily the most technically and logistically dominant. Rather, what separates the best from the rest is their emotional understanding and precision.**

Such is the philosophy of Martin Butler, a renowned expert on marketing, advertising and particularly retail success, whose recent book, *The Art of Being Chosen*, discusses the more intangible qualities that he believes characterize the best of modern retail. Mr. Butler spoke to ALI recently about his book, its messages and what they could mean for both LatAm retailers and multinational retailers entering LatAm and other emerging markets.

### ■ Customers on the Mind

Born over his parents' shop in England, Mr. Butler said that he has always had customers on his mind, both personally and professionally. When he left his family shop, he went into marketing and advertising, working at some of the most important firms in the world before opening his own London-based advertising agency. He sold that agency 6 years ago and, since then, has dedicated himself to gaining a deeper understanding of retail. The

search has yielded several books, the most recent of which is *The Art of Being Chosen*.

For that book, he interviewed 100 of the top retail CEOs in the world and asked them all a single, simple question: "What is it you have done that has had a profound and positive effect on your business?" As he explained to ALI, the answers focused on the intangible over the technical.

"Not one person talked about merchandise or logistics," he said. "They were all interested in the careful stewardship of other people's emotions. That's really where they saw the greatest effort and reward for success."

Mr. Butler pored through his interviews and found that there were 6 "centers of gravity" around which the answers revolved. He used these 6 centers to organize his book, calling them – with what he joked is his

“flair for advertising” – the 6 Secrets to Retail Success.

The 6 secrets/chapters are “Being Chosen,” “Trust,” “People,” “Visionary Thinking,” “Ideas” and “Being Different.” Each chapter is accompanied by illustrative case studies from the 100 CEOs he interviewed, as well as an introduction meditating on that particular value. The style is at once conversational and eloquent, and it is fascinating to get an intimate window into the thinking and experience of so many industry giants. The sum makes it clear that successful retail is, fundamentally, about human communication.

### Chosen Ones

The first chapter, “Being Chosen,” sets the theme for the rest of the book. Mr. Butler explained to ALI that it was the attitude that he detected at the heart of every answer. “The premise of the book is that if you have the mindset that you are in the business of being chosen – not in retail or food, but in the business of being chosen – you will start making different decisions.”

By focusing on being chosen by customers (as well as by employees, as the “People” chapter makes clear), successful companies orient themselves toward the above-mentioned “stewardship of emotions.” Mr. Butler says that the companies who do so tend to be more successful – and that the future of retail is primarily about such emotional engagement and intelligence.

“If someone is running a business and looking for funding or future success,” he told ALI, adopting an investor’s point of view, “I would interrogate him as to what he actually plans to do in terms of emotional connection.”

### The Global Way

Mr. Butler says that North American retailers tend to be ahead of the game when it comes to this new retailing paradigm, followed by Europe. Generally, he finds that retailers in less saturated emerging markets have not advanced as far, and yet there is no essential difference in these markets from an emotional standpoint.

For example, he told ALI an interesting anecdote that also serves as an introduc-

tion to his book. While in South Africa, Mr. Butler visited the Khayelitsha township, a poor area where the South African retailer Pick n Pay had had immense success. When he spoke to its CEO, Nick Badminton, Mr. Butler discovered that Pick n Pay’s emphases in doing business were essentially no different than those of other successful companies in so-called developed markets.

When he asked Mr. Badminton for the secret to his success, Mr. Butler explained, the answer was trust.

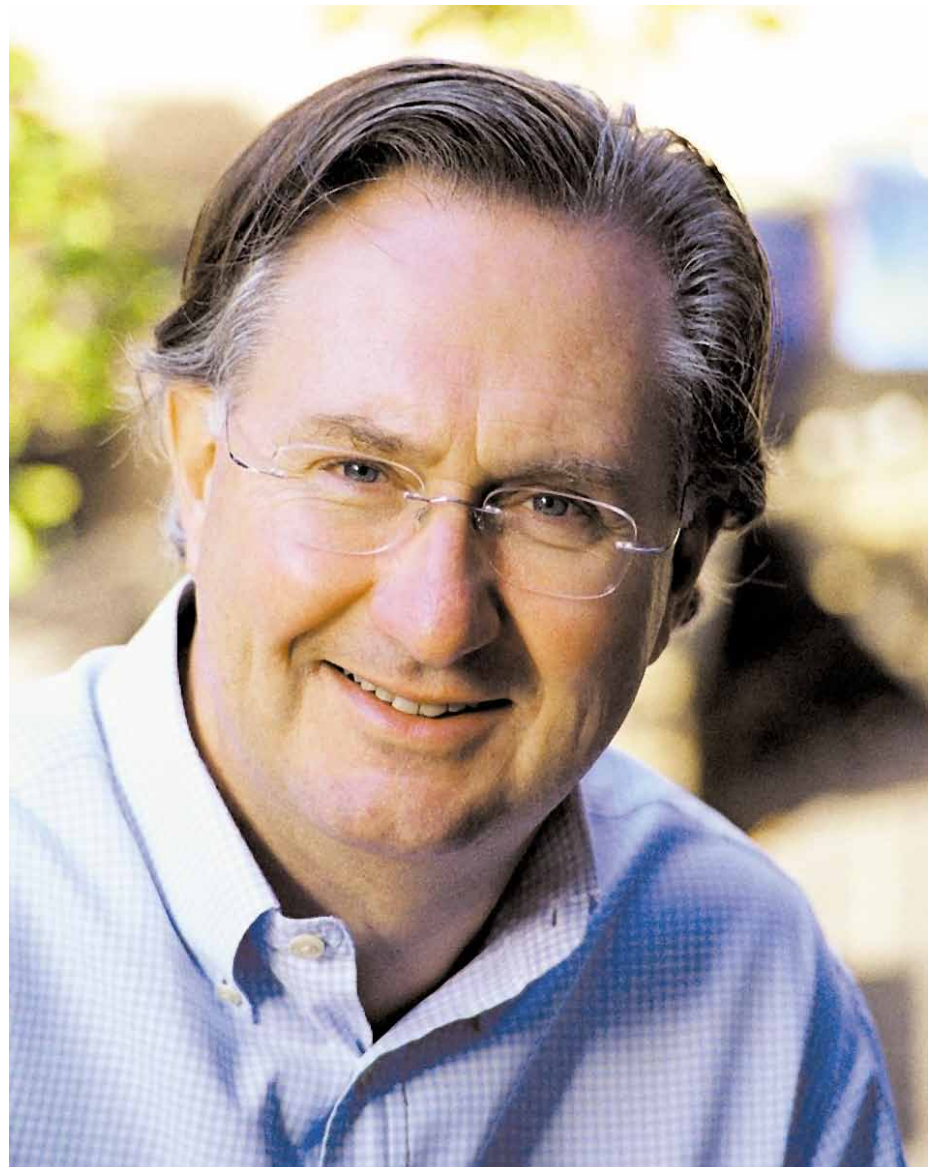
“His store was where they knew they wouldn’t get dysentery from his raw meat. He was affiliated with the radio and the local football team. He knew how to com-

municate with them so that he would be chosen. Essentially the same things that applied to Macy’s applied to his company in the township.”

### Entering New Markets

Mr. Butler also spoke to ALI of the difficulties that North American and European retailers generally have in emerging markets, precisely because of the challenge of connecting emotionally. As an example he gave Walmart, which already has a strong and growing presence in LatAm – though it has not been easy.

“Walmart has actually made a fortune and been incredibly successful by understanding systems for delivering what couldn’t be de-



livered before,” he told ALI. “But they’ve been short on the emotional component that people are now expecting. Most people can get what they want at a pretty good price through the Internet. I think Walmart will have its work cut out keeping up with emotional component of the future of retail.”

For many multinational retailers entering emerging markets, emotional engagement will inevitably mean adaption, something Mr. Butler believes the company Carrefour and its former CEO, Nathaniel Bernard, have done particularly well.

“Nathaniel Bernard said to me that he believed you had to respect and adapt to the local society where you are operating. He and Carrefour have done that to a greater or lesser extent around the world, and it’s essential when you are going into emerging markets. If someone is thinking of moving into an emerging market, the 2 things to understand are the distribution of the stuff you are selling and how you are going to emotionally engage with the local audience.” And yet, Mr. Butler warned, “it’s very difficult to emotionally engage when you are not a local,” and requires toeing a fine line between adapting and maintaining the integrity of one’s company and brand. He cited the case of the ALDO Group International, the Canadian shoe retailer, and its president, Norman Jasolka, who told Mr. Butler that if one’s business has to change more than 15% or 20% to enter a new market, you shouldn’t enter at all.

## Clearings in the Amazon

Mr. Butler hailed Amazon as the primary example of a retailer that, for all its tech-

*Mr. Butler’s book is an excellent primer in the ways businesses can shift their centers of gravity. LatAm retailers and international retailers considering entering the market of this emotionally charged region would do well to read it and reap its common-sense but easily overlooked wisdom.*

nical brilliance, has become dominant because of its emotional intelligence. “They

are the brand that’s keeping all businesses awake, and especially in retail. It has its emotional real estate in everyone’s brain. It hasn’t just retailed, it’s going out of its way to be emotionally precise.” At the same time, however, he agrees with Walmart’s pronouncement that the “future of retail is local.”

“That’s the threat that is affecting retail as we know it,” he said. “I think we’re going to see a renaissance of small corner shops – specialist retail operations where people are known and understood and the offer is very localized. I’m optimistic about the future of the local shop.”

He sees the future, then, as being defined by such emotionally savvy behemoths as Amazon and the local retailers whose true advantage is in their access to customer’s emotions. The key for the latter, he says, is to develop that emotional appeal, instead of flailing in Amazon’s wake.

“Amazon isn’t killing other retailers,” Mr. Butler said. “Other retailers are committing suicide, because they are fighting Amazon on their terms, in their theater, instead of shifting the center gravity.”

Mr. Butler’s book is an excellent primer in the ways a business’s center of gravity can be shifted. LatAm retailers and international retailers considering entering the market of this emotionally charged region would do well to read it and reap its common sense but easily overlooked wisdom.

### Martin L Butler Author and lecturer

Born into retailing, Martin Butler is a true hybrid, part retailer, part marketer and he uses this unique combination to inform his thinking. During a distinguished career in advertising and marketing he has worked with several world-class clients in many international agencies including the Grey, B&B and Saatchi & Saatchi networks. In the 1980s he became one of London’s youngest advertising agency owners by launching his own company, eventually building it into one of the largest privately owned advertising & marketing groups in the UK. He has now sold his companies and spends his time researching, writing and lecturing on global best practice ‘customer service’ as well as running practical workshops - regularly speaking at business schools and international conferences around the world. Books by Martin Butler, ‘People Don’t Buy what You Sell....They Buy What You Stand For’ and ‘The Art of Being Chosen’. For more information, please see [www.martin-butler.com](http://www.martin-butler.com)



# Exporting LatAm Style

## Etiqueta Negra and OndadeMar Expand Abroad

It is no secret that the major trend fueling the LatAm retail sector is the growth of the region's consumer classes. But while much attention has been paid to brands and retailers serving the middle-income population, some investors are turning to high-end luxury brands. These brands cater to upper-income buyers as well the "aspirational" element of the middle segment, and some have the potential to take the leap abroad.

Two prime examples of this trend are Etiqueta Negra, a high-end menswear company from Argentina, and OndadeMar, a classy beachwear company from Colombia. They stand out among other high-end brands in the region for their success not only in solidifying their LatAm presence but in spreading to developed and other emerging markets.

Both companies are owned by Tribeca Asset Management, the largest asset manager in Colombia. Tribeca currently has US\$430 million AUM and 9 portfolio companies across sectors, including healthcare, infrastructure, mining, oil & gas, telecom and fashion retail. Currently the firm is raising a US\$500 million fund to focus on the same sectors, as well as education and clean tech. About half of Tribeca's investors are local LPs, the other half international.

As Felipe Iragorri, an investment director at Tribeca, explains, the firm focuses on growth-phase PE. Etiqueta Negra and OndadeMar illustrate their strategy. In both cases, Tribeca took a company that was small but already had a highly valued brand and expanded it with new business

having been featured on several occasions in the Sports Illustrated Swimsuit Issue, but it had minimal sales and was focused almost exclusively on bikini-style swimsuits. Tribeca changed the business in 2 fundamental ways. First, it expanded OndadeMar's offerings to include women's beachwear and beach accessories of all kinds, summer casual and evening wear, and select men's offerings, as well. The focus is ultimately still on women's swimsuits, but the brand has broadened.

## ETIQUETA NEGRA HOMBRES

lines and markets, including in the US and Europe.

### Beyond the "Swimsuit Issue"

In the case of OndadeMar, Mr. Iragorri says, the company was very well known,

Second, Tribeca expanded OndadeMar into other markets beyond Colombia and opened its own stores. There are now 40 OndadeMar stores in LatAm, as well as stores in US and Dubai. It sells wholesale in the US, Europe and Asia. Mr. Iragorri says the company plans to open several more stores in the US and Colom-

*Etiqueta Negra and OndadeMar stand out among local high-end brands in the region for their ability to solidify their LatAm presence and spread successfully to developed and other emerging markets.*



*OndadeMar Nomad 2013 Cruise Collection*

bia, as well as franchises in Venezuela and Mexico.

“We also want to strengthen wholesale in the US and Europe through boutiques, departments stores and other distributors,” he says. “We probably won’t have our own stores in Europe unless we partner with a very good group. In the Middle East, we are looking to partner with a premium brand group with access to the Turkish market.”

In all, OndadeMar’s sales have grown 6-fold in the last 5 years.

## ■ Exporting a Way of Life

Meanwhile, Etiqueta Negra, already famous in Argentina for its polo style and exquisite stores – making it, in Mr. Iragorri’s words, “practically a way of life” – also expanded geographically under Tribeca’s ownership. Aside from 10 stores in Argentina, it now has a store in New York, 5 in Europe, 1 in Florida and a very successful store in Sao Paulo.

The New York store was the flagship for the brand’s leap abroad. Yet, as Mr. Iragorri explains, some recent economic history spoiled the party. The contract for the New York store was negotiated in March 2008, on the eve of the global financial crisis, and opened that December in the thick of consumer panic and the start of a long malaise.

## ■ Transcending Local Status

Yet despite the underwhelming performance in New York and in some of the European stores throughout that region’s ongoing crisis, Mr. Iragorri emphasizes that having a presence in those developed markets is key for the Etiqueta Negra and OndadeMar brands, as it has created brand awareness in the US and allowed the companies to close new deals in those markets.

“New York was not the success we wanted, but opening there helped us close some deals in Europe and Florida. It became like a showroom, allowing us to find and close some other contracts, and all of those others have been profitable.”

Thus, he explains, most of the 2 companies’ growth has come from the high-growth





emerging markets, but having a presence in the US and Europe was necessary to solidify the brand and transcend its merely local status.

“Our idea has been to bring Latin premium brands to the US and Asia, but since 2008, we’ve focused on expansion in LatAm and Asia, with a footprint in the US and Europe that gives you appeal and proof of concept in these markets. You need to prove your concept in the US and Europe, otherwise you’re just a LatAm brand – and that is what we’ve done. Most markets have been profitable, some have

not, but it’s created the impact we needed for expansion of the brand internationally.”

Mr. Iragorri stresses the dual challenge of having a solid product and concept, both for its appeal to sophisticated customers abroad and to international groups that may be interested in an acquisition. He says that these groups could be luxury-focused or more midmarket groups trying to expand their reach.

“Our idea is to grow these brands and have good enough revenue for luxury groups to

take a look or midmarket foreign groups. There are a lot of groups coming in, and if you’ve proven your concept in the US and Europe, there is a lot of potential for the people who buy this kind of brand.”

He is optimistic about the prospects of luxury brands that are able to prove their product and concept as his companies have. “You will always have premium customers,” he says, “and I believe that luxury will continue to be huge success, especially in these emerging markets that are getting wealthier. Emerging-market buyers like brands that help prove their economic position. It’s about the middle- and upper-middle classes looking for aspirational brands. If you’re aspirational, you’ll have huge success.”

“LatAm isn’t easy,” he says, “but we’ve done it with 2 brands.”

# OndadeMar

ondademar.com

# Kings of Convenience

## Grupo Pegasus Meets the LatAm Consumer's More Sophisticated Demands

**As LatAm's emerging middle class matures, broadens its horizons and aspires upward, its consumer expectations are changing. Convenience, instant gratification and enhanced customer service are migrating to the region from retail cultures abroad. The retailers and brands that are meeting and anticipating these expectations are having the most success.**

“There's clearly been a trend over the last 10 years where the emerging middle class has become more sophisticated,” says Jerónimo Bosch, managing partner at Grupo Pegasus, an investment firm based in Buenos Aires. “We've seen a huge push for certain brands to increase their number of stores and supplies. New concepts and more sophisticated buyer patterns have also come into the market.”

Pegasus specializes in both real estate investment and development and classic private equity, with particular focus on Argentina and Colombia. Both sides of Pegasus' operations have benefitted from the rise of the consumer class and the consequent expansion of retail in the region. On the real estate side, it has developed shopping malls, including a large one in the suburbs of Buenos Aires. While on the PE side it has acquired Freddo, an Argentina artisanal ice cream chain that is among the largest in LatAm, as well as Farmacity, the largest pharmacy chain in Argentina.

Pegasus works with large institutional investors – from the US, Europe, LatAm and Asia – which, Mr. Bosch explains, helps in raising money for large, long-term projects such as shopping mall development.

“Having large institutional investors allows you to build for what's going to happen in the next 3, 5 or 10 years because some of these projects require significant capital and

investment, capitalizing on future trends as to how the cities are growing, how the demand is going to move over time and why.”

### Shopping Spree

In spite of the popularity of malls in Argentina and the rest of LatAm, Mr. Bosch says that there are still huge opportunities. “If you look at shopping mall penetration in the region compared to developed markets and some markets outside LatAm, there's still a huge potential to increase square meters per capita.”

Choosing a location and planning, however, require extensive study and patience. “You need to think 5 or 10 years out at the very least. When you choose a place, you need to study the markets and locate the influenced area you're trying to attack and see why that market needs a mall in that particular place. And it doesn't mean you'll build it and they'll come immediately; generally, you need a ramp-up phase and that could be 2 years, depending on how urban or rural it is.”

In many cases, he says, the best locations for malls are away from the shopping center-saturated neighborhoods. “You start to identify some areas that are underserved compared to others. You don't want to develop one close to an established mall, but there are some areas that have potential, not the typical place where people go all the

time, but 2nd- or 3rd-tier neighborhoods that don't necessarily have an interesting offering today."

For Pegasus in Argentina, the ideal location was just outside Buenos Aires, near the city of Pilar, a middle- and upper-class suburb that has grown substantially during the Argentine boom, quickly developing into a major hub of business in the region.

### At Their Convenience

The success of the Argentine mall and the Farmacity pharmacy chain is due to meeting customers' new needs. "You see it all over LatAm, people that want to consume and have a better experience," Mr. Bosch says.

Those needs revolve largely around convenience and the overall shopping experience. In the case of Farmacity — whose luminous, modern and well-stocked stores are a fixture in most Buenos Aires neighborhoods and elsewhere around the country — Mr. Bosch explains that success is about creating the most convenient and comprehensive shopping experience possible, with increased diversity of products, increased stock, longer hours, better prices for unregulated products and multiple payment options.

"This is the model that has worked in other countries. Convenience and having a great buying experience leads people back into the store," says Mr. Bosch. "We're seeing

*"We've seen a huge push for certain brands to increase their number of stores and supplies. New concepts and more sophisticated buyer patterns have also come into the market."*

— Jerónimo Bosch —

large retail groups, supermarkets and so on, trying to get closer to customers through express stores, stores that are opened longer hours, where they can get whatever they want and don't have to wait. It's instant gratification. The convenience store model is where we're seeing as an interesting trend."

In terms of product selection, Mr. Bosch sees a continued technology trend in the already tech-happy region, and the same trend will continue to affect the shopping experience itself.

"People are getting more accustomed to going online. The quality of connections is better; the security of using your credit card is better now." Bosch notes that while no company has a market share or grip on the public imagination like Amazon, Mercado Libre is clearly the leader. "They've done a huge job, but there are other interesting models that haven't penetrated Argentina as much as other countries like Brazil."

### Virtuous Circle

In spite of some macroeconomic doubts in Argentina and the rest of the region, Mr. Bosch sees the increasing growth in the size, purchasing power and sophistication of the middle classes as a long-term trend.

"Consumption is an area that will continue to grow because there's still a long-term trend having to do with the commodity cycle and food demand from emerging countries. LatAm as a whole has an opportunity to be a provider, and inevitably it is going to receive hard currencies for those goods, and that will flow through the region and continue to be driver of consumption and investment. It's a virtuous circle: that flow of funds creates internal markets, and those markets feed the consumption model."



## CorpBanca and SMU Supermercados Collaborate on an Innovative Consumer Credit Line

# GIVE THEM CREDIT

Chile's mature consumer credit culture allows major retailers there to offer credit lines to its customers more than retailers in most emerging markets. A recent Financial Times special report on LatAm brands featured Falabella, a Chilean department store, showing how that brand has grown steadily in a crowded market largely in virtue of consumer credit offerings.

**N**ow CorpGroup, a Chilean firm run by the entrepreneur Álvaro Saieh, has gone one step further: As the owner of one of Chile's largest banks and one of its most popular supermarket chains, it is pioneering an innovative consumer retail credit line that, in turn, is fueling the bank's steady growth in market share.

"It's a circle," says Claudia Labbé, Manager of Investor Relations at CorpBanca, CorpGroup's private bank asset. "Each part benefits all the others. And it's very different from any other large bank in Chile. No one else has this potential."

CorpBanca, formerly Banco de Concepción, is Chile's oldest private bank and its 4th largest by market share. When CorpGroup bought the bank 15 years ago, however, it was in poor shape, including a large debt owed to the Central Bank, a leftover from the Chilean banking crisis of the 1980s.

Since CorpGroup took over, it has grown from having 4% market share to over 8%, with US\$3.5 billion in market cap – and all of that without the bank's making any acquisitions. "All of its growth has been organic," says Ms. Labbé. "It has grown organically more than any other bank in Chile."

In December of last year, the bank finally initiated its first acquisition by signing an agreement with Banco Santander to acquire all units in Colombia.

Meanwhile, CorpGroup also entered the life insurance, real estate, media and retail sectors. In 2008, they purchased a holding company called Supermercados SMU. SMU owns and operates several brands and formats of supermarket, the largest being the very popular Unimarc. Unimarc is the 3rd largest supermarket chain in Chile, after D&S-Walmart and Cencosud, and ahead of Falabella. It is the largest in terms of number of stores.

“The reason for the acquisition was to boost retail and gain individual business for the bank,” Ms. Labbé says. “All of the acquisitions the group has made have strong potential to allow the bank to increase in the individual sector.”

As Ms. Labbé explains, when the group entered the retail business with CorpBanca’s growth in mind, there was a decision to be made. “Most retail groups have a financial business along with retail business,” she says. “They all have their private brand credit card, and some have grown a lot. CorpGroup believed that this business shouldn’t be done by retail but by the bank itself, because the bank is expert in lending money and assessing client risk. So the Group asked the Chilean superintendent of banks for authorization to create a subsidiary to focus only on consumer credit.”

The superintendent approved, and the result was a joint venture between CorpBanca (51%) and SMU (49%), called SMU Corp. The subsidiary is the only one of its kind in the industry, Ms. Labbé says. “The only thing this company does is issue private label credit cards for SMU, and SMU benefits from being a partner. They give us the clients, and we give the know-how for lending.”

In providing its know-how, CorpBanca chose another innovative route. It was interested in a model that the consumer finance arm of Citibank had used successfully in Chile before merging with Banco de Chile. When Banco de Chile decided not to utilize that model, CorpBanca hired those who were responsible for it at Citibank to spearhead it at CorpBanca.

The model benefits CorpBanca by utilizing a preselection process, she says. “Through the many databases that the bank acquired, we preselect the clients, bring the clients that the bank has already preselected, so the cost of acquisition of a client reduces to half of the cost of the traditional model, and the risk is much lower.”



Once CorpBanca wins these clients through SMU’s retail operations, it can expose them to other offerings at the bank, as well as other CorpGroup products, such as life insurance and residential mortgages. “It’s a business where we can grow a lot in consumer finance. These credit card tickets aren’t large, but we can offer other products. We can also make the clients more loyal because of the benefits we can offer through SMU. The benefits for each client are very customized.”

Indeed, Ms. Labbé says that CorpBanca and SMU are in the process of further integrating the 2 operations, with intention of transforming SMU’s 5,000 supermarket tellers into de facto bank tellers, where customers can cash checks, pay bills, etc.

*As the owner of one of Chile’s largest banks and one of its most popular supermarket chains, CorpGroup is pioneering an innovative consumer retail credit line.*

The result is a win-win situation and no doubt a model for other LatAm markets where consumer credit is beginning to mature.



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# Latin American Art Market

# May 2012 LatAm Sales

**In New York, May was an important month for the LatAm art market, with major auctions at Phillips, Sotheby's and Christie's, the three leading auction houses. Overall, the May sales were inconsistent, with both new records set and high-profile buy-ins of works by some of the most prominent Latin American artists. While Phillips and Sotheby's both hammered in under their presale low estimates, some noteworthy prices for individual artists were realized during the week.**



Recap Provided by Artvest Partners LLC

New records were achieved for individual artists including Roberto Matta (*La revolte des contraires* sold at Christie's for a hammer price of \$4.4 million, \$5 million with premium), Wifredo Lam (*Ídolo* sold at Sotheby's for \$4 million, \$4.6 million with premium), and Jesus Rafael Soto (*Sin título* sold at Sotheby's for \$850,000, \$1 million with premium). The price of Matta's work ranked as the third-highest price paid for a Latin American artist at an international auction, following Rufino Tamayo's *Trovador* (sold for \$7.2 million with premium at Christie's in 2008) and Frida Kahlo's *Roots* (sold for \$5.6 million with premium at Sotheby's in 2006).

Phillips' less than stellar Latin American auction was the first sale of the week. At 39%, the buy-in rate by lot was relatively high, with 66% of lots selling by value. Coming in as the smallest sale of the week, the Phillips evening auction hammered in at almost \$2.9 million, against a presale estimate of \$4.5 million to \$6.3 million. Two lots, 10 and 11, both by Fernando Botero, comprised approximately 31% of the sale's total hammer price. Lot 10, *Reclining Woman with Drapery* (2004), was the sale's top lot, though it hammered in just at its \$600,000 low estimate (\$722,500 with premium).

Sotheby's sale marked the highest-ever results for a Latin American art evening sale for the auction house. In spite of this, the sale hammered in at \$18.2 million, below the presale estimate of \$20.4 million to \$28.4 million. Eighty-two percent of lots sold by volume and 73% by value. Surprisingly, lot 17, Diego Rivera's masterpiece *Niña En Azul y Blanco* (*Retrato de Juanita Rosas a los diez años de edad*) (1939), which was touted as the most significant painting by the artist to appear at auction

for decades, did not find a buyer. With an estimate of \$4 million to \$6 million, the lot stalled at \$3.7 million, below the reserve. It is rumored, though unconfirmed, that negotiations for an after-sale began immediately post-auction. Despite this disappointing result, Sotheby's announced 9 artist records, most notably for Wifredo Lam. Lot 8, Lam's *Ídolo* (*Oya/Divinité de l'air et la mort*) (1944), hammered in at \$4 million, considerably above its presale estimate of \$2 million to \$3 million. It was reported that *Ídolo* was purchased by a South American collector, confirming that Latin Americans compete internationally for masterpieces by their native artists.

The results of Christie's evening auction were the most impressive of the 3 houses, with a total hammer price just above \$19.3 million (within the presale estimate range of \$17.8 million to \$25.5 million). Of 83 lots offered, 69 sold, with a buy-in rate by volume of only 17% and 84% of the sale sold by value. Appearing at auction for the first time, lot 10, Chilean artist Roberto Matta's *La révolte des contraires* (1944), was the



Lot 26  
Latin American Sale  
New York Rockefeller Plaza  
22 May, 2012- 23 May, 2012  
Claudio Bravo (Chilean 1936-2011)  
*Psalterium*  
signed and dated 'CLAUDIO BRAVO, MCMXCVIII' (lower right)  
oil on canvas  
78½ x 59 in. (199.4 x 150 cm.)  
Painted in 1998  
Estimate: US\$800,000-\$1.2 million  
Price Realized: US\$1,142,500  
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Lot 31

Latin American Sale

New York, Rockefeller Plaza

22 May, 2012 – 23 May, 2012

Sale # 2563

Fernando Botero (Colombian b. 1932)

*The Street*

signed and dated 'Botero 95' (lower right)

oil on canvas

59 x 44 in. (150 x 111.8 cm.)

Painted in 1995

Estimate: US\$600,000-\$800,000

Price Realized: US\$1,426,500

CHRISTIE'S IMAGES LTD. 2012

Lot 10

Latin American Sale

New York, Rockefeller Plaza

22 May 2012- 23 May 2012

Sale # 2563

Matta (Chilean 1911-2002)

*La révolte des contraires*

inscribed 'Revolte des contraires' (on the reverse)

oil on canvas

38 x 50 in. (96.5 x 127 cm.)

Painted in 1944

Estimate: US\$1.8 million-\$2.5 million

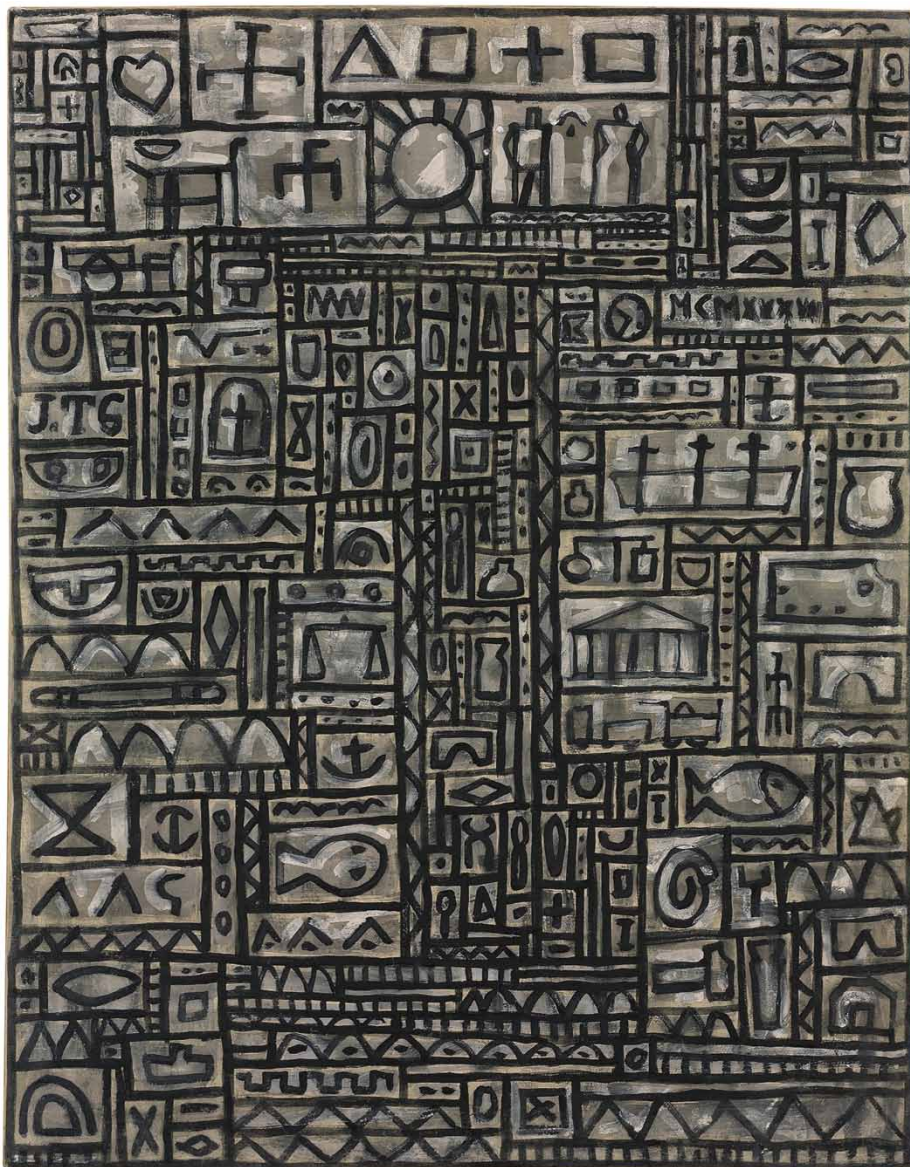
Price Realized: \$5,010,500

CHRISTIE'S IMAGES LTD. 2012

highlight of the sale, achieving a hammer price of \$4.4 million, against a presale estimate of \$1.8 million to \$2.5 million. Matta was also a highlight of the Latin American sales last November, when *Lisgard du Medi* (1953) sold at Sotheby's for a hammer price of \$470,000, against an estimate of \$350,000 to \$450,000. In addition to Matta's new record, Christie's announced records for Candido Portinari (Brazilian), Emilio Pettoruti (Argentinian), and Carlos Cruz-Diez (Venezuelan). Notably, works by Brazilian artists were 100% sold, confirming Artvest's commentary on the November sales, which noted increasingly strong national and international interest in Brazilian art.

As a considerable number of Botero works appeared during this sale season, Artvest took a closer look at the artist's results. While *Reclining Woman with Drapery* was the top lot in Phillips' sale, results for the artist were less impressive during the rest of the week, even though he is currently being honored by a major retrospective at the Palace of Fine Arts in Mexico City. Across the 3 houses, 27 works by the Colombian artist were offered during the evening sales





(compared to just 18 works in the November sales), but only 59% of these works sold, whereas 78% found buyers in the fall. Of the 16 Botero works that did find buyers, a mere 5 managed to exceed their high estimates (31%). This continues a trend Artvest noticed in the fall, when Christie's top Botero lot, *Dancers* (2007), disappointed by selling for just \$1.5 million, at the low end of its presale estimate, despite setting a new auction record for a sculpture by the artist.

On the whole, Artvest upholds its analysis of the Latin American art market published in *Alternative Latin Investor* late last year. While interest in the sector is growing, there is still a supply/demand imbalance. This oversupply of quality property allows collectors to purchase first-rate works of art at reasonable prices. Artvest will continue to track trends in the Latin American art market and will next report on auction results in November 2012.



Lot 16  
*Latin American Sale*  
*New York, Rockefeller Plaza*  
*22 May 2012- 23 May 2012*  
*Sale # 2563*  
*Joaquín Torres-García (Uruguayan 1874-1949)*  
*Grafismo universal sobre fondo gris*  
*signed 'J.T.G.' (center left) and dated 'MCMXXXVII' (upper right quadrant)*  
*tempera on board laid on panel*  
*39 5/8 x 31 5/8 in. (100.6 x 80.3 cm.)*  
*Painted in 1937*  
*Estimate: US\$1 million-\$1.5 million*  
*Price Realized: US\$1,426,500*  
*CHRISTIE'S IMAGES LTD. 2012*

Lot 8  
*Wifredo Lam*  
*Ídolo (Oya/Divinité de bair et de la mort)*  
*signed and dated 1944 lower left*  
*oil on canvas*  
*63 by 50 in.*  
*Estimate: US\$2 million-\$3 million*  
*Sold for US\$4,562,500*

#### About Artvest

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.

While Argentina may be doomed to ignore the lessons of history and again plunge into recession or even economic free fall, investors are not obliged to follow blindly. For investors focused on the consumer products segment, previous crises offer ample clues to how consumers may behave in future crises. Understanding these clues will be critical to crafting an effective strategy for mitigating risk and capturing opportunity in the consumer space should Argentina again march over the precipice.

# Argentina ■ Clinton Carter

## Consumer

## Crisis

## Redux

### *Lessons from History to Inform Investment Today*

Frontier Strategy Group works primarily with large multi-nationals operating and expanding in emerging markets. In an effort to inform strategy for clients with exposure to the consumer segment in Argentina, Frontier Strategy Group shared insights gleaned from experts and leading executives who weathered the past 2 crises in the country, namely the hyper-

inflation of the 1980s and the 2001 debt default and ensuing chaos. While the macroeconomic imbalances that precipitated those crises are different than those driving the country toward recession now, the conditions they produced for the average Argentine consumer could be similar: loss of purchasing power, evaporation of savings, inflation, shortages of goods and unemployment.

Faced with these conditions in past crises, Argentine consumers responded with dramatic purchasing changes as well as lifestyle alterations and increased reliance on community. Practically speaking, this meant consumers reduced consumption of food and non-food consumer staples, substituted regular brands with cheaper alternatives, switched to cheaper transportation options, and were forced to prioritize between food and non-food consumer staples and other essentials such as medicines. Some significant lifestyle changes included consumers moving back from big cities to rural areas, home production of food, selling belongings, living off savings, and sharing housing and resources with many more members of family and community.

For retailers and consumer products companies, the impact of these changes were felt broadly in lower volumes and a massive drop in demand. A more nuanced view, however, suggests some consumer goods brands and retailers were impacted more than others. Some important trends emerged that penalized some and rewarded others. For example, hypermarkets and supermarkets fared poorly in comparison to small, independent grocery stores for several reasons:

- Large-format stores are often located far away, requiring a car, which involved extra fuel costs. There was a significant reduction in automobile usage and an increase in walking and public transport usage for purchases.
- Consumers believed that they could no longer afford larger to-

tals spent that they associated with trips to hypermarkets and modern retailers, regardless of the per-unit costs of goods.

- Consumers felt ashamed asking for smaller product sizes in supermarkets.
- During previous crises, modern retail was largely unable or unwilling to offer credit to consumers. In local corner stores and small, independent markets, personal relationships with consumers allowed the informal extension of credit as a sort of “virtual wallet” in which consumers might have a week to clear the debt. In a small community store, the entire neighborhood is aware of outstanding debts to the local grocer, a social hedge against default risk.

These are just a few of the specific trends that favored certain retail formats over others during past crises in Argentina. Some of these pat-

terns are likely to be repeated and offer insight into a proper response strategy from retailers and consumer goods and food companies:

- Retail chains with a variety of store formats are likely to weather the storm better. Smaller stores embedded in neighborhoods will have an advantage over mega stores located far from consumer concentrations.
- Flexibility with package sizing will be rewarded. This applies to both bulk offerings for shoppers pooling resources to buy large size offerings as well as individual consumers looking to buy single serving or smaller portions of products.
- Credit innovations are key. Stores with the ability to offer some form of credit to consumers will maintain their loyalty over those who cannot.



For investors parsing the tea leaves as to who will be winners and losers in the consumer sphere, history suggests that examining companies through the lenses of store format, packaging flexibility and credit innovation are key. Does a retailer have stores that will be easy and affordable to access in a crisis? Do goods providers have the ability to change packaging and product sizing quickly and at a

local level? Does a retailer or goods manufacturer have the existing infrastructure to evaluate and extend credit to consumers?

Many investors will likely head for the exits as Argentina's economic climate worsens. Yet sophisticated investors may recall the lessons from the past and capitalize on opportunities amidst the chaos.

#### Author Biography

Clinton Carter is Frontier Strategy Group's Associate Vice President of Research for Latin America. Previously, Clinton was FSG's Director of Market Intelligence, focused on qualitative research and business strategy across emerging markets. Prior to joining FSG, he was a consultant in the Middle East and Central Asia with Dubai-based Altai Consulting. He also worked as an analyst for the US Department of State and served as a fellow at the Brazilian Institute of Education in Sustainable Development in São Paulo, Brazil.

Clinton speaks Spanish and Portuguese. He attended Washington and Lee University and La Universidad Autónoma de Guadalajara, Mexico, and holds an M.A. in International Relations and Economics from Johns Hopkins University – SAIS.



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# BRAZIL'S CLO FIRE SALE

■ Tom Kadala



Last year, when Brazil's second largest bank, ITAU Unibanco, sold R\$400 million (US\$200 million) of bundled corporate loans (technically referred to as CLOs, or collateralized loan obligations) to foreign investors, the news media viewed the move as a signal that Brazil's lending capacity was drying up. Like a business that sells its receivables to raise cash quickly, Brazilian banks were replenishing their lending capacity by selling their attractive loan portfolios at a discount to foreign investors. To date, sales of CLOs have been brisk, exceeding R\$50 billion (US\$25 billion). Should investors be concerned that Brazilian banks might be unloading their inventory of corporate loans to avoid a liquidity crisis? If not, what is really going on?

## Could a Seemingly Desperate Move Be a Shrewd Stroke of Brilliance?

Brazil's commercial and industrial backbone consists of over 14,000 mid-cap companies ranging in sales from US\$30 million to US\$200 million. These companies are mostly privately held, which makes buying and selling equity shares for foreign investors more challenging. Funding resources for these companies are limited, and the Brazilian government believes that the bulk of financing for these mid-cap companies, going forward, will have to come from outside sources.

For these and other reasons, the Brazilian government has deliberately used the sale of its double-digit interest rate CLOs, ranging between 12% and 16% per year, to entice hedge funds, private equity firms and investment banks worldwide to consider Brazil as their next port of call.

Compared to the 1% and 2% returns earned back home, it is no surprise that these CLO sales have generated a strong buying demand from foreign investors. Brazil banking authorities hope that these transactions will catalyze a comprehensive consolidation of its mid-cap companies through cross-border mergers and acquisitions activities.

In preparation to receive foreign investors, Brazilian companies have started to hire professionally trained management teams. Their CEOs realize that unless they conform to internationally accepted best practices, their firms could either miss out on a huge funding opportunity or be left behind. It is not up to foreign investors individually to decide where their funds can be invested but rather their shareholders who, by design, require sound investments that include third-party auditing, financial transparency and evidence of proper governance practices.

## ■ The Case of Hering

At a breakfast meeting early this year entitled "Brazil Investment Management," sponsored by the Brazilian-American Chamber of Commerce, a distinguished panel of experts shared their thoughts on viable approaches for Brazilian investments. One of the panelists, Pedro Soares from Eurovest S.A., highlighted one of his company's success stories: the Brazilian clothing manufacturer Hering. By restructuring

its high-interest debt and installing a professional management team, Eurovest unleashed Hering's true growth potential from an initial valuation of US\$50 million to that of a public company currently valued at US\$7.5 billion.

Hering's huge success was in large part attributed to Brazil's growing domestic market, which included over 40 million new consumers that had been lifted from poverty and could afford to buy beyond their basic needs. However, without the organizational

*Brazilian banks have sought out the assistance of foreign investors by selling them their prized portfolio of loans, or CLOs. They promote these high-interest investments as "sure bets," since the government's overall strategy is hinging on its success at attracting more direct investments. Should foreign investors be concerned?*

and financial structural changes spearheaded by Eurovest, Hering could never have achieved this incredible milestone.

Eurovest's success story prompts the following 2 questions: (1) How many more "Hering-like" potential success stories are hidden within Brazil's 14,000 mid-cap firms? (The answer, mostly likely, is a good number.) (2) If potential profits are so readily available in Brazil, why would Brazilian banks be so eager to sell their loan portfolios to foreign investors?

Central to the answers to both questions is Brazil's antiquated and neglected infrastructure, followed by 2 Brazilian nuances that investors should heed.

## ■ Brazil's Infrastructure

It is no secret that Brazil's infrastructure, including highways, airports, railroads and shipping terminals, is vastly inadequate to support its rapidly growing commercial base. Very often the cost of transporting goods from the interior of the country to a nearby port is greater than moving the goods from a port to its intended destination (i.e., China or US).

Building a new highway, for example, is an immense project that not only can take a long time to complete (30-40 years) but also can tie up capital funding that otherwise could be used elsewhere to help grow the economy. However, one cannot exist without the other, and that illustrates Brazil's current dilemma. If Brazilian banks extend credit to the private sector without investing in the country's infrastructure, the higher cost associated with transporting finished goods and workers throughout Brazil would eventually hurt their exports by making their products too expensive and hence less competitive to global markets. On the other hand, if Brazilian banks neglect the private sector's financial needs, good companies will fail, which in turn would increase unemployment and hurt the overall economy. As part of an optimal response to this dilemma, Brazilian banks have sought out the assistance of foreign investors by selling them their prized portfolio of loans, or CLOs. They promote these high-interest investments as "sure bets," since the government's overall strategy is hinging on its success at attracting more direct investments. Should foreign investors be concerned? And what Brazilian nuances should they take into consideration?

## ■ Local Knowledge Premiums

At the Brazilian breakfast panel meeting, a representative from Triunfo Participacoes e Investimentos, Sandro Lima, proudly announced his firm's 3 recent concession awards, which included the Campinas Airport near Sao Paulo (soon to be the largest airport in LatAm), 2 hydroelectric power plants with a combined total of 300 MW capacity, and a container terminal port. When asked what business the firm was in, since all 3 concessions were vastly different from a business model perspective, Mr. Lima explained that Triunfo's core business was not managing construction projects but rather

navigating the Brazilian government's network of officials to secure these concessions. Although there is nothing wrong with leveraging 30 years of government relationships to gain access to lucrative contracts, investors might have good reason to question the company's ability to deliver an economically crucial project on time and on budget.

As Triunfo's example shows, being "well connected" in Brazil is a key consideration for succeeding in business, so much so that Brazilian firms with market shares larger than 80% are considered more valuable by Brazilian brokers and usually priced at a premium above and beyond their normal valuations. On paper this rationale may make perfect sense, but Brazilian sellers may discover a tepid response from foreign buyers. Dominant players from emerging technologies usually involve family-run businesses that may not have earned their dominant position through free market competition but rather from strong-arm tactics. Smaller players with more agile technologies and better aligned management teams will be seen as the more likely disrupters and hence better investments. One might expect that this arbitrage will self-correct as more investors purchase mid-cap winners such as Hering who over time can be expected to take market share from the "overpriced" dominant firms in their respective industries.

## Extended Tax Liabilities

CLOs may look attractive on paper to foreign investors, but when matched to the balance sheets of the companies these loans represent, the advantages may start to look fuzzy to the financially astute. At the meeting, panelist explained that over 90% of Brazilian individuals and company taxpayers today openly hold a past due tax liability with the government. In some cases the amounts in arrears are staggering and could cause great alarm with any investor group not in "the know." As it turns out, those that choose to pay their tax bill hire specialized firms to negotiate with tax collectors. That may appear similar to a developed country such as the US; however, the negotiating leverage falls largely on the taxpayer, who can decide either to postpone payment to the government for another 20 to 30 years at will or to pay a significantly smaller settlement. Some

## Author Biography

Mr. Kadala is an internationally recognized writer, speaker, and facilitator on topics that concern CEO's and political leaders. He is well-versed in economics, engineering, technology, finance, and marketing. His views are regularly published by prominent industry publications and also distributed to an exclusive list of contacts, most of whom he has met personally during his 20+ year tenure as the founder & CEO of Alternative Technology Corporation (ATC, Inc.). He earned a Bachelor in Science in Civil & Environmental Engineering from Cornell University and an MBA with a concentration in Finance from the Harvard Business School.



Mr. Kadala's ability to communicate complex issues to a wide range of audiences in writing or in person (English or Spanish) has won him a favorable reputation among his peers as someone who is "not afraid to tackle tough global issues". Most recently, Mr. Kadala developed a facilitated discussion format called Business Model Innovations or BMI's that was implemented successfully at the United Nations on renewable energy investments strategies for developing countries.

For more details on the BMI process, please visit [www.ResearchPAYS.net](http://www.ResearchPAYS.net)

firms go as far as capitalizing their debt using clever accounting maneuvers.

Humored by the panel's relaxed attitude toward the importance of paying their back taxes, I wondered if the Brazilian taxpayer's past experience with hyper-inflation between 1980 and 1994 had forced the government to overtax as a means of keeping its public sector payrolls funded. Now that the Brazilian currency is stable and inflation under control, the supposed brazen attitude of tax collectors during the hyper-inflation era may have created a sense of animosity among taxpayers.

There is an interesting irony to this story. Due to a recent turn of events, Brazil's tax authorities may win out after all. Brazilians who became accustomed to not paying their "inflated" taxes are now being forced to comply, not because the Brazilian government has clamped down on tax evaders, but rather because firms like Hering would otherwise not get funded by foreign investors who are required by their board of directors to invest in companies that pay their taxes in full.

## A Brilliant Move

Not to be underestimated, the Brazilian authorities know that they must focus on the large and less attractive public investments in order to modernize their current infrastructure. Luring foreign investors with high interest rate CLOs has helped gain the attention and commitment of global fund managers to meet Brazil's pressing mid-cap company needs. At least for now, these foreign investors will bring the contacts and expertise needed to sift through Brazil's rich inventory of 14,000 mid-cap companies and select the Hering-like winners that could one day qualify for a listing on Brazil's Bovespa Stock Exchange.

In retrospect the Brazilian fire sale of CLOs had nothing to do with a crisis of liquidity and everything to do with a renewed set of government priorities, based on an optimal allocation of global resources. Brazil's banking strategy is not only shrewd but brilliant.

**B**razil produces a good part of the software consumed here. But the importation of computed programs or managerial systems is also common. This article will describe how those imports are taxed in Brazil. It focuses on the importation by the end user and will not detail taxation over distributor or master licensees.

## ■ Importation of Tailor-Made Software and Off-the-Shelf Software

When it comes to software importation, taxation will depend on the nature of the software. As in the rest of world, software in Brazil can be classified either as an off-the-shelf program — that is, a software that is not specifically designed for a customer's requirements — or as a custom made software, designed for a specific client, according to its needs.

Off the shelf software is classified as regular merchandise, and is subject to the same taxes as any other product: Import Tax, IPI (industrialized products tax), PIS Importação, COFINS Importação and ICMS (state VAT). All duties are collected when the product is cleared at customs.

After some debate, both the courts and the Federal Revenue Service understand that off the shelf software shall be treated as if medium and program were a single unit. This means the duties will be assessed over the aggregate value of the software plus the value of its medium. That is, the price of the software and the price of the DVD or pen drive that contains it.

The treatment of off-the-shelf software as regular merchandise is valid even for software imported through download, without any material medium. This situation stirred debate a few years ago, but is now pacified.

On the other hand, tailor-made software has been understood by Brazilian courts as a special kind of service. Thus, it is taxed as services are. Instead of collecting Import Tax and IPI, it is taxed by the federal income tax. Instead of paying state VAT, it is taxed by the city tax on services (ISSQN, or simply ISS). Both social contributions (Pis-Importação and Cofins-Importação) are still applicable.

**As Brazil watches the growth and professionalization of the retail industry, especially regarding big players such as supermarket chains and drugstores, a second phenomenon can also be noticed: the use of management, ERP, logistics and financial software is also growing. The reasons are many, but above all are the need for gains of scale and efficiency.**

# Software Importation by End Users in Brazil

## ■ Adler Martins

Finally, technical services are subject to a special contribution called CIDE, which is very similar to the income tax.

Another difference is that taxes must be collected when the payment is made to the service provider. There is no need for customs clearance.

One should also notice that, if the service provider (the software developer or seller) is located in a country with which Brazil maintains a non-double taxation agreement, the payment of the income tax in Brazil may be eliminated. More on that later.

## ■ Actual Taxation of Off-the-Shelf Software

Off-the-shelf programs are taxed as any other commodity. As a general rule, this kind of product is classified under subchapter 85.23 or 85.24 (media for recording) of the Harmonized System, even if the importation is made via download, without the actual physical media.

As cover the taxation in detail is beyond this article's scope, it suffices to say that the final price in Brazil, after applying all import duties, could easily reach about 1.85 to 1.93 times the FOB price, considering importation through a hard medium.

If importation is made through download, the lack of international freight, insurance and customs brokerage costs might reduce this ratio to 1.80 times the FOB price.

## Custom-Made Software

Tailor-made software is regarded as a special kind of service. Its taxation is outlined below:

|                                               |         |
|-----------------------------------------------|---------|
| IRRF (Income Tax)                             | 15%*    |
| CIDE                                          | 10%     |
| PIS/Importação                                | 1.65%** |
| Cofins/Importação                             | 7.6%**  |
| ISSQn (Service Tax)                           | 5%***   |
| IOF (Tax on the exchange of foreign currency) | 0.38%   |

\*In case of payments made to tax havens, taxation will be 25%.

\*\*Both PIS-Importação and Cofins-Importação are calculated over the software value, plus the ISS, plus the value of PIS and Cofins themselves (calculation on the inside). In consequence of this, the final value due is superior to the percentage indicated here. The Brazilian Revenue Service has published a mathematical formula that defines the right way to calculate them.

\*\*\*Service tax varies according to each city. It may be anywhere between 2% and 5%.

After due calculation, taxes above will amount to about 42% of the software value. That is, the final cost for the end user would be about 1.42 times the original price.

Please notice that the purchase of software developed in Brazil is subject to a taxation of about 8% (factor of 1.08 the original price). This reflects the Brazilian policy of favoring foreign direct investment instead of importation.

It is important to highlight that, if the custom made software is imported through a physical medium, such as a CD, then it must be subject to clearance at customs. Also, the physical medium will be subject to import duties, calculated solely on the value of such medium (e.g. a \$2 CD-ROM).

Although the taxation of the physical medium is negligible, the procedures to obtain clearance are troublesome and demand specialized help. Therefore, the use of download is recommended.

If the end user gets access to the source code, and does not just acquire a license to use the software, the operation may be considered as transference of technology that must be filed before the Brazilian Institute of Intellectual Property (INPI).

Federal courts have recently decided that payments remitted abroad for the payment of services rendered by foreigners shall be exempted from income tax, as long as the supplier is located in a country that keeps tax treaties with Brazil, and provided that the foreign supplier does not keep any permanent business establishment in Brazil.

Unfortunately, the Federal Revenue Service has not updated its policies to reflect the federal rulings. This means that, more often than not, the importer will have to collect the income tax and request a refund later, either before the Revenue Service or before a federal court.

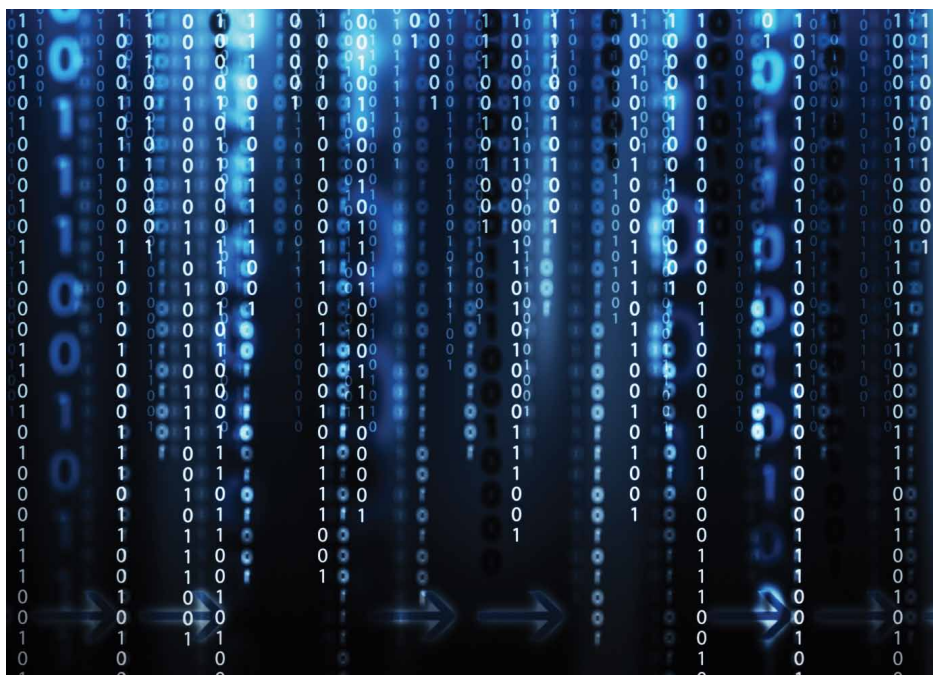
In spite of the trouble, the economy of 15% usually makes it worthwhile pursuing the lawsuit.

## Author Biography

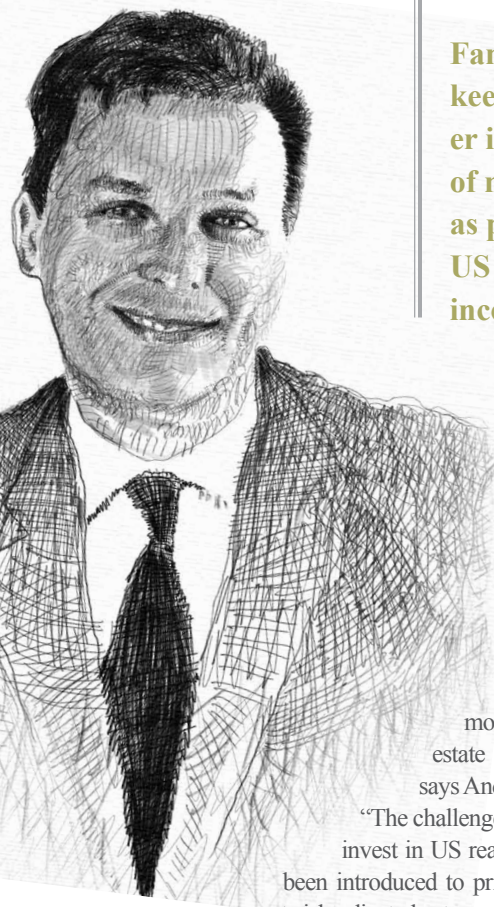
Adler Martins is a law graduate from one of Brazil's top law schools, The Federal University of Minas Gerais (UFMG). He is also an MBA by Fundação Getúlio Vargas. He is presently attending master's course credits (LLM) at Pontifical Catholic University of Minas Gerais and a post-graduation course in financial planning at São Paulo City University. He can speak English, Spanish, Portuguese, German and some Chinese (Mandarin). Adler has professional experience in Argentina, Mexico, India, England, China and Dubai, aside from extensive experience in Brazil.

He is the co-founder of UFMG's group on the study of International Trade Law (GEDICI) and has represented UFMG at the Vis Arbitration Moot, in Austria. He is also a pioneer in legal research of contracts between Brazil, Russia, India and China.

Mr. Adler has lectured on foreign investment regulation in Brazil to audiences in Brazil and India. Recently, he lectured about Brazilian import regulations at the E-commerce Expo 2011 in London, as a guest speaker. Currently, he works advising companies and entrepreneurs on doing business in Brazil.



ALI Speaks with  
Andrés Szita,  
Chairman of  
Ethika Investments



# U.S. Real Estate: Seizing the Day

**Family offices and high-net-worth individuals from LatAm traditionally keep a portion of their assets in the US for diversification purposes, whether in savings accounts, equity shares or in real estate holdings in the case of more sophisticated investors. Real estate is particularly attractive now, as post-recession prices are at historical lows and renewed growth in select US markets is progressively creating an opportunistic window to acquire income-producing properties.**

**E**thika Investments, a US-based real estate investment firm, originally founded to serve Latin Americans wanting to invest in US real estate, provides access to a unique platform for investors around the world. “We see more and more interest in real estate from LatAm family offices,” says Andrés Szita, Ethika’s Chairman.

“The challenge is not that they don’t want to invest in US real estate, but that they haven’t been introduced to prime opportunities with greatest risk-adjusted returns. So a company such as ours, with an on-the-ground understanding of the market and a proven track record, is a perfect vehicle for them,” he adds.

Ethika invests in real estate assets that require an average of US\$5 million to US\$20 million of equity capital for a total capitalization of US\$20 million to US\$75 million; relatively low levels that the company believes are attractive to LatAm family offices. Specializing in income-producing properties with attractive risk-adjusted returns, Ethika has maintained its focus on the hospitality and office sectors, where it can implement its strategy of acquiring assets opportunistically. Then, Ethika applies a series of value-adding techniques to deliver high returns.

## Where It’s At

There are tremendous opportunities in certain areas of the US after what Mr. Szita calls the “biggest correction in the real estate market in decades. Every seven years (more or less), you have a correction

in real estate, but without a doubt, the correction in 2009 and 2010 was probably the strongest one since the Depression, or at least the 1970s.” Seizing these opportunities, he says, is a question of timing, targeting select asset classes and moving into the right markets.

Many off-radar markets, he says, are not familiar to LatAm investors. “Majority of investors from LatAm that have attempted to invest in the US have been drawn to Miami due to similarities in culture. However, they can solidify a more prudent investment position by expanding their reach. There are many other markets within the US that have valuable drivers.”

Ethika generally invests in top metropolitan areas that exhibit attractive employment and growth prospects, such as San Francisco, which is currently riding a tech boom, but avoids markets with minimal upside such as New York, which Mr. Szita points out was virtually untouched by the recession.

As an example of an attractive, value-add market, Mr. Szita gives Pittsburgh, which is experiencing job growth due to the fact that one of the largest deposits of natural gas in the US was found in layers of underground rock throughout the region called the Marcellus Shale. “Pittsburgh hasn’t always been known for its strength in the market, but now that they’ve found the shale reserve, business is booming there,” he says.

“Parts of California, Texas, and many other top metropolitan areas are growing as well,” he says. “Even the Miami-Dade area reported median sale prices of condominiums rising over 40% in February 2012 year-over-year. This after Miami was saturated by over eager investors before the crisis, who faced the “condo bust” during the correction period. There is positive traction again in hospitality and office as well. Leading research companies are projecting mid-single digit RevPAR gains and 17% increase in hotel values in 2012

and 2013 for hospitality. Office vacancy rates dropped to 17.4% in the first quarter of 2012, the lowest level since 2009. “Ultimately, it’s essential to treat markets distinctly because each has its own unique drivers,” Szita says.

## ■ Off the Beaten Path

Mr. Szita further explains that Ethika not only explores high-barrier-to-entry markets with growth potential, but slightly off-radar areas within major markets, where an asset may have less iconic status but be a more attractive investment alternative resulting in greater returns for investors.

“Typically real estate funds require \$50 million to invest in an asset and you end up acquiring assets with low returns, 4 to 6 caps,” he says. “We are focusing on assets that project 8 plus caps. We have a building in San Francisco, for instance, not on the Bay, but on Market Street, which is in the Civic Center submarket near the financial district. It’s not a core, AAA asset but is a high quality asset in a great location with an attractive rent roll that will generate substantially higher returns. From an investment point of view, our strategy of tactically investing in opportunistic real estate assets can achieve higher risk-adjusted returns.”

## ■ The Right Kind of Asset

Along with finding the right markets within the US, Mr. Szita says investors are wise to seek certain asset types in the current environment. “Ideally, those that can be bought at historical lows and generate income, with the greatest opportunities found in the office and hotel sectors. Hotels experienced a significant decline in value during the correction period, creating great opportunity to buy at bottom levels.” He adds that hotels are particularly attractive because they are able to generate revenue expansion more rapidly during periods of economic growth, and full-service hotels especially are making an important comeback.

There are also opportunities to buy office buildings freed up in the wake of the downturn, he says. “High unemployment meant employers needed less space for their employees and that resulted in vacancies. Now there is a great opportunity to buy office buildings as employment levels begin to increase.”

Mr. Szita states that “land was the number one type of distressed property during the correction and is still a challenging investment in the current real estate market, as it’s not inherently income-producing and there are limited construction loans at the moment. Retail has also been hit hard but there are interesting, select opportunities in that sector.”

## ■ Bad Apples Turned Good

Ethika is currently making opportunistic acquisitions that were over-leveraged during the correction and are going back to market because, as he notes, leverage balloons after 5 years. “Commercial mortgage-backed securities (CMBS) loans were very popular during the past boom in US real estate,” Mr. Szita explains, referring

to the bond-like vehicle that mortgage lenders in the US utilized to sell debt to third parties.

“Many of these properties have loans that are coming due, yet assets have suffered on the revenue side and their debt coverage ratios have deteriorated. In many cases, the asset is worth less than when the loan was made, and so they can only support less debt. Meaning the assets are going back to the lender, who are either refinancing with current borrowers or selling off the assets. This presents a great opportunity for companies such as ours who have good connections in the market to acquire properties at prices below their historical basis.”

He stresses that, in such situations, it was the previous debt that was aggressive, not the asset itself. “The asset is healthy again. The asset never changed, it was just a reset of the leverage. It means the bank will either lose money or the equity is gone, but the bottom line is that you’re buying a healthy asset at a reset basis. One of the most important things to bear in mind when making a real estate investment is the level of leverage related to potential swings in revenue; it’s essential to be able to meet the debt-coverage ratio.”

“If you are putting your asset in an over-leveraged position and income goes down,” Mr. Szita warns, “you’ll face problems. But if you keep debt healthy enough to boost returns while understanding that it can go up and down, then the debt is healthy.”

## ■ Home Style

Ethika maintains relationships with numerous LatAm family offices and high-net-worth individual investors, with many referred by those who have already invested with the company, but is also expanding and working with institutional capital from the US and Middle East. Mr. Szita says that these LatAm investors are attracted to Ethika Investments because it is a boutique firm that provides personalized, one-on-one communication, yet operates in an institutional manner.

“The investor feels closer to the asset but receives corporate reporting, which creates the confidence that their resources are in good hands,” he says. The company is audited by Ernst & Young, and the J.P. Morgan Private Equity Fund Services Group serves as its administrator.

“Investors are also attracted to the solidity and permanence of virile real estate assets, compared to the volatility they encounter in other investment outlets,” he says. “When you invest in shares or derivatives, their value is more unstable, but with real estate, your value is tangible. Louis the XVI was the last monarch of Versailles, but it still stands today. The ancient Egyptians are gone, but the pyramids are still there. Good real estate is solid. It remains.”

# Brazilian Internet

## and Online Advertising Investment

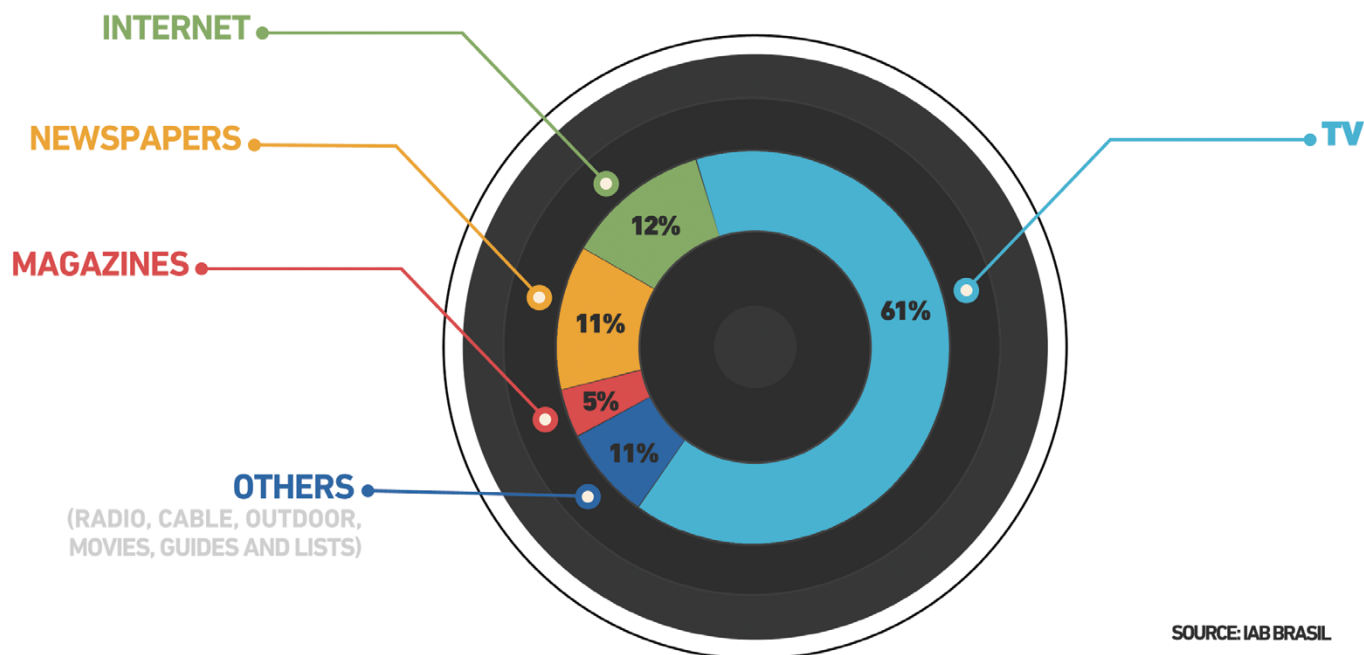
Recently Brazilians heard the news from IAB Brazil that the Internet will soon be the 2nd largest advertising medium – behind only broadcast TV and ahead of cable TV, newspapers and magazines. Beyond numbers, this shows that advertisers and brands need to adapt to the trends of an increasingly digital and connected market.

■ Pedro Filizzola

Besides being where people now spend most of their time, the online world brings great benefits when it comes to advertising, such as targeting and measurement. If we add interactivity to these characteristics, the format that comes into our heads can only be video. In Brazil, almost 40% of the pop-

ulation watches online videos. These users are consuming content no longer predetermined by traditional TV.

Following up on this trend, more and more ad agencies are exploring this medium to get a better return on investment. Betting on the saying “video or die” and following



## ONLINE VIDEO IN NUMBERS

IN 2016, ONLINE VIDEO WILL REPRESENT **54%** OF ALL INTERNET TRAFFIC **IN THE WORLD**.

**LATIN AMERICA** IS THE REGION THAT WILL PRESENT THE **2ND HIGHEST** GROWTH IN VIDEO TRAFFIC IN THE WORLD WITH **59%** PER YEAR.

**BRAZIL** IS ONE OF THE LEADING COUNTRIES WHEN IT COMES TO CONSUMPTION OF AUDIOVISUAL CONTENT. **83% OF BRAZILIANS** WATCH ONLINE VIDEOS.

IN DECEMBER 2011, BRAZILIANS VIEWED **4.7 BILLION VIDEOS**, AN INCREASE OF **74% OVER** THE SAME PERIOD LAST YEAR.

SOURCE: COMSCORE, CISCO.



**70%** OF ADVERTISERS PLAN TO INCREASE SPENDING ON ONLINE VIDEO ADVERTISING IN 2012

# ROI

THE ROI OF ONLINE VIDEOS IS **8% HIGHER** THAN ONLINE ADVERTISING GENERALLY AND **22,7%** THAN PRINT ADVERTISING.



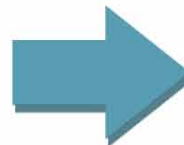
**MAY 2012 WAS ANOTHER RECORD BREAKING MONTH FOR AD DELIVERY IN THE U.S. WITH OVER 10 BILLION ADS**



VIDEO ADS ARE ESTIMATED TO **GROW 40% IN 2012**



**\$210 MILLION** WAS SPENT ON ONLINE VIDEO ADS IN 2011 IN BRAZIL



AND THIS IS EXPECTED TO REACH **\$650 MILLION** IN 2015

(NOTE: THE PERCENTAGE THAT ONLINE VIDEO ADVERTISING REPRESENTS IN THE U.S. WAS APPLIED TO THE ONLINE VIDEO ADVERTISING MARKET OF BRAZIL).

**SOURCE: COMSCORE, EMARKETER, MEDIAPOST.**

up on market data makes it impossible to close your eyes to the opportunities of on-line video.

Audiovisual content adds value to the end-user experience, increases conversion rates and audience retention on a site. Also, it's now very simple to produce and deliver content, which makes video an excellent marketing tool to promote the relevant message.

Publishers such as media groups and both vertical and niche portals have already realized that video is a rich medium, with several interactive possibilities. Moreover, this format is showing considerably better CPMs (cost per thousand impressions, the business model most used for video ads), than display media, has more accurate metrics and is considered by many as the flagship of digital media. But in order to start monetizing and making videos profitable,

it's necessary to have a clear strategy, and to do so, the secret sauce is betting on a scale with large volume of video views and premium content, which means high-quality content that matches target interests.

According to a report from Reel SEO, ad agencies in the US are already predicting a close race for available inventory to serve video advertising during the presidential elections. This trend is reflected in the lo-

cal market, where it shows huge potential. In LatAm, more than 80% of Internet users watch online videos, with 8 to 11 hours of monthly consumption per user.

Indeed these numbers show that there is a sufficient market to bet on online advertising, and especially on video. The Brazilian situation is particularly exciting and ripe for opportunity. Many new businesses emerge each year, and much of this is due to a change in the Brazilian population's mentality, as Brazilians are choosing to assume more risk and endeavor to do more than just get a job. Now is a great moment to start a new company due to the spread of broad-

#### Author Biography

Pedro Filizzola, is the Communications Manager at Samba Tech. Born of Samba Tech, Samba Ads is the leading online video platform in Latin America. The company makes it possible for media buyers to advertise to a large-scale premium audience at once and bring inventory fulfillment to publishers. Samba Ads is committed to bringing the best results to advertisers and high revenue rates for publishers. Samba Ads' solutions for advertisers and publishers are based on 3 pillars: local segmentation, premium publishers and innovative formats. The company is a reference for online video advertising in the region.

*In Brazil,  
almost 40% of  
the population  
watches online  
videos. These  
users are  
consuming  
content no longer  
predetermined by  
traditional TV.*



band, better credit lines for SMEs, easy and available information, consulting programs and acceleration. Brazilians are spending more time online, and this is extremely positive for the country and especially for the tech scenario. Here are some other reasons to invest in Brazil's online sector:

- Brazil is one of the fastest-growing major economies in the world, with

- GDP growth over 5%.
- Brazil is the world's 6th largest economy, already overtaking the UK. By the end of 2015, it will be the 5th largest.
- Investment in the World Cup will reach R\$30 billion, and in the Olympic Games, R\$12 billion.
- Brazil is the 5th largest internet market globally.

- 40% of Brazilians access the Internet regularly.
- Brazil's 80 million Internet users spend \$13 billion online per year.

# Education for a New Reality

## LatAm Alternatives Unveils its PACIF Program for FINRA Registration

**A**s alternative asset investments gains traction in the LatAm region, education is becoming paramount. It is essential that investors understand the benefits of investing in alternative assets; that foreign companies understand the opportunities to be found in the LatAm alternative asset space; and that LatAm investment professionals have the proper knowhow and accreditation

to be successful in an increasingly regulated and globalized market.

And yet, so far, such education has been in short supply.

“There is a great disinformation about the reality of alternatives in Latin America,” says Victor Hugo Rodriguez, the CEO of LatAm Alternatives and Head of the

LatAm chapter of the Hedge Fund Association (HFA).

At the end of 2010, Mr. Rodriguez got together with a group of other well established LatAm finance and investment professionals under the shared belief that this education gap needed to be filled. In 2011, they formed LatAm Alternatives with a two-pronged educational mission: to properly inform and train LatAm investors and investment professionals, and to serve as a third-party advisory marketer and consultant to companies and alternative asset managers entering the region.

“We realized that some people didn’t feel comfortable analyzing suggesting or investing in hedge funds, PE, infrastructure, real assets, and so on, in the region,” says Mr. Rodriguez, “because there is no real education in Spanish about these instruments risks/returns. those important topics. So We are the first company doing education in Spanish at a high alternative investment level the region.”

On the consulting side, he added: “We also deliver major consultancy for banks, insurance companies, telecom companies and consumer industries. A lot of these LatAm companies have to optimize their sales approach so they can fit better into the very competitive integrate more in global markets – also major companies from Europe and the U.S. that need to understand perfectly how they can tweak their sales approach

to conquer a LatAm space that is growing so dramatically. We’re in the business of discovering creating opportunities for them”.

### ■ FINRA Registration

Mr. Rodriguez says that it is essential for LatAm investment professional to be trained as well as their international counterparts so that they can be inserted into the new global financial reality on equal footing. That reality, he says, is characterized first and foremost by regulations.

“The markets are in “regulation mode”, and this new reality is what triggered the inclusion of education within our business model. Every regulator who oversees capital

markets in a country knows that they need better regulation to better supervision on the participants.”

With the globalized nature of finance and investing, it is not enough to have an understanding of the regulations within your own country and be accredited with a local regulator. “Some of them are registered with local SEC’s in LatAm, but if they can be registered with FINRA or the SEC in the U.S., they will instantly gain more credibility.”

He notes that such accreditations are necessary not only if investment professionals are working abroad or trading internationally,

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*“We realized that some people didn’t feel comfortable analyzing, suggesting or investing in hedge funds, PE, infrastructure, real assets, and so on, because there is no real education in Spanish about these instruments risks/returns.”*

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— Victor Hugo Rodriguez —

but also if they are working collaboratively with foreign companies, whose compliance departments will require certain standards.

For that reason, LatAm Alternatives launched a program specifically designed to help LatAm investment professionals pass the Series 65 test and become registered investment advisors with the U.S. SEC.



“We are the first company offering this type of program where foreign people can be registered with FINRA as a registered investment advisor,” he says, “and that is very compelling.”

## The PACIF Program

LatAm Alternatives call its education and FINRA accreditation program for investment professionals PACIF, or Programa Avanzado de Capacitación en inversiones y Finanzas (Advanced Training Program in Investments and Finances). The program prepares investment professionals to take the Series 65 exam to become a registered investment advisor (RIA). PACIF takes between 90 and 120 days to complete, with both self online and live on-line in-person training, and is divided into 5 stages:

- A detailed evaluation, where the trainee meets via on-line personally with an executive at LatAm Alternatives to discuss the trainee’s career and form a plan of study
- An online 90/120 days training course for FINRA-SEC accreditation
- Defining a plan of action, where the trainee again meets with a LatAm alternatives to discuss his or her professional future
- A 2-day intensive live on-line class covering some of the more difficult elements of the Series 65 exam
- A cognitive assessment profile, a series of online tests that allow trainees to compare scores gauge their own strengths and weaknesses

## “There is a great disinformation about the reality of alternatives in Latin America.”

Victor Hugo Rodriguez

- Defining a plan of action, where the trainee again meets with a LatAm alternatives executive to discuss his or her professional future

## Unique Method

For Mr. Rodriguez, what makes PACIF important, unique and effective is not only that it brings new content and focus to prospective investment professionals in the region. It also employs cutting edge methods that all but ensure the trainees’ success on the Series 65 and during their careers as professionals of a global standard.

He points in particular to the mix of self on-line and live on-line in-person education, which LatAm Alternatives views as the optimal approach, and to the most innovative aspect of the program: the cognitive evaluation.

“It’s not only important for them to pass the Series 65 and become registered investment advisors,” he explains. “It’s also essential for them to compare themselves with other advisers out there, and evaluate their own weak and strong points, so they can improve their own profiles.”

Mr. Rodriguez stresses, too, that prospective investment professionals should not necessarily take the Series 65 test and complete the PACIF program at the expense of other industry tests and accreditations, but in addition to them. “I’m strongly recommending that they get designations like CFA and CAIA, also an MBA as well if possible. We are not competing with them; this is a complement. But people today need to understand that they need this FINRA designation so they can have all the tools they need to succeed in today’s capital markets.”

## Quality over Quantity

In only its first year, LatAm Alternatives’ PACIF program has already attracted great interest from the LatAm investment community, including important business schools and universities in the region who aim to integrate the program into their own curricula. But even as the company and its educational offering are well-positioned within a booming market and promise to grow more in coming years, Mr. Rodriguez says the focus now is not on numbers.

“We try to take a down-to-earth and humble approach,” he says. “At the beginning, what matters is focusing on quality, not quantity. It’s very important to deliver a type of product and training that can last and be a game changer for these individuals, for how they are perceived, so we must make sure this potential project goes slowly but surely.

“We’re confident it will attract people,” he adds, “but we also believe people are looking for quality content, so focusing on that for the time being is our recipe for success.”

For more information about this program contact Nate Suppaiah at [Nate@caprg.com](mailto:Nate@caprg.com) / +1-202-905-0378



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## Inaugural Structured Finance Column

We are creating this column to track developments in Latin American structured finance markets, present cutting-edge analysis of new deals and provide a venue for discussion of best practices. While structured finance provides an important channel for financing economic activity in any economy, it offers vital services to developing markets. A strong structured finance sector is generally a sign that a country's debt market is developing and maturing.

structured finance can provide a source of financing when other channels are closed, or can provide cheaper financing than other traditional forms. Investors are attracted to the asset class because it is an efficient form of risk transfer. Structured deals generally transfer risk through the sale of securities that represent a small ownership right to a larger diversified pool of assets.

Our inaugural article looks at the new Driver Brasil One asset-backed security issued by Banco Volkswagen. This deal is important because it introduces financial

ABS market with its first Fundo de Investimento em Direitos Creditórios (FIDC). The deal was oversubscribed by 2 times as investors clamored for "European-style" structuring technology. It priced at 125 basis points over Brazilian Libor (CDI) for the Senior quota (functions as tranche in Brazilian FIDCs) and 205 basis points over for the Mezzanine quota. These levels represented a 50 and a 70 basis point tightening from the initial price talk, respectively.

Driver Brasil One is the first of its kind in

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# Driver Brasil One

## Banco Volkswagen

### Could Have Done Better

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Vernon H. Budinger, CFA & Jason A. Smith, CFA

The bank sector in the developing markets of Latin America tends to be deep but not broad. That is, Latin American banks tend to offer a wide array of financing alternatives to their biggest and best customers, but they generally do not serve a broad swath of the economy. Structured finance provides needed financing to rapidly growing but underfinanced sectors of the Latin American economies.

The market for small and medium size companies is a prime example of an underserved market. Small growing companies find that

"technology" from developed markets to Brazil's developing market for Fundos de Investimento em Direitos Creditórios, or FIDCs. Driver Brasil One is the first FIDC that utilizes a pass-through-type structure where the prepayment and default risk flow through to the investors. We look at the financial engineering employed by the banks structuring the deal, the design of the FIDC and comment on the implications for investors.

Banco Volkswagen priced Driver Brasil One on April 11 and entered the Brazilian

Brazil, an FIDC that uses a static portfolio of collateral and passes the collateral's prepayment and loss performance through to the quota holders. Furthermore, while other FIDCs have used derivatives to control interest rate risk, this is the first FIDC to feature an amortizing interest rate swap matched to the quotas. We have reverse-engineered the deal and spoken to deal structurers as well as the rating agencies who rated the transaction, S&P brAAA/Moody's brAAA. This paper is a summary of our findings and conclusions.

Driver Brasil One, from Volkswagen's "Driver" shelf, is a product of the car company's global asset-backed securities (ABS) issuance program. Driver currently comprises 9% of Volkswagen Financial Services' total financing, and management has indicated that they wish to grow this to 33% of firm financing by 2018. The other two-thirds are to be split evenly between capital markets and deposits, currently running at 24% and 33%, the difference being made up in miscellaneous liabilities and equity. At today's funding needs, this amounts to a global increase of ABS issuance (in addition to refinancing) of 18.72 billion Euros (R46.68 billion).

*While structured finance provides an important channel for financing economic activity in any economy, it offers vital services to developing markets.*

The rumor among Brazilian ABS market participants is that the Driver Brasil One structure will be the basis for future securitizations of vehicle loans using FIDCs, which is Brazil's most popular legal structure for ABS. We hope that this is not true, as new does not always denote better. Our results from modeling and scenario analysis suggest that this structure has some major shortcomings. In our opinion, the marketing success of this deal demonstrates the still nascent understanding that Brazilian money managers have for ABS products and structures. In particular, it is clear that investors paid little regard to the characteristics of the assets sold into the structure and the resulting implications for performance of their investments. We conclude that Banco VW could have done a better job of bringing its global program to Brazil

and could have set the bar even higher for Brazil's developing ABS market.

Let us clarify from the start that neither Latin America Structured Finance Advisors nor the authors have any economic ties to any of the parties discussed in this article. We have taken the time to reverse engineer this deal because we are committed to tracking the development of ABS markets in Latin America. This article contains our opinions based on a combined 50 years of experience in ABS markets worldwide, and hundreds of combined hours of modeling and analyzing this deal in particular.

### Deal Structure/Reverse Engineering

The R\$1 billion deal was very large for the Brazilian market. The issue had 3 quotas: an AAA-rated R\$875 million senior quota (Moody's and Standard & Poor's), an A-rated R\$55 million mezzanine quota, and an unrated R\$82.8 million subordinated quota that is retained by Banco VW.

Unlike most Brazilian FIDCs backed by vehicle loans, the deal has no revolving period; similar to most non-Brazilian deals, one pool of loans will be sold into the structure and the quotas will amortize as a function of amortization rate on the underlying vehicle loans. Delving more deeply into the collateral of the FIDC, only the principal from the loans is being discounted by an inter-

est rate tied to the rates on the quotas and the administrative costs for the fund. This is a critical point of understanding, because the face value of the loans is much larger than the book value of the assets within the FIDC. Furthermore, it is not clear how or if interest payments are passing through the deal. We disregard them completely. Finally, this structure allows Banco VW to receive a roughly R\$45 million upfront profit when the deal was issued.

The coupon rates for the quotas are calculated daily using a formula that compounds the rate and makes it consistent with Brazilian yield-to-maturity formulas, which assume 252 business days in a year:

$$\text{Daily Coupon for Quotas} = [(1 + \text{CDI})^{(1/252)} * (1 + \text{Spread})^{(1/252)}] - 1$$

*Discount Rate*

$$\text{For the Principal} = [(\text{Weight Swapped Senior Cost} + \text{Weight Swapped Mezzanine Cost}) * (1 + \text{Rate for Costs of Fund Annualized}) * (1 + \text{Estimated Credit Losses Annualized})] - 1$$

$$(1 + \text{Rate for Costs of Fund Annualized}) * (1 + \text{Estimated Credit Losses Annualized}) - 1$$

The structuring banks for this deal had to contend with Brazil's abysmal state of accounting for FIDCs. One of the worst features of the government-mandated accounting is that there is virtually no way to separate coupon and principal in the waterfall. The banks came up with an innovative approach where the available cash from the

#### Initial Reinforcement of Credit

|                                 | Senior | Mezzanine |
|---------------------------------|--------|-----------|
| Initial Reinforcement of Credit | 13.50% | 8.00%     |
| Mezzanine Cotas                 | 5.50%  | NA        |
| Subordinated (Equity) Cota      | 7.00%  | 7.00%     |
| Liquidity Reserve               | 1.00%  | 1.00%     |

#### Target Guarantee Percentages (Ratios)

|                   | Senior                                                     | Mezzanine |
|-------------------|------------------------------------------------------------|-----------|
| No violations     | 15.50%                                                     | 8.50%     |
| Level 1 Violation | 18.50%                                                     | 10.00%    |
| Level 2 Violation | Amortization of cotas in sequence until the Fund is closed |           |

loan principal will be allocated using guarantee ratios.

The simultaneous solution of the target ratios as a percentage of the discounted principal value (15.5% for the senior and 8.5% for the mezzanine) also provides the amount of the cash flow to allocate to each tranche to maintain the balances between the quotas. While technically the senior quotas fall first in the waterfall, the result of this solution is basically equivalent to a *pari passu* allocation between the 2 quotas as long as the FIDC has not violated any of the triggers. This mechanism also passes through the prepayment and default performance of the underlying collateral.

The Level 1 violation occurs if cumulative losses before recovery pass 2.6% during or before the first 12 months and 4.8% after month 12 but before month 25. The Level 2 violation occurs if the cumulative losses before recovery pass 7.4% during any amortization date.

In reverse engineering this deal, we constructed a portfolio of 10 loans based on the maturity bucket in the breakdown given in the prospectus. We then used the amortization schedules in the prospectus to work out the base assumptions for the loans sold into the deal. Given that we have a few scenarios that provide most of the information that we need, we were able to reverse engineer a model that ties out to the dollar in *par* terms. (Note: The prospectus does not provide the same level of information that we see for ABS deals in the United States, or else we would have been able to tie out to the penny.)

The model portfolio passes the cash flows to the model waterfall with all of the triggers implemented in the real deal. The cash flows pass through the waterfall and are allocated to the senior and mezzanine quotas to amortize them in accordance with the rules in the prospectus. Our output matches the tables on pages 411 through 450 in the prospectus.

(Note: We talked to a representative at the structuring firm who claimed that the interest payments had been sold into the FIDC. We are waiting for more information and for an explanation of the cash flow tables in the prospectus from the key structuring

person, who has not been available. Principal-only cash flows are the only inputs that allow our optimization models to tie out the loan profile in Table 8, page 433 of the prospectus, to the amortization schedules. The prospectus uses the exact terms “Valor de Principal” or “Principal Value” to describe the figures. Furthermore, our calculations for the amount to be sold to the FIDC (Value of the Discounted Principal) matched, to the penny, when we used the remaining principal from the column Value of Actual Principal without Discount and did not include interest. This is a fairly easy calculation in Brazil since vehicle loans use straight-line amortization. There is zero probability of

*A strong structured finance sector is generally a sign that a country's debt market is developing and maturing.*

a solution with interest included given the data in the prospectus. Bottom line, Banco VW and the 2 banks on the deal need to explain why they included 10 pages of data based on principal-only calculations in the prospectus.)

### ■ Coupon Stripped/Discount Rate

So, at the minimum, the interest payments are not included in the Principal Value calculations that drive this deal. Looking back on all of the data provided, the solution is fairly easy to calculate. Use the undiscounted principal values from Table 9 on page 435 of the prospectus, discount the monthly principal cash flows by 15% (the annual discount rate initially supplied in the prospectus using 30/360 day count and the compounding formula also in the prospectus) and you find that you have to sell R\$1,230,382,731 in face value with the interest payments to equal R\$1,000,006,444

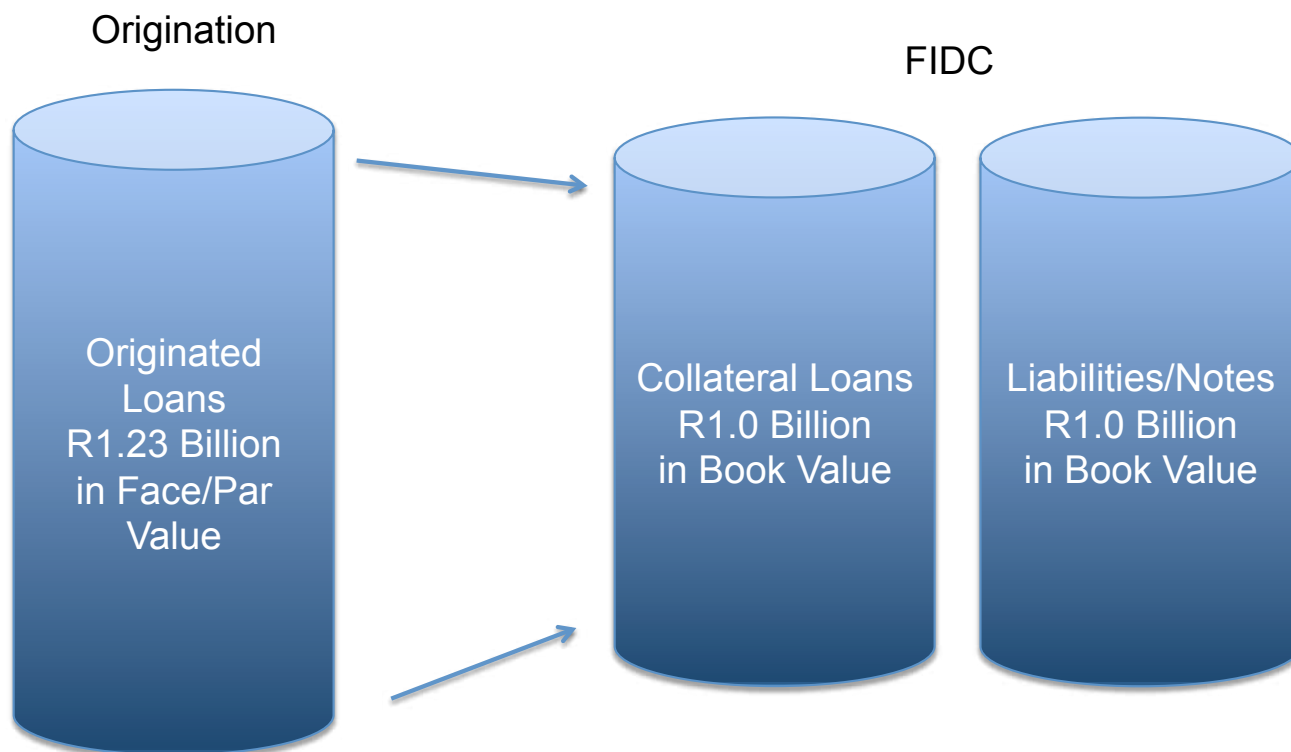
in book value for the FIDC as displayed on page 434.

The Comissão de Valores Mobiliários delayed the deal until the arrangements can be made to provide third-party custody for the loan documents, tombstone announcing the closing of the deal appeared in the July 16 edition of *Valor*. Banco VW and the issuers provided the initial 15% estimate for the collateral discount rate when CDI was about 11%. The prospectus estimated that the senior quota would yield 12.75% and the mezzanine quota 14.5% in the 11% CDI environment. If we use the CDI rate 7.83% for July 13 and maintain the same cost ratio, we estimate that the actual discount rate for the principal value is about 11.5%. The weighted cost of funds for the 2 quotas is about 9.23%, leaving an excess spread of about 2.27%. We believe that the best practice calls for the transfer of the loans at face value from the books, this would have provided an excess spread of 9.7% for the investors and Banco VW could have earned the difference with efficient management of the deal.

The practice of ceding or transferring loans using a non-market price based on a discount rate that is a function of the coupon on the quotas is a disease that plagues the Brazilian ABS market. Banks issue loans with the going interest rates because those rates reflect the risks and the costs associated with lending in Brazil. This risk-return relationship is completely destroyed when the loans are repriced based on the coupons that are to be paid to the investors. This disengages almost all the economic incentives that tie the issuer to maintain the deal since the issuer usually receives most of the cash for purchasing the most subordinated tranche from the more senior investors. We question how many investors are aware of this primary misalignment of value within FIDC structures.

### ■ FIDC Origination

Additionally, the stripping out of the coupon from the loans in the calculations for Driver Brasil One raises questions such as who ultimately owns that coupon (IO) cash flow from the collateral. In a liquidation scenario the value of the collateral becomes of paramount importance to the notehold-



ers. Loans that have been stripped are less liquid on the secondary market. If the collateral cannot be sold at the FIDC carrying value, it would seem to us that the terminal value of the assets might be very different from the reported values and therefore adversely affect the quota value. Furthermore, it is not clear that the Brazilian courts or Brazilian law have addressed this separation of coupon and principal.

### Credit Enhancement Concerns

Banco VW is a lightly collateralized deal coming to market in the midst of a huge storm for Brazilian consumer debt. We feel that the FIDC lacks the credit protection of other deals because it does not have the excess spread seen in many other Vehicle FIDCs in Brazil, such as Omni IV with over 39% excess spread. We make the case that this year's credit environment is different from the default history before 2010.

Vehicle loans in default (over 90 days past due) have skyrocketed from 2.49% of bank portfolios in December 2010 to 6.1% in May. This is the highest percentage record-

ed in the Banco Central do Brasil database. The average default rate in the Banco Central database was 3.63% over the January 2006 to July 2011 time period used in the Driver Brasil One prospectus. May's observation represents more than 3 standard deviations from the 3.63% mean.

The past 5 years of default history for consumer vehicle loans in Brazil have been marked by increased volatility and defies the context of a historical pattern. This has been typically explained by the differing rate and economic environments; however the increase in defaults since 2010 clearly is tied to changes in the profile of the typical Brazilian borrower.

The booming Brazilian economy has enabled many lower-income consumers to enter the middle class. In addition, the government implemented incentives to consumers to borrow money for car purchases in 2009 in an effort to help the economy. The average Brazilian consumer is carrying a heavy debt load as measured by the debt service ratio. The result has been a sharp spike in defaults on vehicle loans that began in late

2010 and shows no sign of slowing down. Felipe Marques interviewed Oscar Herrera, the Vice President of Credit Risk for Santander Brasil, in the May 24 edition of Valor Económico. Herrera admitted that his bank had failed to recognize the new profile for Brazil's borrowers for vehicle loans and this was driving the default rate on vehicle loans to historical levels in Santander's portfolio. He attributed this change to the changing profile of the average Brazilian borrower. We believe that this sea change is affecting all lenders.

While Driver Brasil One can be viewed as a type of pass-through security, most of the current revolving FIDCs resemble mini-financial institutions. The quotas are generally amortized on a straight-line basis through the funding from a revolving portfolio of collateral with no direct links to prepayments or defaults. They do not have the risks that pass-through quotas in Driver Brasil One possess. There is nothing inherently bad about a pass-through but investors should be compensated for the additional risks that they are taking, especially when the loans that are being sold into the deal

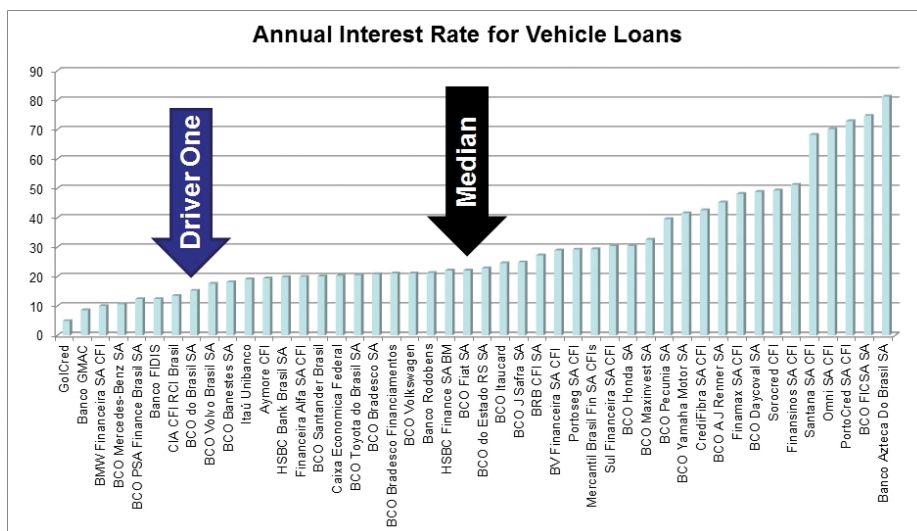
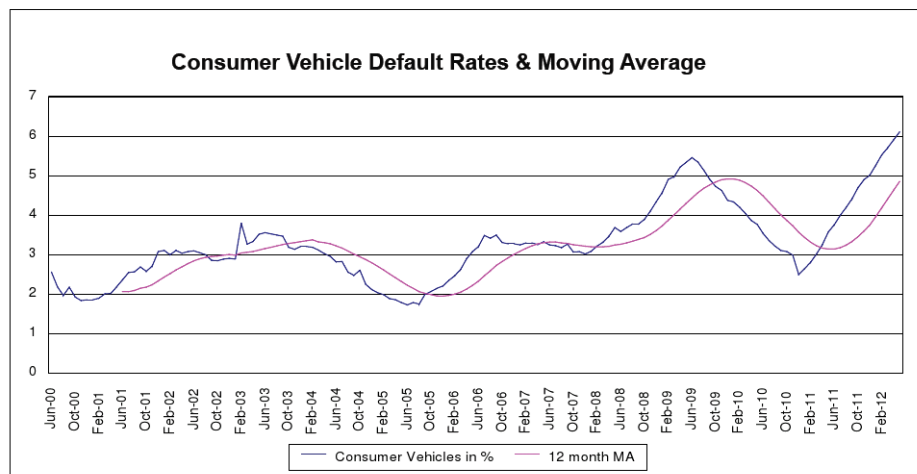
are at a below-market coupon. We found it strange that investor demand for this deal was so strong that the spreads were tighter than those for other auto deals with similar credit quality and no variability in the cash flows.

We do not believe that the subordination is as strong as it looks. First, the roughly R\$45 million or more of the subordination reflects the markup from selling the loans with 18.9% yields into the structure at a price determined with a discount rate of around 11.5%. This is pure book value accounting that would not be realized if the deal had to be liquidated. The investor would immediately take a mark-to-market loss. In addition, Banco Volkswagen is clearly issuing loans at below-market rates to subsidize sales (see graph below). Investors in the quotas would be further penalized in a liquidation process because any bank would at least want to pay middle of the market prices for loans coming out of an FIDC that is being broken up. We estimate that senior and mezzanine investors would have to take a 10% to 20% haircut if the FIDC were liquidated.

*The past 5 years of default history for consumer vehicle loans in Brazil have been marked by increased volatility and defies the context of a historical pattern.*

## Conflicts of Interest

All this calls into question the inherent conflicts of interest for Banco VW. Inherent because when the loans are sold into the deal at a premium based on Banco VW's cost to originate (11.5% discount rate versus 18.9%,



the WAC, assuming loans were properly underwritten and priced) they realize an immediate gain on sale upon the issuance of the FIDC. While separating the IO stream could represent some “skin in the game,” the deal is structured to back-end the equity cash flows so far into the future that they effectively become option value, creating a strong conflict of interest for Banco VW. Since they have been paid the majority of their profit upfront, what incentive do they have to create a long-term, well-performing deal? The incentive would likely switch to issuing as many deals as possible.

Furthermore, all the fund payments from the borrowers to the quota holders go through Banco VW first. This is troubling given the clear lack of principal-agency separation. Ratings writeups mention this but cite as a mitigating factor a “one day delay,” which does nothing to resolve the intrinsic differences in motivation between the agent (Banco VW) and the principal

(noteholders). While we are certainly not accusing Banco VW of impropriety, the recent experience of Banco Morada has made it clear that this system does not follow securitization best practices, and there should be a separate trustee, servicer or custodian sitting between borrower's remittances and the FIDC to remove any conflicts of interest.

## Summary/Conclusion

Driver Brasil One was issued at the same time as Omni VII, an FIDC offering a senior quota priced at CDI plus 300 basis points. Driver Brasil One flew out the door while Omni struggled for a few months to sell all of the quotas. We are amazed that there are R\$2 billion worth of investors in the Brazilian market who would buy the senior quota of Driver Brasil One at CDI plus 125 basis points and leave Omni VII's senior on the table at CDI plus 300 basis points. It is even

more astonishing that investors would buy Driver Brasil One's mezzanine quota at CDI plus 205 basis points instead of the senior quotas of Omni VII. Omni has demonstrated that it is a successful operator in this field and their total credit protection is much higher than in the Driver Brasil One FIDC.

It seems that Brazilian investors still overweigh the importance of the financial condition of the underlying company. Clearly, in their minds they were buying AAA Banco VW bonds for CDI plus 125 basis points and A-rated Banco VW bonds for 205 basis points spread. (We are aware that quotas do not have the same rights as bonds and that Brazilian investors are aware of this, but clearly the investors are buying the corporate VW name in this deal). We hope that future investors read this piece and demand that the issuers structure the deals more responsibly for quota holders. Moreover, investors should boycott any deal that prices the assets so that the investors lose 10% to 20% of their collateral in the event of liquidation because of nonmarket pricing.

We also find the cash transmittal process troubling. Brazil has one of the most modern

fund transfer systems in the world; it seems that there should be a simple solution to avoid conflict of interest inherent in Driver Brasil One. That an additional fiduciary layer was not added is puzzling.

Lastly, and perhaps more importantly, Banco VW could have done better. Driver Brasil One was a chance for them to show off their global program to a market that needs a shining example. This demonstrates that it is imperative for all investors to have strong quantitative models that can independently evaluate and deconstruct FIDCs before purchase, regardless of the issuer. Given the increased complexity of deals like Driver Brasil One, and the likelihood that future vehicle-backed FIDCs will be similar, gaining a solid understanding of the payments, collateral and deal mechanics is more important now than ever before.

(Note: Neither Latin America Structured Finance Advisors nor its employees have any economic relationships with Banco VW, any of the underwriters for this deal or the ratings agencies. All opinions are based on our analysis and not meant to be in-

vestment advice. Investors are encouraged to base their investment decisions on their own due diligence and analysis.)

#### 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.



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# Due Diligence Background Investigations on Hedge Fund Managers in Latin America:

## What to Know, Where to Look and What to be Aware Of

■ Amy Ajay

**A**s the oldest privately held investigative due diligence firm in the United States, Bishops Services Inc. has seen, in the past few years alone, a substantial increase in our clients' investment volume in developing countries across the globe. Specifically, there has been a significant uptick in hedge fund investing in the BRIC countries (Brazil, Russia, India and China), as well as increased investment activities across other Latin American countries such as Argentina, Chile, Colombia, Ecuador, Mexico, Panama, Peru and Venezuela.

Investing in Latin America brings with it many unique challenges, particularly when investing with local and emerging fund managers as part of an international multimanager investment strategy. These challenges run the gamut from geographic and geopolitical concerns, to the level of transparency

**When considering a potential hedge fund investment in emerging markets such as Latin America, it is imperative to work with an experienced professional to navigate the often murky waters of due diligence. While this article focuses on hedge fund investing, much of the advice and guidance toward effective due diligence is applicable across multiple business transactions, including M&A and private equity investments, corporate partnerships and other investment vehicles.**

in reporting and information retention, to the basic fact that this is an emerging and rapidly developing financial market for the hedge fund platform. Prior to any hedge fund investment in Latin America, we recommend conducting full-scope, comprehensive investigative due diligence (IDD)

efforts to complement any operational due diligence (ODD) assessment.

While IDD efforts can be conducted discreetly and without the knowledge of the subject fund managers, when engaging in such efforts in Latin America it is recom-



mended that investigations be conducted as a transparent endeavor. For a multimanager investor, the first litmus test in the IDD process often comes from the fund manager's response to your request that he/she consent to and cooperate with a comprehensive background investigation. Careful consideration should be given to those investment opportunities where a manager is reluctant or refuses to provide such authorization.

Due to the commonality of names, the transient nature of residency, the time constraints surrounding every investigation and investment, and other factors weighing on these types of investigations in Latin America, there are several preliminary factors that can help in facilitating an accurate and expedient IDD process. First, the more information the investor can provide about the fund manager at inception, the more focused and effective the investigation will be from the outset. This would include providing full names of the managers, as well as their biographical statements, relevant information from their prospectus

or marketing collateral, address information and any other identifying information that may be deemed helpful in such background investigative efforts. Also critical in achieving comprehensive intelligence is to have an individual's national identification number (similar to a US Social Security Number). Many records in Latin America are recorded only by a name and national identification number; thus this information is critical to ruling out false positives, and honing in on relevant details.

It is important to remember that access to information is not as streamlined in Latin America as it is in the United States. Records may be destroyed during regime changes, are often out of date or incomplete, or may not be made public as a result of political conditions within each country, including an increased susceptibility to external influences within the political, business and financial services sectors. As a result, relying exclusively on commercially available public database information will leave a potential investor with, at the very

least, an incomplete understanding of the hedge fund manager, and at worst, an errant or unreliable version of the facts.

Incorporating independent third-party on-the-ground investigative efforts as part of your IDD process is essential to digging below the surface and having a true understanding of the critical information necessary for making important investment decisions. Working with an IDD partner with access to indigenous resources who are knowledgeable about local laws, customs, conditions and methods of obtaining and recording information, and who know how to accurately research and interpret such intelligence, is a necessary part of any comprehensive IDD effort. These individuals often include former law enforcement and military officials, skilled corporate investigators and researchers, members of local watchdog groups, investigative journalists, and resident business and industry experts.

Successful investigative efforts will vary from country to country in Latin America,

and often by region or city within each country. While public record information is more readily available in major cities such as Bogotá, Buenos Aires, Lima, Mexico City, Rio de Janeiro and São Paulo, it is less so in outlying areas. Thus, more creative efforts, including closely held intelligence assets and effective research and analysis is key in rural areas where information is sparsely available and might not be completely reliable.

*When investing in Latin America, the decision of whether to investigate the hedge fund entity in addition to the individual fund managers rests on a few simple factors, including the risk threshold of the investor, how long the fund has been in existence, the country and/or region where the fund operates, and the investment strategy of the fund.*

When investing in Latin America, the decision of whether to investigate the hedge fund entity in addition to the individual fund managers rests on a few simple factors, including the risk threshold of the investor, how long the fund has been in existence, the country and/or region where the fund operates, and the investment strategy of the fund. A seasoned IDD expert can provide guidance

on best practices to assist clients in making the determination of whether to include the fund entity into the process on a case-by-case basis. Based on our experience, however, incorporating research of the fund into the IDD process from the outset greatly lessens the possibility that records and information exist that solely name the fund entity and would thus not otherwise be revealed.

When examining a business entity in Latin America it is crucial to look at the ownership records of the fund in order to uncover trends, signs or any red flags of potential concern. For example, we have found that in some Latin American countries there is a higher tendency for business entities to hide ownership or other previous liabilities through a system of false or shell businesses. Similar tactics have been uncovered with respect to obfuscating bankruptcies and other undesirable historical intelligence, which reiterates the importance of incorporating research of the fund into your standard IDD process.

Effective international due diligence hinges upon having a well-versed IDD partner, particularly in places like Latin America where

there are so many varying factors influencing the availability and reliability of information. Before you expand your investment spectrum into other countries or regions of the world, be sure that your due diligence process is prepared to handle the cultural and informational nuances that come with it.

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### Author Biography

Amy R. Ajay, CFE — Vice President, Global Investigations

Amy Ajay joined Bishops in 2010 and is responsible for conducting global due diligence and executive pre-employment background investigations, as well as complex asset search and fraud investigation matters. Prior to joining Bishops, Amy was a Senior Investigator at a renowned corporate security firm in New York, where she conducted domestic and international due diligence and asset investigations, as well as having supervised the day-to-day operations of an extensive team of in-house and external investigators. Prior to joining the private sector, Amy served as an officer with the US Central Intelligence Agency (CIA). During her tenure with the CIA, Amy gained extensive experience in intelligence collection and management, as well as data analysis and investigation management. Amy was a Collection Management Officer within the Near East Division of the CIA's Directorate of Operations where she directed the collection of intelligence and managed resources in several South Asian countries. She also oversaw the dissemination of clandestine intelligence to US policymakers and was responsible for implementing intelligence gathering programs to support CIA field operations. Amy received her bachelor's degree in international relations from Pennsylvania State University, as well as a certificate in forensic accounting from New York University's School of Continuing and Professional Studies. She is also a certified fraud examiner and a member of the Association of Certified Fraud Examiners.

## ■ The Challenge

Why does the 6th largest economy in the world — Brazil — still have a 20% unemployment rate among youth and almost a 10% illiteracy rate overall? A new way of investing, building capacities and multisector collaboration might be a response to this apparent paradox.

Brazil is increasingly capturing global attention due to its steady economic development, its abundance of natural resources and its popularity both for work and travel as it prepares for the next FIFA World Cup and the Summer Olympics. Despite this situation, Brazil is still in many ways a developing country with a host of social problems and very high level of inequality. Brazil's weak public school system not only leaves some cities with an illiteracy rate of 28%, but test results also reveal alarmingly low reading comprehension levels, resulting in a stark disconnect between access to education and the need to prepare Brazil's youth for the labor market. In addition, Brazil's informal economy makes up 40% of Brazil's gross national income, a much larger share than in India or China.

## ■ High Risk

Within this context, there is a new set of investors who are adding more risk to their desired return on investment and looking to make a social impact through impact investing. This investment strategy is still developing in Brazil but catching the attention of policymakers and civil society. With impact investing, funds are now slowly beginning to reach the base of the pyramid, providing resources to smaller and less established social businesses. Though critics in the investor community are still watching from the sidelines, there are a few organizations that are taking the bold steps needed to support social businesses and make them investment ready for the larger impact investing community. One of these is NESsT, an organization that provides tailored, ongoing capacity and financial support to a portfolio of high-impact social enterprises in emerging market countries, including Brazil.

## ■ High Reward

Most social enterprises in Brazil are running without a business plan or access to growth

# Impact Investing in Brazil

# Worth the Risk

capital or management support. NESsT targets this exact problem through its comprehensive approach. In addition to its personalized work with organizations, NESsT reduces risk by providing the country-level legal, cultural and societal due diligence and research—through country studies and legal assessments — that investors and policymakers should trust in and develop impact investing further. This work also encourages the networking and partnering needed to foster new government policies and innovative private funding.

Nicole Etchart, co-CEO of NESsT, recently presented at the International Conference

on Policy Innovation in Impact Investing in June, in conjunction with the launch of the Impact Investing Policy Collaborative. “In Brazil, NESsT works with impact investors and the bottom of the pyramid to develop sustainable social enterprises to solve critical problems. Through a careful early-stage development strategy, NESsT has worked with hundreds of social enterprises globally to make them more sustainable in emerging market economies,” Etchart shared, encouraging investors and policymakers to get involved. Where many NESsT portfolio organizations begin with a strong business idea, strong team and the best of intentions, they often are underperforming or

underequipped to meet their business goals. After going through NESsT's engaged process, 100% of NESsT social enterprises are able to conduct market research and 90% can assess the financial potential of their social enterprise idea. About 50% of social enterprises in the NESsT portfolio are meeting or exceeding their social impact goals and financial/organizational performance goals. One such social enterprise in Brazil,

ensuring that they will be able to become permanent employees.

Due to the high skill levels required by the Brazilian job market, many youth

abandon school in search of informal occupations with very low wages. The main goal of INCORES is to address this problem, preparing youth for the market while making a healthy profit to sustain

*"The NESsT methodology is incredibly thorough. It addresses all the key concepts, steps and procedures for building a business with high potential for success. We appreciate the opportunity to grow and learn with NESsT!"*

INCORES, enjoyed a 542% increase in income last year, offering jobs, economic improvement and resources to a group historically overlooked by investors.

### ■ High Return: INCORES

The 186 teenagers rescued from potential unemployment or underemployment by INCORES might be the greatest outcome of this social enterprise based in Salvador, Bahia. INCORES offers training for low-income youth and placement with companies that need to comply with federal training laws. Youth receive 1,840 hours of hands-on training and 460 hours of in-class theory over a period of 2 years while working, en-



INCORES: High ROI for Brazil's future generation



INCORES: Hands-on training and learning

its work. During their first year of incubation, INCORES provided employment opportunities to 186 at-risk youth in 2011, up from 77 in 2010, and it had an annual income growth rate of 1,094.23%. With NESsT support, the social enterprise is planning to expand to other cities in Brazil, in order to reach many more at risk youth and ultimately contribute to reducing the country's extremely high youth unemployment rate.

### ■ Impact Investing – a Collaborative Approach

The challenge now is to make sure that impact investing is not just addressed from the top-down or from a one sector perspective; but that it becomes a multi-sector integrated effort from all stakeholders ensuring that even early stage social businesses are offered an opportunity. The need for this approach will be addressed at the upcoming Social Enterprise

World Forum in October, which will bring together policy makers, corporations, entrepreneurs, investors, foundations and more to the largest impact-investing summit ever in Brazil.

And there, the paradox surely will not be solved entirely for Brazil, but it will be addressed, in collaboration and on a global scale.

#### About NESsT

NESsT is a catalyst for social enterprises in emerging markets and worldwide. We achieve our mission by providing financial capital, training and mentoring, and access to markets for a high-impact portfolio of social enterprises. We combine the tools and strategies of entrepreneurship and investment with the mission and values of the social sector to enable our portfolio to: better plan, improve management capacity, grow, and increase their social impact.

The Social Enterprise World Forum (SEWF2012) - Fórum Mundial de Negócios Sociais 2012

This premiere global event is focused on supporting the development of social enterprises -- businesses applying market approaches to solve critical social and environmental problems.

Theme: Growing the asset class of “impact investing,” with a focus on attracting new investment capital for social enterprise.

SEWF2012 will include a variety of sessions and speakers to inspire, inform and connect participants. Join 1,000 delegates from 30 different countries, and over 100 speakers in the 10 exciting tracks planned, along with an Investor Day, social enterprise marketplace, social enterprise site visits and study tour, social enterprise awards gala, training workshops, clinics and a pitching place.

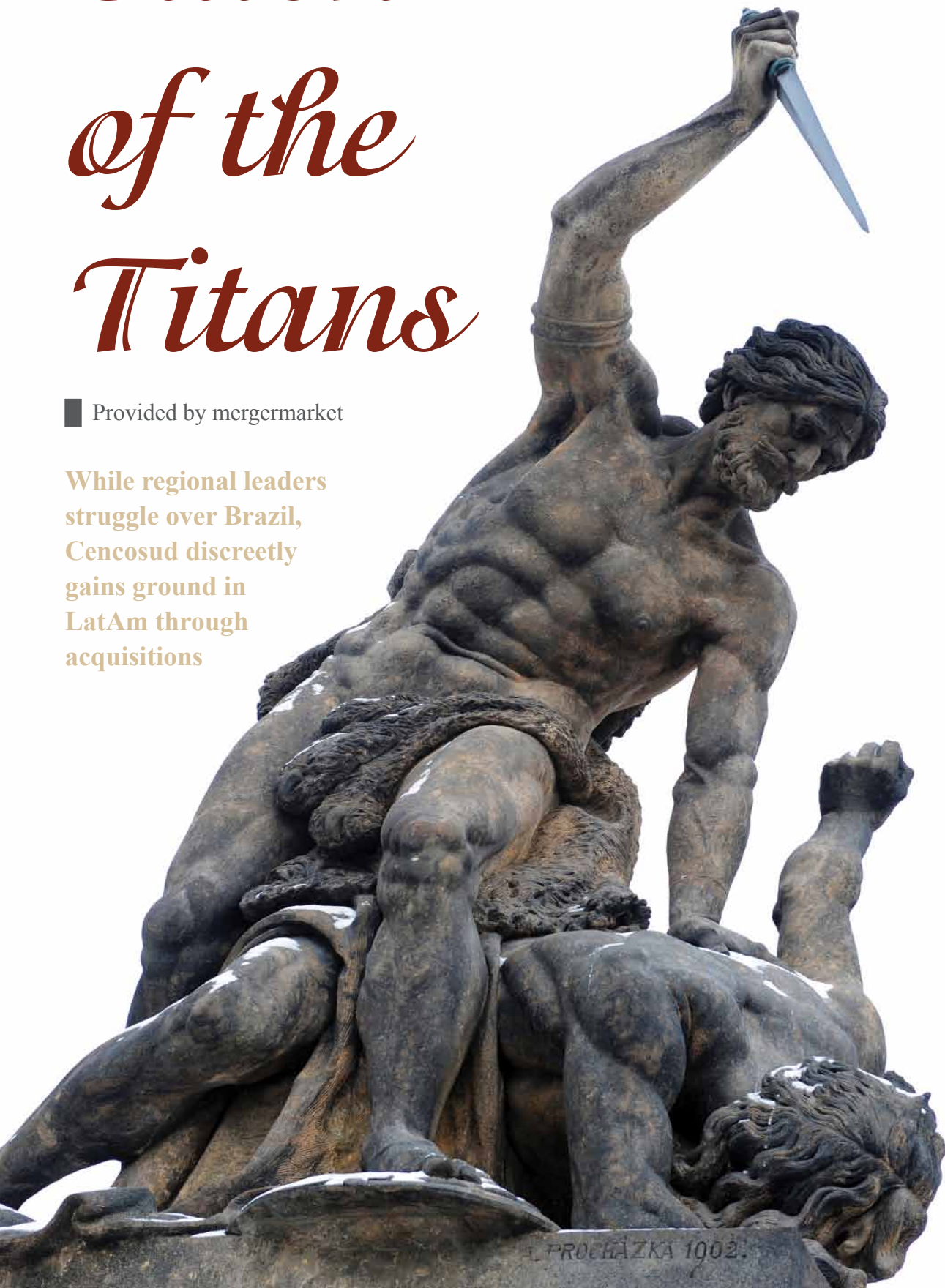
The SEWF2012 is being hosted by NESsT, a pioneer of social enterprise since 1997 and in Brazil since 2007 and has supported the development of over 3,500 social enterprises addressing critical social problems in emerging market countries. [www.nesst.org](http://www.nesst.org). For more information and registration details for SEWF2012, visit [www.sewf2012.org](http://www.sewf2012.org).



# Clash of the Titans

■ Provided by mergermarket

While regional leaders  
struggle over Brazil,  
Cencosud discreetly  
gains ground in  
LatAm through  
acquisitions



L. PROCHÁZKA 1902.

**B**razil's top supermarket groups have stolen the spotlight in Latin America's retail scene, and the ownership struggle between Casino's Pao de Acucar, its founder Abilio Diniz and Carrefour still looks far from over. Meanwhile, Chile's Cencosud is discreetly gaining ground in the regional rankings using acquisitions of medium and small supermarket chains in Brazil to boost its ascent.

With reported revenues of CLP 7.6 trillion (US\$15.4 billion) in 2011, Cencosud has surpassed Carrefour Brazil as the third largest retailer in Latin American countries after Walmart's Mexican operation, Walmex, and Pao de Acucar. The Chilean group Cencosud, owned by Horst Paulmann, a German-Chilean businessman, also became the largest Latin American-owned supermarket in June, after France-based Casino finally acquired a controlling stake.

Walmex reported US\$24.6 billion in revenues in 2011, and Pao de Acucar, as Companhia Brasileira de Distribuicao (CBD) is known, reported R 46.6 billion (US\$22.8 billion). Carrefour France reported net sales of EUR 11.1 billion (US\$13.6 billion) in Brazil in 2011. Meanwhile, in 2011 Cencosud more than doubled its gross sales in Brazil, from R 3.5 billion in 2010 to R 8.9 billion in 2011, according to data from the industry union Abras compiled by Deloitte for this report. Its growth comes in large part from a steady acquisition campaign in Brazil.

In the Brazilian market, Cencosud doesn't yet look threatening, as it still occupies a distant 4th place in the rankings. According to the Deloitte data, CBD has an estimated market share in Brazil of 23%; Carrefour, 13%; Walmart, 10%; and Cencosud, 4%.

In Brazil, rumors now have turned to the possibility of Diniz selling his 20% stake in CBD to Casino and buying a stake in Carrefour. However, a spokesperson for Diniz denied he is in talks with Carrefour. This comes after a mid-2011 announcement from Diniz that CBD would merge with Carrefour Brazil, reportedly an attempt to dilute Casino's stake in CBD and avoid giving up the controlling stake.

The plan was canceled 2 weeks later, under protests from Casino. After Casino assumed control, Diniz retained a 20% stake in CBD, valued at R 4 billion, and remained CBD's chairman. The current speculation is that Diniz's difficult relationship with Casino in recent years will lead him to again seek an alliance with Carrefour. For Carrefour, a deal with Diniz would help smooth out the group's global turbulences, said a Brazil-based sector banker. A spokesperson for Carrefour Brazil did not reply to a request for comment.

### ■ Cencosud's string of buys

Cencosud has spent over US\$2.1 billion in seven acquisitions in Brazil since 2007, when it purchased GBarbosa, a chain in the

northeast, for US\$450 million. In 2010, it acquired Ceara-based Supermercado Familia for US\$33 million, Bahia-based Perini for US\$28 million, and Minas Gerais-based Bretas for US\$813 million. Last year, it acquired Bahia-based Cardoso for an undisclosed amount and Rio de Janeiro-based Prezunic for US\$500 million. This year, Cencosud finally stepped into Brazil's largest consumer market, Sao Paulo, with the purchase of Russi Supermercados for US\$297 million, in May.

In July, Cencosud bought the 38.6% stake in its Argentine subsidiary it did not own for US\$483.6 million, shortly after raising US\$500 million in a secondary public offering on the Santiago Stock Exchange and on the NYSE.

Cencosud will continue to grow in Brazil targeting medium-sized companies for acquisitions, said a Chile-based industry source. A spokesperson for Cencosud said that the company does not comment on future acquisitions or investment plans.

The ideal potential targets for Cencosud are medium-sized groups that are strong in specific regions of Brazil, such as Zaffari, with R 2.5 billion in revenues in 2010, Sonda Supermercados, with R 1.5 billion, Supermercados BH, with R 1.5 billion, Savegnago Supermercados, with R 993 million and Supermercados Zonal Sul, with R 986 million, said a Brazil-based industry source.

Zaffari is the last large independent supermarket in Brazil, said the Brazilian sector banker. It is receiving a lot of offers and it could possibly be sold, the banker added. A spokesperson for Zaffari did not reply to a request for comment.

Zona Sul has also been targeted by several players but negotiations have failed because of price, said the banker and a Rio de Janeiro-based financial advisor. A spokesperson for Zona Sul did not reply to a request for comment.

### ■ Mexico a tough market

Despite its bold incursion in Brazil, Cencosud has yet to start exploring Latin

*Despite its bold incursion in Brazil, Cencosud has yet to start exploring Latin America's most challenging market: Mexico, where the US\$49.4 billion revenue giant Walmex dominates.*



America's most challenging market: Mexico, where the US\$49.4 billion revenue giant Walmex dominates. Multinational players like Carrefour have been unsuccessful in exploring Mexico's retail market in the past, but region-specific groups such as Grupo Ley, which has strong presence in the Northern states of Mexico, would be interesting entry options for a Brazilian or a Chilean group

like Cencosud, said a Mexico-based banker. According to the banker, it could also make sense for Controladora Comercial Mexicana (Comerci) to sell its brand Sumesa after it sold its 50% stake in Costco de Mexico to Costco for US\$760.4 million in June.

For now, however, Cencosud plans to stay safely south of the Equator, as Mexico

would be too large of an investment, said the Chile-based industry banker.

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*By mergermarket reporters: Priscilla Murphy in Rio de Janeiro, Juliana Cavacana in Sao Paulo, Ana Toral in Santiago and Adriana Curiel in Mexico City*

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