

# Views from the Field: Argentina



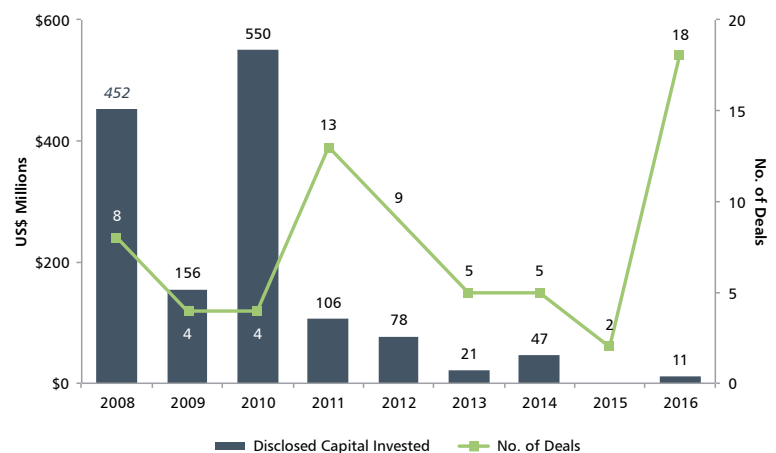
For investors who have endured nearly two decades of hardship in Argentina, new developments in one of Latin America’s largest economies point to better days ahead. The country was once a leading destination for private equity when the asset class emerged in the region in the 1980s. However, after facing chronic economic challenges and

growing competition from other regional markets, conditions for investment in Argentina declined significantly. The culmination of its woes came at the turn of the century, when the country defaulted on its public debt during a crippling financial crisis. The deep recession dealt a severe blow to foreign investors, who all but deserted the country.

Amid this crisis, Argentina turned to the populist protectionism of presidents Nestor and Christina Kirchner in 2003. ‘Kirchnerismo’ erected economic barriers—isolating Argentina’s economy—and employed widespread subsidies to redistribute wealth in an effort to ameliorate the country’s situation. The commodity boom of the last decade sustained the Kirchner regime, propping up a system based on the concentration of power in narrow, clientelistic political institutions and short-termism that hindered Argentina’s growth over the long term. The effect of the government’s shackling of foreign investment was clear: between 2008 and 2010, disclosed private capital invested totaled US\$1.2 billion, with three large deals accounting for more than 80% of that total. Since 2011, however, that total has been just US\$262 million (see Exhibit 1).

In spite of these challenges, a new chapter has begun in Argentina. Following more than a decade of Kirchnerismo, the election of Mauricio Macri in 2015 signaled a shift towards market-oriented policies and the opening up of the country.

**Exhibit 1:** Disclosed Private Capital Deals in Argentina, 2008-2016



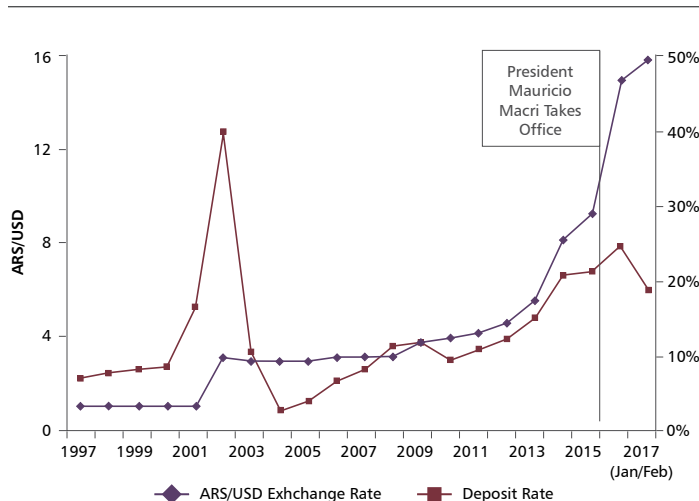
Source: EMPEA. Data as of 31 March 2017. Published 28 April 2017. Includes private equity, private credit, infrastructure and real assets.

Since taking office in December 2015, Macri has begun the painstaking process of reforming the country's economy.

Argentina has rejoined international financial markets, removed capital controls to liberalize its foreign exchange regime (see Exhibit 2) and implemented government initiatives to foster entrepreneurship and private capital investment. These changes have caught the attention of international investors, and while some of the reforms may take time to take effect, the Argentine economy is expected to recover in the years ahead (see Exhibit 3).

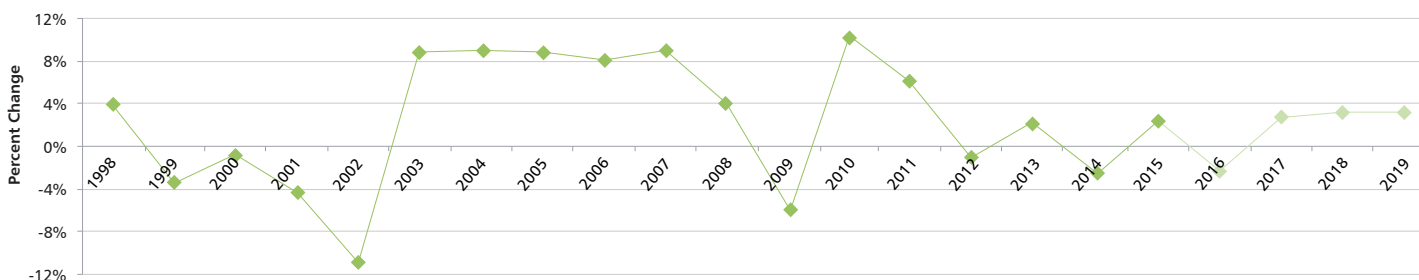
In this *Views from the Field*, veteran fund managers from across the private equity and venture capital spectrum offer their insights and perspectives on the competitive landscape and opportunity set for private capital in Argentina, recent economic and political trends and key considerations for investors as they evaluate rapid change in one of Latin America's key markets.

**Exhibit 2: Argentina Exchange Rate and Deposit Rate, 1997-February 2017**



Source: International Monetary Fund. "Deposit Rate" denotes the weighted average rate offered by financial institutions in Buenos Aires and surrounding areas on 30- to 59-day time deposits in national currency. The rate is weighted by deposit amounts.

**Exhibit 3: Argentina GDP Growth Rate, 1998-2019**



Source: World Bank. Accessed 5 April 2017.



**Carlos Garcia**  
Co-Managing Partner  
and Chairman,  
Victoria Capital  
Partners

### How do you view opportunities in Argentina today from a historical perspective?

If you look back to the 1990s, Argentina was the largest private equity market in the region. Then the country went through a massive crisis in 2001, and some firms suffered a lot. This traumatic history is important to understand because as we come out of the Kirchner days and settle into the new administration, we enter a new era where not only do people have

to believe that Argentina has changed, but they also need to know that they will not be hurt again.

In the last 16 months since President Macri took over, Argentina has generated a lot of interest, but activity is still limited. There is still a big gap in expectations. Local asset owners naturally expect that prices should already reflect that Argentina has changed, whereas prospective buyers, who have seen the country's performance since the 2001 crisis, are looking at Argentina and saying, "There might be good opportunities, but I better be prudent."

From a political standpoint, Argentina is coming out of the woods in a moment when Latin America has lost some attraction as a region. It is happening right in the middle of Brazil's macroeconomic situation and after President Trump's election has raised concerns about Mexico. Argentina has changed and is moving toward a more rational administration and a more stable environment, but we have to be patient. We are a GP and we have limited partners that a year-and-a-half ago probably wouldn't even consider co-investment opportunities in Argentina. Clearly, there has been a change in perception, but it is going to take time.

### What are the key areas for growth?

The energy sector is a key potential growth area, which is driven by two things. For one, the Kirchners maintained an irrational policy for 12 years whereby they were incentivizing consumption and penalizing investment, creating a significant shortfall in energy supply. Part of the solution is to eliminate subsidies, but Argentina needs to invest significantly in extra generating capacity over the next five to ten years. Second, the government has now created a new regulatory framework to attract investment in renewable energy sources like wind and solar. It is very likely that the government will try to attract private equity to supply the capital needed by some of these ventures alongside government initiatives.

Aside from energy, there are many industries where Argentina is a leading player globally, such as agribusiness. When it comes to technology development and adoption, innovation, quality of personnel and management skills in the agricultural space, Argentina is at the forefront of the world.

Additionally, in information technology (IT) services or IT-enabled businesses, Argentina's talent puts it clearly at the forefront of development in Latin America. When you look at companies like Globant, Mercado Libre or Despegar, they are all businesses developed in Argentina with very little physical investment and with a lot of intellectual investment. Argentina has a very well-educated population, so businesses that are heavily dependent on human capital are positioned for growth.

### How do you address currency risk?

President Macri freed up the foreign exchange market as soon as he took over and since then the exchange rate has been stable. The peso will remain appreciated for some time, but I believe that eventually Argentina will have to adjust its currency—either by the government proactively going in that direction or by the market causing the adjustment to take place. It won't happen immediately, but over the next three or four years, we'll have a natural balancing of the exchange rate.

We deal with currency risk through three different tools. First of all, we like to invest in sectors that may have some natural hedge, not necessarily because they are exporters, but because the industry dynamics are dollarized or strongly linked to dollar rates. Second, we invest in businesses that, despite the exposure to foreign exchange risk, have a potential growth rate that is very likely to exceed any devaluation. In high-growth industries, your currency could devalue, but your local currency growth is so strong and your pricing ability is so powerful that you can recover from that situation. Last, but not least, when we price the assets we buy, we tend to reflect the potential devaluation.

### What do you expect in the near term for PE in Argentina?

I am cautiously and rationally optimistic about the future of the Argentine economy and the investment opportunities that we may come across in the future. The transformation the country is going through is profound, and it is not going to happen overnight. Therefore, you need to calm your anxiety and understand that after many, many years of being out of the private equity market, rejoining it will take some time.

My advice is, don't panic when you see the headlines because Argentina is a country with an intense political culture. Be patient. Be prudent. This is the place where you will probably see the best values in the region. Let's be realistic and cautious, but let's also be cognizant that the opportunities are there. ●●

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**Gustavo Eiben**  
Managing Director,  
The Rohatyn Group

### What factors are contributing to PE opportunities in Argentina at the moment?

In 2001, Argentina was coming out of a default. Since then, and mostly over the last five years, a lot of companies have been battling day in, day out to survive. Now under the new administration, they see a light at the end of the tunnel, saying, "I'm tired and I don't have a succession plan. Maybe this is a good opportunity for me to pass this company on to someone else to take it from here," or, "I need a partner to take advantage of the opportunity of the country's new growth phase." Many companies, who see this as the time to grow, need a partner on the financial and technical side in order to do so. We see opportunity, both on the growth equity side, as well as in selective buyouts.

### Have Latin American GPs begun to come back to the market?

When PE started in Latin America in the 1980s, there were only two main markets: Argentina and Chile. In the late 1990s, other markets emerged, and by the mid-2000s Argentina had virtually disappeared. For more than ten years, Argentina was not even on the map for PE investment, but after the 2015 presidential elections Argentina is back on the map.

We are seeing activity, no question about it. For now, most of the interest has come from very few regional players looking to make select investments in Argentina from their regional funds. Many people have told us, "We will wait and see how things evolve in the first year, maybe the first two years, of the Macri administration." Obviously, we respect that view, but we feel very strongly that the opportunity is now and we are ready now. We have the team, we have the pipeline and we have the capital to deploy, so we are in execution mode. We closed our first investment early this year.

### In what sectors do you see the greatest opportunity?

Aside from industries where Argentina has a sustainable competitive advantage, including food and agribusiness, infrastructure is a huge opportunity. This not only includes utility or telecom companies, but companies that provide services, like logistics businesses.

### Has access to capital improved following Argentina's return to international financial markets?

Since most of the bond offerings so far have been on the sovereign and quasi-sovereign side, that capital hasn't trickled down yet as it should. Only a limited number of corporates have issued international bonds, in most cases large companies. That said, the capital market is rebounding strongly. International banks and some hedge and credit funds are more active, and cross-border funding is slowly returning to Argentina. We haven't yet seen an improvement of availability of international funding for mid-market companies.

In terms of the equity markets, the first international initial public offering (IPO) was completed by a local bank in mid-2016, and we see a significant pipeline building, both in the local and international markets. When you consider private equity, an IPO conversation is key because that is a potential route for exit. As the capital market gets more robust, it will also change our perspective on acquiring and exiting companies.

### How do you address key LP concerns?

The number one macroeconomic concern for most investors is whether it is possible that the Kirchner administration will return. Even if President Macri is not reelected—and we think he will be—the chances of going back to an administration like the Kirchners are very, very low.

On currency, LPs in Latin America have suffered big time. Surprisingly, in Argentina the currency has been quite stable, so the question is whether we are buying at the right time or whether we should wait until the dollar appreciates even more. This is not exclusive to Argentina. The region has gone through a major readjustment in terms of currency, but the reality is that LPs know that this is a risk when they enter emerging markets. What we do is pursue businesses that are more dollar-related than peso-related to try to mitigate this currency risk.

### Do you think conditions might be more favorable down the road?

For us, this is the time to go. Valuations are very attractive and the pipeline is there. There have been many cases in newer markets like this where it takes a while for GPs to build a pipeline and find deals. Mexico was a clear example of that. When the opportunity in Mexico arose, it took a while for managers to start putting money to work. The pipeline wasn't there. If you get the money from your investors and you don't put it to work right away, that's a major drag on your net internal rate of return (IRR). No LP wants something like that. ●●



**Gonzalo Costa**  
Founding Partner,  
NXP Labs

### What has made Argentina's venture capital ecosystem so successful?

Entrepreneurs from Argentina have historically been at the top of the charts in Latin America. Currently, out of the nine Latin American technology companies with valuations of over US\$1 billion, four are companies from Argentina, though they maintain a regional footprint. Perhaps because the country's seclusion from international markets limited

domestic growth potential for these companies, they knew from day one that they could not focus on just conquering the local market, but rather needed to eventually find a way to grow outside of Argentina.

What we usually tell investors is to imagine, "what if?" If these companies managed to get off the ground and survive, and in some cases grow, despite all the factors against them, imagine what could happen if those same companies are fully supported by the local government with more access to the international market. So we're very positive about the future for entrepreneurs in Argentina these days.

### Have any changes introduced by the Macri administration had an effect on the startup scene?

Rejoining international markets and making the currency flow freely are just the start. There is also now a new law for entrepreneurs that focuses not only on entrepreneurs, but also on venture investors. We will see less red tape for founders wanting to start a business, as well as interesting incentives and tax breaks for investors. The government is really committed to fostering more and better startups in Argentina, and they see venture capital as a big component in this equation.

### Have you seen an uptick in investor interest?

While investment interest has increased, it will take longer for more institutional-type money and international investors to enter Argentina. It is up to us to prove that we now have a more stable economy and a stable ecosystem for entrepreneurs and investors. I'm very excited about it, I think that we are in the beginning of a new journey. But we have to prove that this time it's for real, and it's for the long term.

### What makes Argentina attractive to an early-stage investor?

There is a new wave of companies that are created locally but try to be global from day one. We are already starting to see that type of company take off from Argentina, which has a key advantage: companies can leverage a very lean P&L because talent in Argentina is both top quality and, at the same time, much cheaper than the same type of talent in tech hubs like Silicon Valley.

Argentina is specifically very well positioned to take over in agtech (agricultural technology). Argentina has a history of bringing innovation into the agricultural market. Another attractive area is fintech, given that Latin America as a whole is very delayed in that area compared to more sophisticated markets. In the last 12 to 18 months, we have seen a new wave of companies essentially trying to bring down the banks and bring reinvention to the financial market. Fintech is a sector we are very, very excited about.

### What are the exit paths available to startups in Argentina?

IPOs have been a rare thing for startups coming from Latin America. For this new wave of companies trying to be global from day one, however, it could be feasible to have an IPO in an international market. If they manage to get off the ground, survive, and grow, they will end up being international companies. They just happen to have a more efficient P&L back in South America, but at the end of the day, they are selling globally.

Many of our companies have raised money from investors in Silicon Valley and New York and other sophisticated markets that do not perceive them as Latin American companies but rather as global companies with employees abroad. By focusing on the regional market, companies open themselves up to potential strategic buyers that are looking to have a presence in Latin America, but for these companies that are going global, the pool of potential strategic buyers is much larger.

### What are the prospects for VC in Argentina in the coming years?

I believe the venture capital market in Argentina is still in its infancy. We have the talent, entrepreneurs are hungry for success and we believe that early investors in this new wave of technology companies will bring extraordinary results. ●●