

# The Private Equity Outlook in Latin America, India and Africa

*Latin America, India and Africa remain places of interest for PE firms because of bullish long-term trends but they are cautious about getting in at present due to current upheavals in certain areas. In Brazil, the sharply devalued currency makes deals more attractive, but there is a sense that the floor has not yet been reached and so PE is still shying away. At present, Colombia, Peru and Chile are enjoying stronger economies but deals large enough for PE are not easy to find.*

*PE is bullish on Mexico and India as well, but the latter could face risks because it is not part of the Trans-Pacific Partnership trade deal. Africa presents big opportunities for PE that want to make financial services plays since most of the population remains unbanked. Discussing these trends in detail with Knowledge@Wharton are Michael Rogers, EY's global deputy private equity leader, and Stephen M. Sammut, a senior fellow and lecturer at Wharton.*

*An edited transcript of Part 2 of that conversation follows.*

**Knowledge@Wharton:** Let's turn to Latin America. Mike, I know you follow that region very closely. But looking at some of your reports in Latin America, not counting Mexico, PE activity fell 30% to the lowest point since 2009. The reasons were China's economy again, the drop in commodity purchases and rising interest rates. The political problems affecting Brazil are obviously huge with what's happened there. Argentina is having issues, as is Venezuela. Could you give us an overview of Latin America?

**Michael Rogers:** This is really the tale of many different markets. There was the assumption that Latin America traded in-line with each other, all of the different countries, and we're certainly seeing this dispersion of performance. What we're really noticing was that the biggest entity in the market, Brazil, had led the markets for a long time. The number of transactions that were done in Brazil dwarfed what was done in the other markets.

We've seen the rise of the Pacific Alliance, which has helped with reforms for countries engaged in that process, both from a government perspective and economically. That has actually been to the

benefit of countries including Mexico, Peru, Chile and Colombia. We have seen better performance out of those countries.

To hit the biggest one first, Brazil is experiencing a crisis of confidence. The political corruption process that they have been going through has really moved into the business economy. They have been in a recession for some period now. A lot of people are very concerned operationally there, in terms of what is going to happen in Brazil. You touched on the currency issue and that drives activity in a market. If there is any truth to that, Brazil would be a case where that would be a great opportunity because the real is down as much as 40% to 50% against the dollar. If you're a U.S. dollar investor, it would seem like an appropriate time.

But even with the discount you may apply to some of the companies, there are still very savvy investors who say, "You know what? We can still go further down from here." There is not a lot of confidence that they are picking the bottom of the investment cycle relative to the currencies, so we have actually seen people continue to shy away in

many cases, although PE oftentimes is contrarian. When they go in, they tend to find the right spots and to find opportunity. You would think that is the situation right now in Brazil, but valuations have not come down as far as people would like, so that's going to hold up deal flow for a while. But we think there is a great market for PE there longer term because of the size of transactions.

As you move around to some of the other countries, maybe their economic situation is a little stronger. In Colombia, Peru and Chile, for example. However, there are not very many large-scale companies that are available for purchase. A lot of family-run, smaller entities probably need to go through a cycle of a first-stage buyer, if you will, before they get professionalized and large scale enough to be attractive to larger PEs. The one economy that has done a nice job in a tough environment is Mexico. When we travel the world, people often ask us about two or three locations that are liked from a PE perspective. One is India, which seems to be at the top of the heap in some ways right now. Another is Mexico, and maybe a third is Colombia. There is still a lot of interest in that Pacific Alliance area, and I think that Mexico has done a better job of diversifying their economy away from energy and looks attractive long term.

**Knowledge@Wharton:** Let's turn to India now. Steve, I know you spent time there and are closer to that market than some others. Give us your overview of how things are shaping up.

**Stephen M. Sammut:** India is always a fascinating story because it is so many countries and cultures rolled into this one thing that we call India. There remains within India significant state and regional differences, but the overall trend is positive. It runs the gamut of venture capital and private equity because there is a substantial amount of technology activity and information technology, biotechnology.

The Modi government put through a number of very important reforms in each sector that I think are going to increase confidence pretty

substantially, especially health care and biotech, which is the sector I stay very close to. The flow of capital will remain robust but sober in the sense that I don't see huge spikes in the amount of capital going in. But I think it will be steady. At least for the time being, valuations have become a little bit more rational and reasonable than they have been. The Indian entrepreneurs and sponsors may reverse that on the turn of a rupee, but that is positive. Across all sectors, everything from consumer to education to health care, we're going to see a lot of very fertile ground for investment activity.

The one area that remains almost open, but perhaps the most complex, is infrastructure. If there was an opportunity anywhere for significant infrastructure investment, it would certainly be India. But again because of governmental complexities, and the fairly decentralized way in which the states operate vis-a-vis the national government, that particular sector will remain challenged. But overall, I suspect India is going to be very robust.

**Knowledge@Wharton:** It sounds like government regulation is a risk or at least a barrier. What other things are going well for India right now? Lower oil prices have helped since it's a big net importer, but what risks remain going forward?

**Sammut:** Well, there's one in particular: The Trans-Pacific Partnership. If it is implemented, that could have a negative effect on India because it is not part of the TPP. That might divert more economic activity to other countries in the region, possibly at the expense of India, and India may have to re-align.

**Knowledge@Wharton:** Mike, what is your overview of India?

**Rogers:** We do see thriving consumption over there and low inflation. This is one emerging market that actually gets the benefit of lower oil prices. We have seen a little bit of press around their 'Make in India' program, as well as 'Startup India' and 'Stand Up India,' which are governmental programs that are trying to drive

business activity. We see them as positive for the most part, and I think that is helping lead a lot of these companies forward and improve their economy.

We've seen a current trend in PE investments in the consumption-led and technology-driven sectors like e-commerce and financial services. Steve touched on health care, which seems to be resounding around the world. And the PE firms we are talking to are looking for majority deals. Improvements have been made by the government, but still within that, lie some risks. ... I think some of the tax risks that have been discussed, those issues seem to get tweaked and improved, and at the same time they can become a bottleneck for transactions. The Indian government has shown that it has a willingness to change policies very quickly, and sometimes that can throw PE off when they are making assumptions and trying to figure out how to invest.

I also think that the competition for PE deals is going to continue to get heightened. Again, like some of the other markets that we have talked about, there are not that many large companies because many of the entities in India have grown up as family businesses, and that's not typically the model that is supportive of PE. But it's evolving, and we see bigger companies being put together and growing, and that should bode well. But as I mentioned, we do get a lot of questions around the world, and India does pop up on the top of the charts for a lot of our PE clients around the world.

**Sammut:** Can I share that this is a resounding example of what's going on in India, and it's something I've been directly involved in? Two years ago, we released a report that I co-authored on what the obstacles were in India for the growth of its pharmaceutical and biotechnology industry. Every single recommendation that my co-author and I made about what India needs to do has been implemented. We are seeing a government that is trying to be very responsive

and remove what obstacles it can. I find that very encouraging.

**Knowledge@Wharton:** Let's move on to Africa. During 2015, private equity in Africa was very positive and exits hit a nine-year high, despite the fact that firms were holding onto their investments longer on average. EY research also shows that private equity in Africa continues to outperform private markets, and financial services once again was the most common sector for exits. Please explain why the financial services sector is so hot.

**Rogers:** Let me lay out the facts. Obviously, financial services remains a very important sector for PE firms in Africa. In fact, they represented 20% of the companies exited by PE firms between 2007 and 2013 — and 24% over the last two years.

The investments have definitely increased. Based on our conversations with funds in the region, we believe it will continue to remain a significant sector for PE.

Africa, as a whole, is massively underbanked, but it's changing slowly. In 2011, about 24% of the population in Africa had a bank account. By 2014, that was up to 34%. So growth rates are extremely high and they represent a very attractive opportunity for PE firms. But I think there is also this concept of leapfrogging, where a lot of activity will move from the people being unbanked, to smartphones and applications and folks using banking in a different fashion than the traditional sense of brick-and-mortar banks being established in those countries. It's a different model, but I think it's important how that trend is playing out there as well.

**Sammut:** I think there is a very critical observation to make about how the private equity sector differs in Africa from the rest of the world. That is, most of the private equity players in Africa include, among their limited partners, development finance institutions (DFIs), like the IFC (International Finance Corporation), and substantial funds from the Northern Europe

social democracies. So, many of the private equity funds that are participating in Africa have a development and social impact agenda. They are there to make money, make no mistake about it, but the individuals involved have a somewhat different orientation. This is one of the things that has contributed attention to two of the important backbones of economic development: financial services and telecommunications.

Over the last 10 years, private equity investors have recognized that unless they address those first and bank the population and allow the population to enter the digital age, that the whole private equity enterprise is going to be a disappointing one. And it's exactly playing out that way. The private equity funds have been supplements to the activity of the DFIs, which quite wisely are using the private equity funds as ways of inducing private capital flows into the region.

It's an interesting story, and now we're starting to see more diversified interest across the board, not only in health care, not only in education, but consumer goods, retail — all of the ingredients of a diversified economy are playing out. While there may be perturbations from year to year, the overall trend for sub-Saharan and Africa is very positive. And more and more, the entrepreneurs and sponsors on the ground in the African countries are getting more comfortable with working with private equity funds. What we haven't seen yet is money for the earlier end of the development process, particularly venture capital, which is important because there are a few pockets of high tech — in Lagos, in Nairobi, particularly in South Africa — that can add yet another component to economic growth in the region. There is still a scarcity of capital there, but it eventually will follow. ■