

Mergers and Acquisitions 2012 – Costa Rica

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1 Has the level of M&A activity slowed, and what are conditions like today? In general terms, what level of activity is foreseen for 2012?

Costa Rica was not hit by the crisis as hard as other markets. M&A activity is not expected to slow down in the country in 2012 as compared with 2011.

For 2012, M&A activity is expected to remain similar to 2011, with increased uncertainty around the world's slow recovery and the country's possible fiscal reform, which is currently being discussed in Congress and may include substantial increases in taxes and the applicability of some taxes to new sectors (for example, VAT to services and income tax on dividend distribution for free trade zone operations).

The capital city of Costa Rica, San José, has been recently selected by experts of the Investigation and Intelligence Department of the Financial Times 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.

2 Which industries do you expect will see the most M&A activity this year?

It is our belief that the sectors with the most M&A activity will be financial services (especially commercial banking), in which some deals are already currently underway, consumer branded products, retail and building materials.

Acquisitions of free trade zone operations by multinational companies expanding to Costa Rica are also to be expected, especially in the medical sector, whose exports have grown extensively over time (from US\$87.6 million for 1998 to US\$1,169.2 million in 2010, when they corresponded to 24 per cent of the country's total exports, constituting the third largest exporting sector of the country).

3 What types of deals do you expect to see?

Most M&A activity in Costa Rica comprises total acquisitions of family-owned local companies or local divisions of global companies, both by industry players.

Other possible deals correspond to the acquisition of small scale local manufacturing operations by multinational companies interested in using currently existing infrastructure as a means to achieve a more agile start-up of their presence in the country and the region.

Joint ventures are still possible but occur much less frequently.

- 4 .Discuss the level of M&A activity you have seen over 2011 and expect to see in 2012 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 are seldom and unlikely to occur.

The above indicated trends will probably continue.

As follows, examples of noteworthy deals for 2011:

- domestic deals:
 - April, 2011: Horizonte Morado, a Costa Rican investment group, acquires Deportivo Saprissa, the most popular soccer team in the country;
- foreign acquirer deals:
 - March, 2011: Panamanian company Petróleos Delta acquired Shell's 31 gas stations in Costa Rica;
 - April, 2011: Farmacéutica Socofar, a Chilean drug store chain, acquires a 50 per cent participation in Corporación Cefa, Costa Rica's leading drug store chain with over US\$250 million annual sales;
 - May, 2011: After the opening of the Costa Rican cell phone market and the elimination of the then existing monopoly by state owned ICE, Telefónica, a Spanish telecommunication multinational, was adjudicated with one of the three frequencies for operation in the Costa Rican telecommunication market after paying US\$95 million and América Móvil, a Mexican telecommunication multinational, was adjudicated with another of the three frequencies for after paying US\$75 million;
 - June, 2011: Cargill acquires Corporación Pipasa, Costa Rica's leading poultry and meat processor;
 - July, 2011: Panamanian bank Banco General, which had recently began operations in Costa Rica, acquired Citi's mortgage loans in Costa Rica;
 - August, 2011: Grupo Terra, an Honduran group, acquired Chevron- Texaco's gas station operations in Costa Rica, Belize and Nicaragua
 - September, 2011: Equifax, a United States company specialising in credit records and software development, acquired Datum, the leading Costa Rican Credit Data Company;

- October, 2011: Carlson Wagonlit Travel, a United States company specialising in business travel, meetings, and event management, acquired Centennial Group, its local partner; and
- October, 2011: Pintuco, a Colombian paint group, acquired the operations of the Costa Rican paint company Vastalux for US\$5 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 being the most relevant. Most of the latter PE groups are funded by soft monies from developed country agencies.

6 Is acquisition financing available for deals? For strategic buyers? For private equity buyers? From which domestic or international sources?

There is financing available, but not like that typically available in developed markets.

It is rare to see acquisition financing above 3x 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 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 overleveraged and consumer fundamentals were stronger than in developed markets, thus there were few M&A transactions driven by this.

The effect on the local M&A market was that of a freeze in M&A activity across industries and a focus on cash preservation.

Because of the financial troubles, we do not expect M&A-driven transactions to be a significant factor in the near future.

8 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 that is under a difficult financial situation, as long as the company is not completely bankrupt and salvation is feasible. This possibility is not for all companies, but only for those whose disappearance would cause serious consequences to society. Since the purpose of the reorganisation proceedings is saving the company from its definitive liquidation, closure and disappearance, the company must continue operating, but under judicial intervention and following a salvation plan. According to article 714 of the Code of Civil Proceedings, it is possible to include in such salvation plan, among other measures, the acquisition of the company to save it from definitive bankruptcy.

It must be clarified 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, we can state that 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; therefore, it is feasible for a company that is 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 allow saving the company from bankruptcy. Such plan could consist in buying out all credits so that the investor would become the only creditor of the company, under new conditions that would imply that the company would no longer be bankrupt

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

9 What other types of activity are resulting from the economic situation?

The biggest current driving force in M&A activity is the opening up of trade barriers and the regionalisation of strong local companies in individual markets in Central America and the Andean region.

The above has resulted in intense local competition; local or regional consolidation, or both, is usually the driving force behind M&A activity.

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.

11 Have directors changed how they conduct themselves in M&A deals? Should directors and management be more concerned today about negative publicity, shareholder criticism, regulatory pressure and liability from potential litigation? From your experience, are directors 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 controlled, corporate governance structures tend to be less sophisticated and not exposed to negative publicity, shareholder activism or litigation.

12 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. If the buyer is a company that is not from the region (Central America mainly), 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 although they may also be structured under a more regional perspective and the use of the Spanish language may prevail.

In any case, due diligence procedures are pretty standard and for the most part follow international standards.

Specific components of the deals, which require local registrations and/or authorisations are also components of the deals and follow local procedures and language so implementations can be effectively made.

13 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 to:

- 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 go through arbitration in 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 scare resource given economic growth and entry of many multinationals.

I4 Have there been changes in the process for how M&A transactions are conducted in your jurisdiction?

None that are material.

I5 Have there been any significant developments in the regulatory area – your country's security exchange commission, antitrust regulators, etc?

None that are material.

I6 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?

At this time, there are no recent regulatory developments that substantially affect M&A activity. Notwithstanding the above, a recent modification to the Law to protect the citizens from the excessive requirements and administrative procedures, Law Number 8220, has been an important advance in simplifying government procedures and registrations, and having faster reactions and responses from government entities towards private investors.

As previously mentioned, a major tax reform for the country is currently being discussed in Congress.

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 this law is approved. Most of these sectors are currently very actively lobbying Congress and the final outcome is therefore still not clear at this time.

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