The number of private equity investors seeking out large cap deal opportunities in Latin America has increased significantly over the last few years. Between 2010 and 2011 a total of seven $1bn+ funds were raised for the region, while large international PE firms are competing to close new investments.

Across Latin America private equity investment as a percentage of GDP is still a fraction of that in developed and other emerging markets, but it is evident that for large-cap investors competition and asset prices have increased in Brazil, Mexico, Colombia, Peru and Chile.

As a result, many investors are convinced that better returns will be generated from mid-market deals, where PE firms benefit from a larger stock of target companies and more attractive entry multiples.

Definitions of the mid-market vary, particularly when comparing Brazil to other Latin American countries. One of the most common means of defining the mid-market is by ticket size -- or the amount of capital committed to a deal -- which for a mid-market transaction could range from $10m to $100m. Alternatively, the mid-market may be defined as deals involving companies with annual revenues between $30m and $250m.

Some investors in the region also cite overall enterprise value as a benchmark, involving companies with a value between $100m and $500m.

Drawing on proprietary LAVCA data, three criteria can be used to estimate the number of mid-sized deals closed in 2010 and 2011: first, the size of the company (if revenues are known); second, the size of the investment made (if the financial details of the transaction were disclosed); and, third, the fund strategy as described by the private equity firm completing the investment.

On this basis, 107 mid-market deals were closed during 2010 and 2011, or 61 deals in 2011 and 46 in 2010. In dollar terms, a total of $1.73bn was invested in mid-sized deals in 2011 against $1.59bn in 2010.

Brazil accounted for 52 per cent of deals by volume, but 69 per cent of deals by total value in 2010-2011, indicating that the average mid-market ticket size in Brazil is higher than in other countries in the region. Mexico made up 16 per cent by volume and 12 per cent by value.

In Brazil, the concentration of investors has created an auction-like process for larger deals. By the account of one LAVCA member, more than 80 per cent of the PE capital available in Brazil is chasing a relatively small pool of 3,000 large companies (those with annual revenues of more than $200m). Meanwhile, the mid-cap market is only receiving around 15 per cent of available private equity capital despite the fact that there are 14,000 companies in Brazil with annual sales between $30m and $200m.

According to reports from local fund managers, this concentration has also driven up multiples, with large private companies in the range of 10 to 12 times Ebitda, while mid-sized private companies are being acquired for six to eight times Ebitda. However competition from Brazilian strategic or corporate investors has also pushed up valuations at the top end of the middle market.

Growth Strategy

The majority of mid-market companies in Latin America are family owned. Mid-market PE investors will typically seek to acquire a majority stake, but fewer owners have been willing to cede control as capital has become more abundant in the last few years. Recently many of the PE firms investing in Latin America have adopted a more flexible approach, balancing a minority stake with board seats and other guarantees that interests are aligned.
The overwhelming majority of mid market deals tracked by LAVCA in 2011 was classified as growth financing, with a lesser share of buyouts and expansion stage investments.

Strong macroeconomic performance over the last decade in Brazil, Mexico, Colombia, Peru and Chile has led to the rise of the middle class and demand for new products and services. As a result, many smaller companies catering to this segment have grown to mid-market in size. Mid-market private equity investors generally take a hands-on, operational role in working alongside management to help firms capitalize on trends in middle class consumption, or on increasing capital expenditures in the corporate sector.

In the mid-market segment, the buy and build/roll up strategy has been a popular vehicle for driving growth

One seasoned regional investor described growth rates for mid-market businesses ranging from 15 to 25 per cent a year, with well-managed companies increasing annual revenues from $100m to $200m within a typical investment timeframe of three to five years.

In the mid-market segment, the buy and build/roll up strategy in a particular sector has been a popular vehicle for driving growth. With capital and strategic input from a private equity investor, a well-managed company can achieve scale by acquiring competitors in order to establish a dominant position in a given sector.

One example of this is Nexxus Capital’s investment in Taco Holding, a holding company comprising a diversified platform of leading brands in the quick service restaurant industry in Mexico. Since March 2011, the company has expanded rapidly by acquiring various brands and fast food chains including Arrachera House & Sixties Burger, Krispy Kreme de Mexico, Neve Gelato, Sbarro Mexico, and Caffé Diletto.

In the technology sector, regional investor Riverwood Capital has set out to create a cloud computing leader in Brazil, first acquiring ALOG Data Centers do Brasil in 2011 followed by Mandic SA and Tecla Internet. The transactions target increased technology spending from corporate and small and medium enterprises in Brazil by offering Software-as-a-Service and Infrastructure-as-a-Service.

The opportunity to scale businesses across Latin America has driven ambitious sector-focused mid-market strategies within a number of leading PE firms active in the region. Riverwood has also backed companies in the cloud computing sector in Chile (Synapsis) and Argentina (Globant), among other markets.

And Advent International, which is currently investing a $1.65bn fund raised in 2010, made two mid-sized investments in the pharmaceutical industry in 2011, first acquiring Laboratorio LKM, an Argentina-based pharmaceutical manufacturer, and then Biotoscana Farma in Colombia in a bid to build a regional platform in the sector.

Target Sectors

The majority of PE firms making mid-market investments in Latin America are targeting sectors related to domestic demand, with a concentration around consumer products and services.

In dollar terms, mid-market investments reported to LAVCA in 2010 and 2011 were concentrated in logistics and distribution (22 per cent); other services, including fleet management, leasing of vehicles, parking companies, restaurant chains, rental and lease of machines and equipment (13 per cent); retail (12 per cent); and education (11 per cent).
A total of 10 deals with stakes ranging from approximately $10m to $75m were completed in logistics and distribution, including investments from CRP, Darby and Aqua in Brazil and Alta Growth Capital in Mexico.

Financial services deals were represented with a half dozen mid-market investments in 2010 and 2011, including deals in Brazil, Mexico, Colombia and Central America. In Mexico, Darby Overseas took a stake in Controladora Vertice which targets housing and construction finance; Acon Investments backed Credivalores, a Colombian consumer loan company; Linzor Capital acquired Colombian pension fund manager Colfondos; Altra Investments backed CrediQ, an auto financing company, in its expansion in Central America; and Patria invested in Brazilian credit card services company Suppliercard.

The majority of PE firms making mid-market investments in Latin America are targeting sectors related to domestic demand

Investments in the education sector have been a major theme across Latin America, with both larger and mid-market deals represented. Among the mid-market deals reported in this sector, Capital International Private Equity invested $64m in Brazil’s IBMEC Educacional, while Graycliff Partners (formerly HSBC) joined Nexus Capital in Harmon Hall Holding, the largest specialized English language school in Mexico.

Victoria Capital Partners has been an active investor in education deals, most recently with a commitment to Ideal Invest, a company specialized in student loans for private post-secondary education in Brazil.

Brazil and Mexico were the main markets where investments were closed in the retail sector, including FIR Capital’s stake in building materials retailer ABC (Atacado Brasileiro da Construção), Gavea’s investment in men’s clothing retailer Camisaria Colombo, Linzor’s buyout of Mexican eyewear chain Colsa, and Nexus Capital’s buyout of Moda Holding.

A number of mid-market private equity investors have also set out to target sectors that relate directly or indirectly to agribusiness, natural resources or energy. Pampa Capital has invested in soya bean production in Paraguay, Argentina and Brazil as well as in livestock and agribusiness companies in Argentina and Brazil.

Several firms based in the Andean region are pursuing mid-sized investments across the energy sector. Peruvian investor AC Capitales backed the Maple Companies, which is engaged in a range of energy-related projects including ethanol, exploration and production of crude oil and natural gas, and refining, marketing and distribution of hydrocarbon products. Colombian PE firm Tribeca invested in thermal power plant TEBSA, and in oil and gas exploration through Petrolatina. And Bogota-based LAEFM joint ventures with specialized operators who have contracts with the Colombian National Hydrocarbons Agency and/or with Ecopetrol.
Exits and Market Liquidity

Private equity managers realized record exits in 2011, with over $10.5b raised in strategic sales and IPOs. Sellers looking to divest mid-market portfolio companies are benefiting from a dynamic environment where international firms compete with Latin American strategic investors and large global asset managers to acquire assets in the region.

Multinationals from the US or Europe - whose home markets are sluggish – are seeking a foothold in the Latin American marketplace. At the same time, the rise of the ‘Multi-Latina’ in Latin America has created opportunities to sell portfolio companies to regional firms looking to expand into new sectors or markets.

Some Latin American fund managers have also been able to capitalize on the opportunity to sell assets to large global private equity firms seeking deals in the region. Two examples include Apax’s acquisition of outsourcing services company Tivit from Brazilian firms Votorantim Novos Negocios and Patria Investimentos, and Thomas H Lee’s buyout of the Fogo de Chão restaurant chain from GP Investimentos.

A total of seven exits were realized through IPOs in 2011, but most of these involved larger transactions. With increased volatility in capital markets over the last year, IPOs have become far more difficult to execute. In Latin America IPOs are generally only available to the biggest and best-managed companies. For example, in Brazil a company needs annual revenues between $500m and $600m to consider listing on the Bovespa.

However, in May, Stratus Group successfully listed Senior Solution, an IT company which specializes in software provision for financial institutions, on the Bovespa Mais segment of the Bovespa exchange. The news marks the first private equity-backed company to list on the AIM or Nasdaq equivalent of Brazil’s exchange.

And in Chile, Linzor Capital listed mid-market portfolio company Cruz Blanca Salud on the Chilean stock exchange in June 2011, divesting 44% of its stake and generating $233m. Mid-market investor Nexxus Capital has also been successful in listing portfolio companies on the Mexican exchange.

### HIGHLIGHTED MID-MARKET DEALS

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(*) HSBC Latin America is now Graycliff Partners
(**) ‘Other Services’ includes sectors such as fleet management, leasing of vehicles, parking companies, restaurant chains, rental and lease of machines & equipment, etc.
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