

Mergers & Acquisitions 2013 – Costa Rica

Henry Lang

Lang & Asociados

1. Has the level of M&A activity increased, slowed, or remained flat in 2012 as compared to 2011, and what are conditions like today? In general terms, what level of activity is foreseen for 2013?

Costa Rica experienced a significant increase in the amount of M&A activity in 2012, driven by sales of local companies in retail and branded consumer products. The country is experiencing strong interest from Latin American multinational companies wanting to enter the market, which is seen as one of the most attractive countries for further expansion in Latin America.

San José has been recently selected by the *Financial Times*' iDi Intelligence as one of the 10 best cities in Latin America for future foreign direct investment, due to its competitive advantages to promote business establishment and growth. The country has also been ranked as one of the most competitive destinations in the continent on several occasions.

For 2013, M&A activity is expected to remain as vibrant as in 2012, driven by expansion plans from multinational companies in other Latin American countries, especially Colombia. Despite a major degree of uncertainty around the world's slow recovery, the EU's macroeconomic issues and a possible US fiscal freeze, Latin America is experiencing strong growth from its developing local consumer base and a wave of emerging Latin American "multinationals" that are filling the M&A vacuum left by North American and European multinationals.

2. Which industries do you expect will see the most M&A activity in 2013?

It is our belief that the sectors with the most M&A activity will be the branded consumer products (both edible and non-edible, but with an emphasis on food and beverages), retail (which covers several sectors) and industrial/manufacturing industries. Some of these deals are currently under way, but will be either announced or completed during 2013.

Acquisitions of free trade zone operations by multinational companies expanding to Costa Rica are also to be expected – especially in the medical sector, where exports have grown extensively over time, from \$87.6 million in 1998 to \$1,169.2 million in 2010, which accounted for 24 per cent of Costa Rica's total exports, making it the country's third largest exporting sector.

Additionally, Costa Rica has allowed for the creation of publicly traded real estate investment funds (additional to the pension funds with have been around for more than a decade). As they have grown significantly in size and assets under management over the last years, they have become an important player in the real estate M&A area. This trend is expected to continue given the relatively large amount of commercial real estate being developed in the country.

3. What types of deals do you expect to see?

Most M&A activity in Costa Rica comes from complete acquisitions of family-owned local companies, or local divisions of global companies, by industry players. Given the type of M&A activity we are foreseeing, we expect this trend to continue.

Other possible deals relate to the acquisition of small-scale local manu-

facturing operations by multinational companies interested in using currently existing infrastructure to quickly establish a presence in the region.

Joint ventures are still possible, but occur much less frequently.

4. Discuss the level of M&A activity you have seen over 2012 and expect to see in 2013 of: (i) pure domestic deals; (ii) deals in your jurisdiction involving a domestic target and foreign acquirer from Latin America, or a foreign acquirer from outside Latin America; and (iii) deals involving a domestic acquirer and foreign target in Latin America or a foreign target outside Latin America.

There continues to be a significant interest by Latin American multinationals, especially from the Andean region (Colombia, Peru and Venezuela), in entering the Costa Rican market. The vast majority of M&A activity revolves around sales of local companies to foreign multinationals, most of them Latin American.

Pure domestic deals have been picking up, especially in the food and beverage industry, as part of a local consolidation of the sector around four key players (FIFCO, Dos Pinos, Coca-Cola Femsa and Colombia's Grupo Nutresa). These trends will probably continue.

Noteworthy deals of 2012 include the following:

- Domestic deals:
 - March 2012: Gessa, a Costa Rican supermarket chain owner, acquired Saretto, a local independent supermarket;
 - March 2012: Distribuidora Lucema, a local food distributor, acquired Salsas Alfaro, a local sauce and condiment producer, for \$4 million;
 - March 2012: Florida Ice and Farm Co (FIFCO), Costa Rica's largest beverage company, signed an alliance with Coopeleche, a local milk cooperative, for the production and distribution of dairy products;
 - April 2012: Inversiones Azul Dos Mil Cincuenta, an independent company, acquired Productos de Concreto, a subsidiary of Holcim with operations in Costa Rica, for \$11 million;
 - May 2012: Dos Pinos, Costa Rica's largest dairy company, merged with Coopecoronado, a local dairy producer;
 - June 2012: Quebradora Ochomogo, a Costa Rican company, acquired Holcim's aggregates plant in Costa Rica for \$600,000;
 - October 2012: Grupo Montecristo, a local family group, acquired Zona Franca BES, an industrial free trade zone park;
 - October 2012: FIFCO acquired North American Breweries, the largest independent brewer in the United States, for \$388 million; and
 - November 2012: ICE, a public telecommunications company, received approval by Sutel (Costa Rica's telecommunications regulator) to acquire Cablevisión, a local cable TV provider.
- Foreign acquirer deals:
 - January 2012: Grupo Bolívar, a Colombian insurance and financial service company, acquired HSBC Centroamérica, an HSBC subsidiary with operations in Costa Rica and Central America, for \$801 million;

- April 2012: Puma Energy, a global energy company, acquired Exxon Mobil assets in Costa Rica, Central America and Belize for \$100 million;
- May 2012: Grupo Mundial, a Colombian conglomerate (including paint division Pintuco) acquired Kativo, HB Fuller's subsidiary in Central America, for \$120 million;
- September 2012: Grupo Unicomer, a Salvadorean company owning of several retail chains in Central America, acquired Gollo, Costa Rica's second-largest white-goods retail chain, for \$200 million;
- October 2012: Grupo Nutresa, a Colombian processed-food multinational company, acquired American Franchising Corp, a Panamanian ice company with operations in Costa Rica and Central America, for \$110 million; and
- November 2012: Globalvia, a Spanish infrastructure company, acquired Infraestructuras SDC Desarrollos Internacionales, a Costa Rican company owning a 17 per cent stake in Costa Rican highway concessionary company Autopistas del Sol, for \$20 million.

5. What is the level of private equity activity? Are domestic or international funds involved? What kinds of deals are they doing?

There is a timid private equity market in Costa Rica, most of it deal-specific. It is led by local private equity groups funded by monies from Central American family offices, although more recently there has been increased interest by global PE firms from the US and Europe in sector-specific opportunities, energy and retail being the most relevant.

Mesoamerica, the region's largest domestic private equity group, currently manages three private equity funds: a joint venture fund with Actis in the renewable energy area throughout Central America; a food service fund that has made acquisitions in the Colombian coffee shop and fast-food industry; and an in-progress joint venture fund with a global private equity player in the business process outsourcing industry.

The global private equity funds view Costa Rica as part of a Latin American acquisition package in industries such as energy, retail and business process outsourcing. In few exceptional cases there have been some global private equity groups participating in Costa Rican specific targets, in industries like food and beverage and retail. This is a trend that is becoming more and more frequent.

6. Is acquisition financing available for deals? For strategic buyers? For private equity buyers? From domestic or international sources? What amount of debt:equity leverage are you seeing in private equity transactions?

There is financing available, but not like that which is typically available in developed markets. Depending on the type of acquirer, M&A is financed in the acquirer's home market (like most Colombian multinationals) or through syndicated loans including regional banks (ie, banks with a presence in several Central American countries) and global banks. It is worth noting that global banks are losing significant market share to the regional and Colombian banks in this type of financing.

It is rare to see acquisition financing higher than three times the rate of earnings before interest taxes, depreciation and amortisation (EBITDA). There are, however, multiple sources of funds given the regionalisation of the financial service industry and the excess liquidity in this area of the world, and it is common to see banks from Guatemala, Panama and Colombia competing with international banks in deal financing.

7. How open is your country to investments and acquisitions by foreign buyers? Is there a level playing field when foreign and domestic bidders compete to buy the same domestic target company?

From a pure M&A perspective there is a completely level playing field for all acquirers, regardless of the location or type of company (family-owned, private corporation or public company). In most cases a foreigner is seen as more favourable to a domestic player, with the expectation that the former will bring best practices, new products, more competitive pricing or better technology to the market.

8. Do you expect more M&A activity involving financially troubled companies?

Costa Rica was less affected by the global financial crisis given most companies were not over-leveraged and consumer fundamentals were stronger than in developed markets, thus there were few M&A transactions driven by this.

Costa Rica's economy is expected to grow between 4 per cent and 5 per cent during 2013, with solid macroeconomic conditions, so we do not foresee relevant M&A activity involving financially troubled companies.

9. Does your country's bankruptcy law permit the reorganisation of the debtor as a going concern, and the acquisition of the entity out of bankruptcy?

Costa Rican law includes the possibility of reorganising a company in a difficult financial situation, as long as the company is not completely bankrupt and recovery is feasible. This option is not extended to all companies – only those whose collapse would cause serious consequences in Costa Rica. Since the purpose of the reorganisation proceedings is to save the company from its definitive liquidation and closure, the company must continue operating, but under judicial intervention and following a restructuring plan. According to article 714 of the Code of Civil Proceedings, it is possible to include in such plan, among other measures, the acquisition of the company to save it from bankruptcy.

It must be said that in Costa Rica, when bankruptcy proceedings are initiated, the company is not allowed to reorganise; the intention is to liquidate it, and that usually implies its definitive closure. Bankruptcy proceedings are different from reorganisation proceedings. That said, under Costa Rican law, there is no specific provision that allows the acquisition of a company under bankruptcy proceedings; however, there is no prohibition either. It is therefore feasible for a company under bankruptcy proceedings to be acquired by a third party (investor).

For convenience and business opportunity reasons, the investor can propose, within the bankruptcy proceedings, an acquisition plan that may enable saving the company from bankruptcy. Such plan could consist of buying out all credits so that the investor would become the only creditor of the company, under new conditions implying that the company would no longer be bankrupt.

Additionally, the acquisition plan could consist of acquiring all or part of the shares of the company and, by way of such purchase, fully paying all credits or updating them so that the company would be no longer be considered bankrupt.

10. More generally has there been any increase in hostile takeovers and shareholder activism? What defences and responses are target companies using?

Capital markets are less developed in Costa Rica, and this type of activity is very rare.

A vast majority of the publicly traded companies in Costa Rica have been acquired through friendly processes originated by the owners, who typically have more than 50 per cent of the stock. We expect this trend to continue.

11. Have directors, management and controlling shareholders changed how they conduct themselves in M&A deals? What kind of fiduciary duties do directors, management and controlling shareholders have under the laws of your jurisdiction? From your experience, are directors, management and controlling shareholders more diligent today in their review of M&A transactions and other matters?

As most M&A activity does not involve publicly traded companies, this has not been a factor for local companies in the past. Additionally, given that the vast majority of companies are family owned and closely controlled, corporate governance structures tend to be less sophisticated and are not generally exposed to negative publicity, shareholder activism or litigation.

Duties and liabilities for directors and management do not derive from specific legal regulations; rather, they are reached by general legal stipulations on the responsibility of individuals having a mandate to act for third parties. Following the general rules, they would be responsible only for consequences deriving from their own actions, and for those which are against the best interests of the company or its shareholders and applicable law and regulations, as well as those

which are in breach of the company by-laws.

In the case of controlling shareholders, they would be liable in case of breach of applicable law, regulations or company by-laws.

12. Should directors, management and controlling shareholders be more concerned today about negative publicity, shareholder criticism, regulatory pressure and liability from potential litigation?

As there is a global trend towards more scrutiny in the role of directors, management and controlling shareholders, it would be fair to say that there should be a greater concern today, especially given that a significant part of the M&A activity involves a publicly traded company (as buyer) that is subject to several restrictions of this nature.

13. Are there major differences in how domestic and cross-border deals are being conducted? For instance, does the type of purchase agreement used in your jurisdiction differ significantly from the international style of agreement? If so, which type is being used more often?

There are two basic transaction structures used in Costa Rican M&A. If the buyer is a company that is not from the region (principally Central America), transaction agreements tend to follow typical US-based M&A procedures and documentation is in English. If buyers are local or from within the region, transactions usually follow the same standards as above, although they may also be structured under a more regional perspective and the use of Spanish may prevail. In any case, due diligence procedures are standard and for the most part follow international standards.

Specific components of the deals, which require local registration and/or authorisation follow local procedures and language for effective implementation.

14. For international buyers and investors looking at deals in your jurisdiction, what are the three most important pieces of advice you have and what are the pitfalls that should be avoided?

The three most important pieces of advice in this matter are:

- make sure you spend enough time understanding the local way of doing business and how this might affect your valuation. Every country in the region has a distinct form and culture;
- look for top-quality local advisers rather than just global brand names. The latter typically have little or no local knowledge and tend to send more junior teams. Spend enough time conducting due diligence. Virtually all M&A contracts have an arbitration clause that take it to Panama or the US, and this is a costly process (in both time and money) you should seek to avoid – don't rest assured on representations and warranties without due diligence; and
- ensure there is a strong local management team in place. Talent is becoming a scarce resource given economic growth and the entry of many multinationals.

15. Have there been changes in the process for how M&A transactions are conducted in your jurisdiction?

See question 17.

16. Have there been any significant developments in the regulatory area – your country's security exchange commission, antitrust regulators, etc.?

See question 17.

17. Describe recent and forthcoming regulatory developments that affect M&A, whether involving the securities and markets regulator, competition agency or other regulatory agencies that review deals?

The first of these derives from recent changes to the Antitrust and Consumer Protection Law, which was amended so that certain transfers, fusions, business acquisitions and other M&A processes now require prior approval from the government. Such transfers are referred as 'concentrations' and, as such, are subject of government approval if they have as their purpose or effect (a) acquiring or increasing the substantial power in a significant manner which limits or displaces the competition; (b) facilitating the express or non-express coordination between competitors or producing adverse results for the consumers; and (c) diminishing, damaging or avoiding the competition or free market with respect to equal, similar or substantially related goods or services.

The recent amendment to the above-referenced law also establishes an obligation to notify the Commission for the Promotion of Competition of certain concentrations, established per value of productive assets as well as per total income in Costa Rica for the past fiscal year.

The second relevant regulatory development corresponds to rules established by the recently approved Law for the Strengthening of Tax Actions (Law No. 9069), which in turn modified several sections of the Law on Real Estate Transfer. The modifications include, among others, the application of transfer taxes (previously only levied on transfers of real estate at the Public Register) to the transfer of shares of an entity holding such real estate. In regard to M&A deal implementations, it is still unclear if the change will affect transfers of an entire business in which real estate is only one of the assets held, but there are possibilities it would. This will probably be clarified in the near future once regulations and case law start to be created.

Additionally, for the last few years, there have been several efforts by the central government to pass an integral fiscal reform through Congress. They have all been unsuccessful. It is expected, however, that the government will try to pass parts of the law, including a VAT law (taxing services currently not being taxed) and income tax on dividend distribution for free trade zone operations). The sectors that would be affected by this reform and the specifics of how they would be affected is still uncertain, but it is expected that the service, manufacturing, construction, retail, import and free trade zone sectors may see a new set of applicable rules if a fiscal law is approved.

Lang & Asociados

Henry Lang

hlang@langcr.com

Parque Empresarial Forum I

Torre G, Piso 3,

Pozos de Santa Ana

San José

Costa Rica

Tel: +506 2204 7871

Fax: +506 2204 7872

www.langcr.com