

Tuesday, December 5, 2017

Infrastructure in Latin America

A view of risk & opportunity over the next five years

Live webinar

► Agenda

I **A region on the turn**

Iain Donald

Senior Partner, Control Risks



II **Economic outlook: Latin America in a “sweet spot”**

Marcos Casarin

Head of LatAm Macro Research,
Oxford Economics



III **Mexico, Central America and the Caribbean**

Gavin Strong

Associate Director, Control Risks



IV **The Andean region**

Laura Sharkey

Analyst, Control Risks



V **Brazil and the Southern Cone**

Thomaz Favaro

Associate Director, Control Risks



VI **Seizing the opportunities**

Iain Donald

Senior Partner, Control Risks



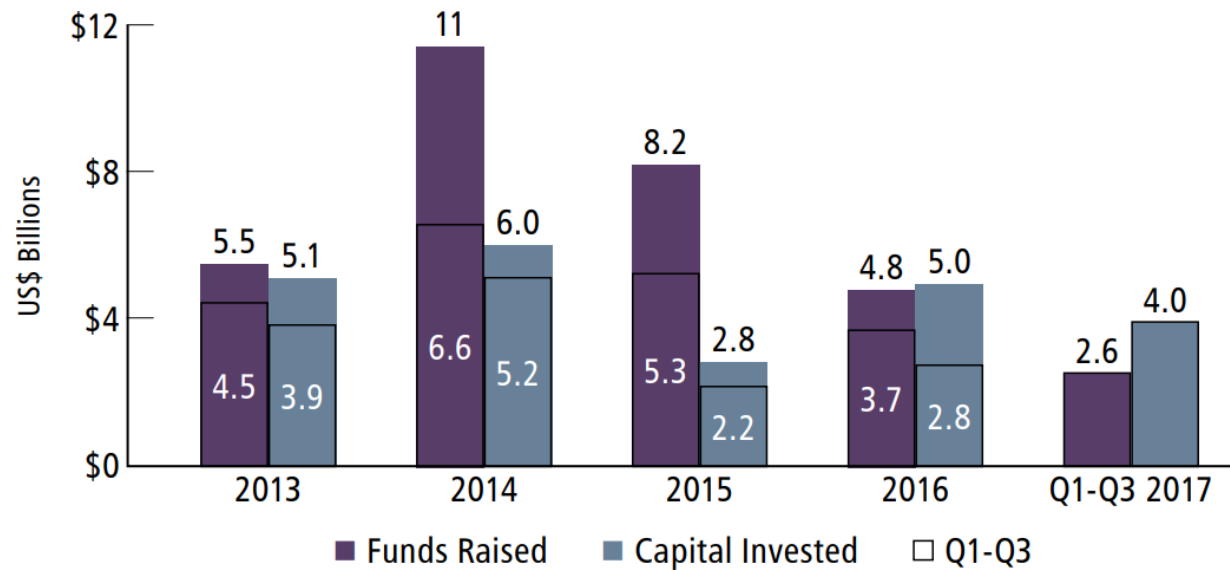
A region on the turn

Iain Donald
Senior Partner, Control Risks
New York

▶ Private capital flowing back into the region

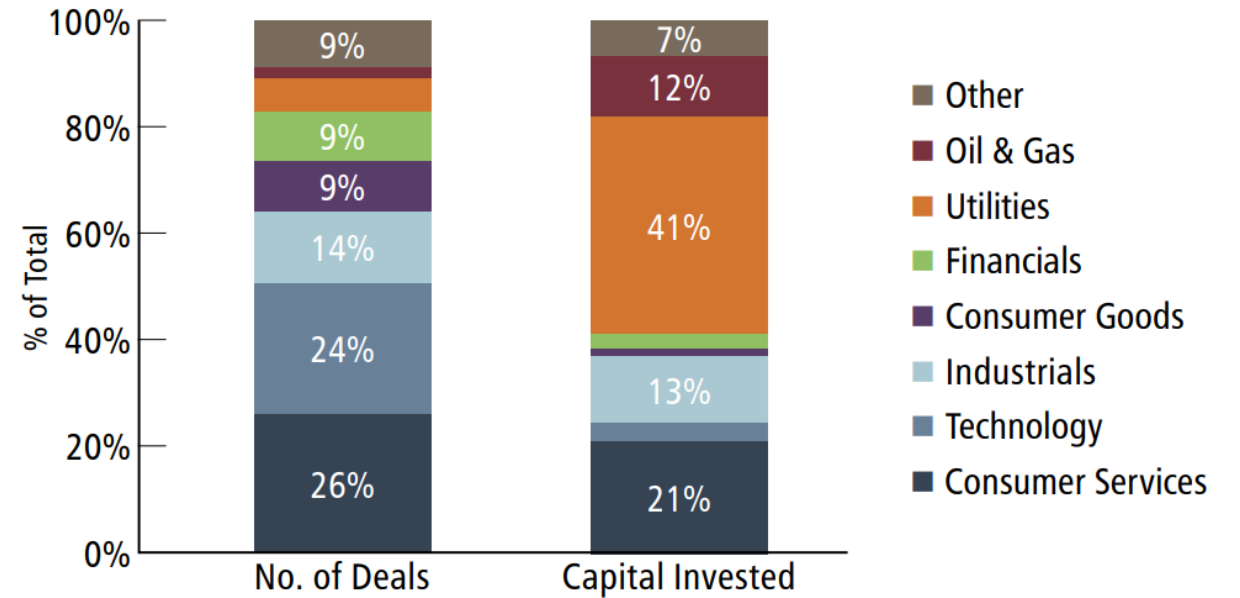
Total capital invested in Latin America in Q1-Q3 2017 increased 42%, year-on-year, to USD 4 billion

Latin America Fundraising and Investment, 2013-Q3 2017



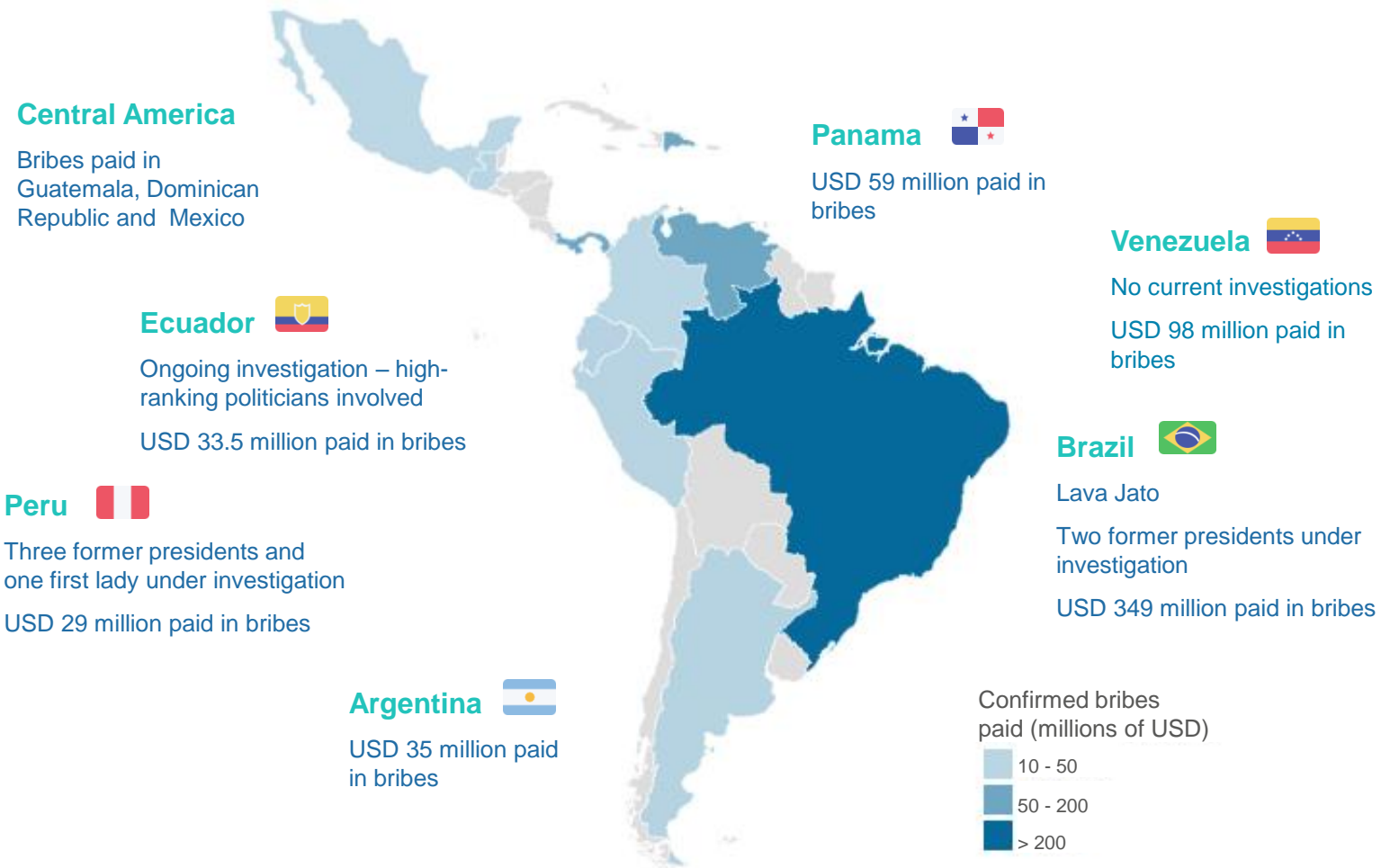
Investments in utilities and oil & gas accounted for more than half of capital deployed in the region so far in 2017

Latin America Investment by ICB† Industry, Q1-Q3 2017



Data and charts courtesy of EMPEA
www.empea.org

► The Odebrecht scandal driving some opportunities...and concerns



Source: El Pais



Economic outlook: Latin America in a “sweet spot”

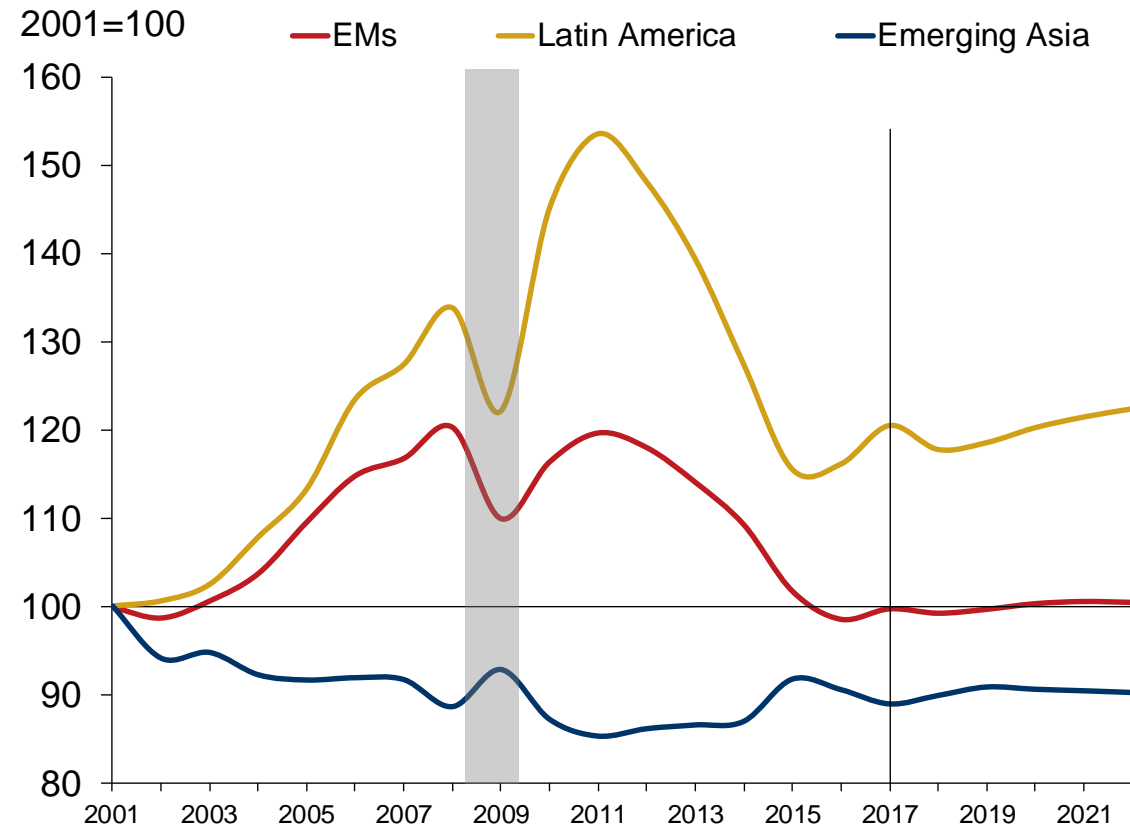
Marcos Casarin
Head of LatAm Macro Research, Oxford
Economics
London



▶ Economic outlook: Latin America in a “sweet spot”

As a key commodity exporter, region is benefiting from recent upswing in prices

Emerging Markets: Terms of trade

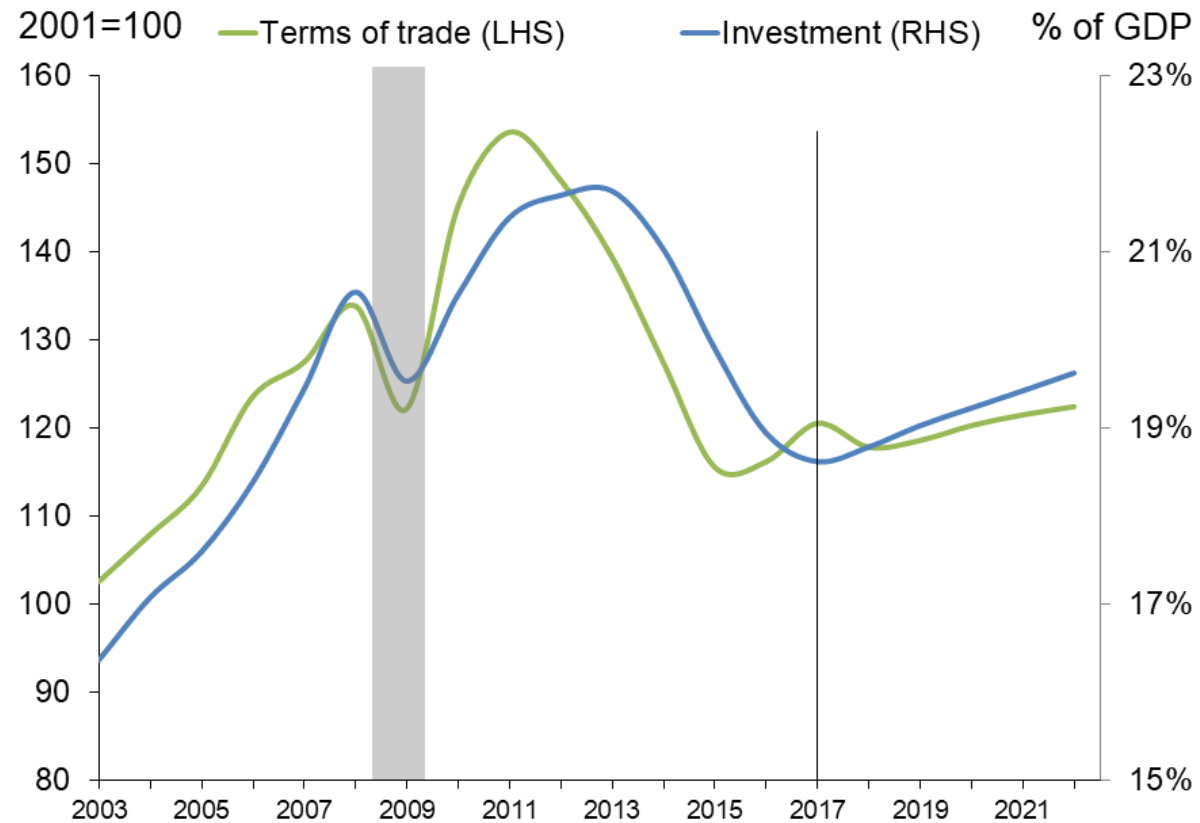


Source: Oxford Economics/Haver Analytics

▶ Economic outlook: Latin America in a “sweet spot”

Investment cycles tend to be associated with those of terms of trade

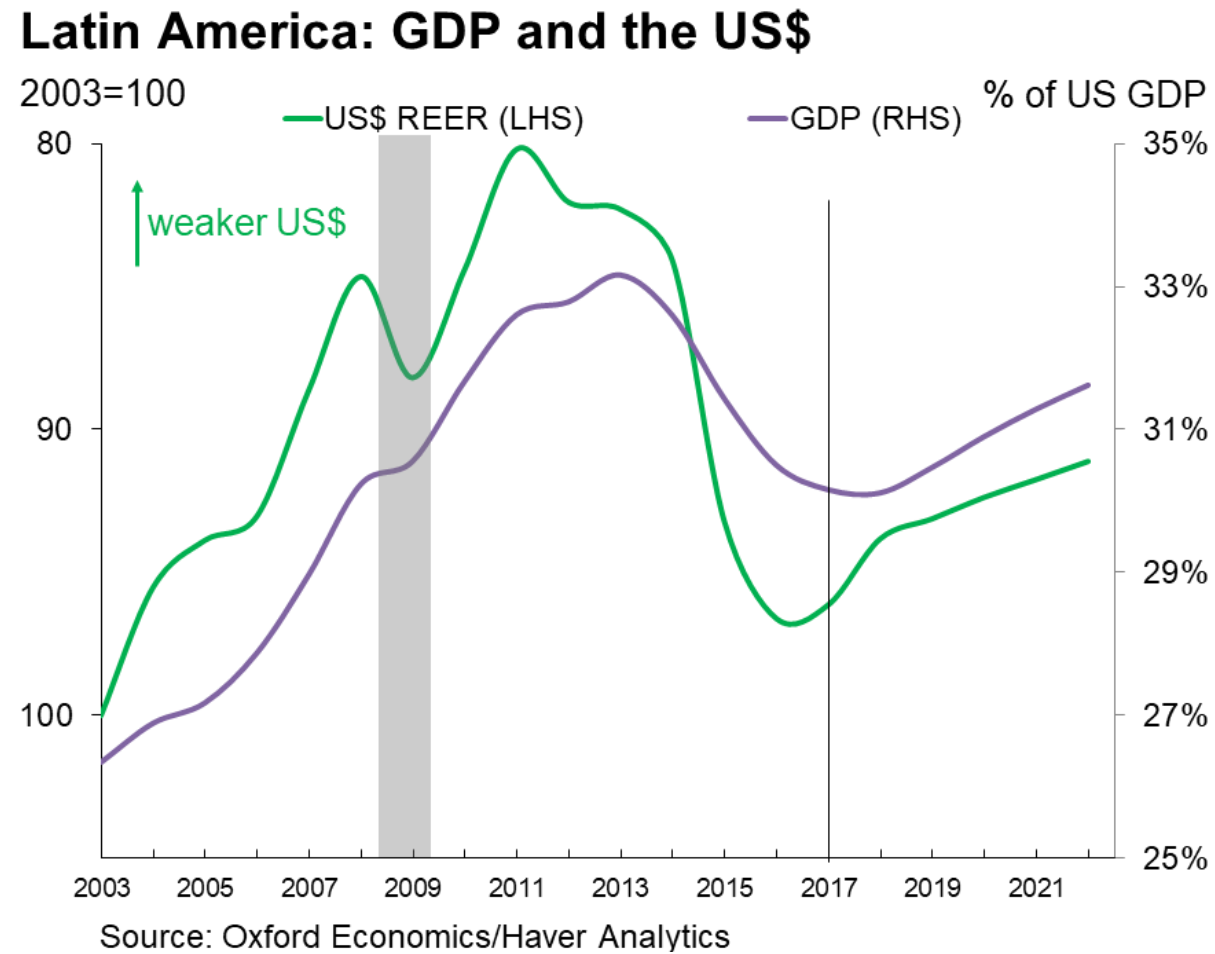
Latin America: Terms of trade and investment



Source: Oxford Economics/Haver Analytics

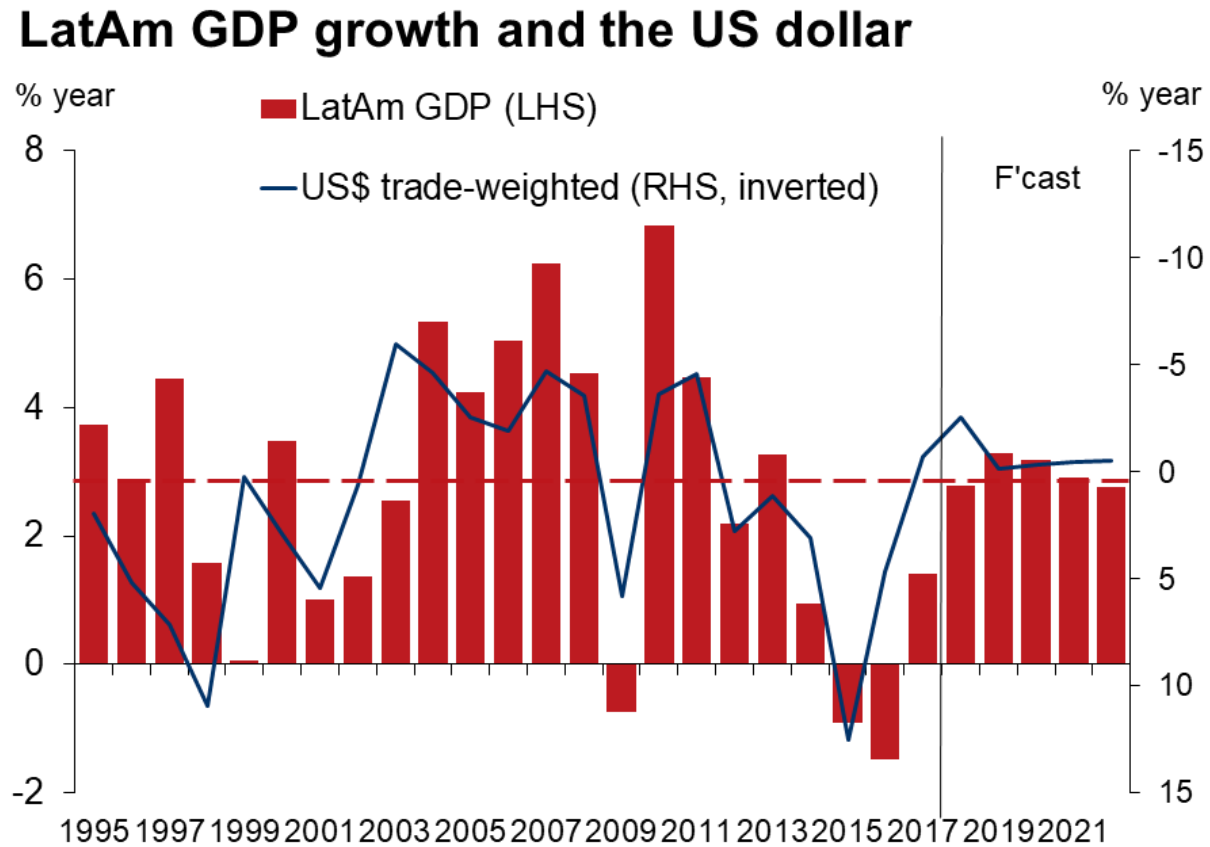
▶ Economic outlook: Latin America in a “sweet spot”

Traditionally, LatAm also benefits from periods of USD weakness (correl = -0.7 since 1995)



▶ Economic outlook: Latin America in a “sweet spot”

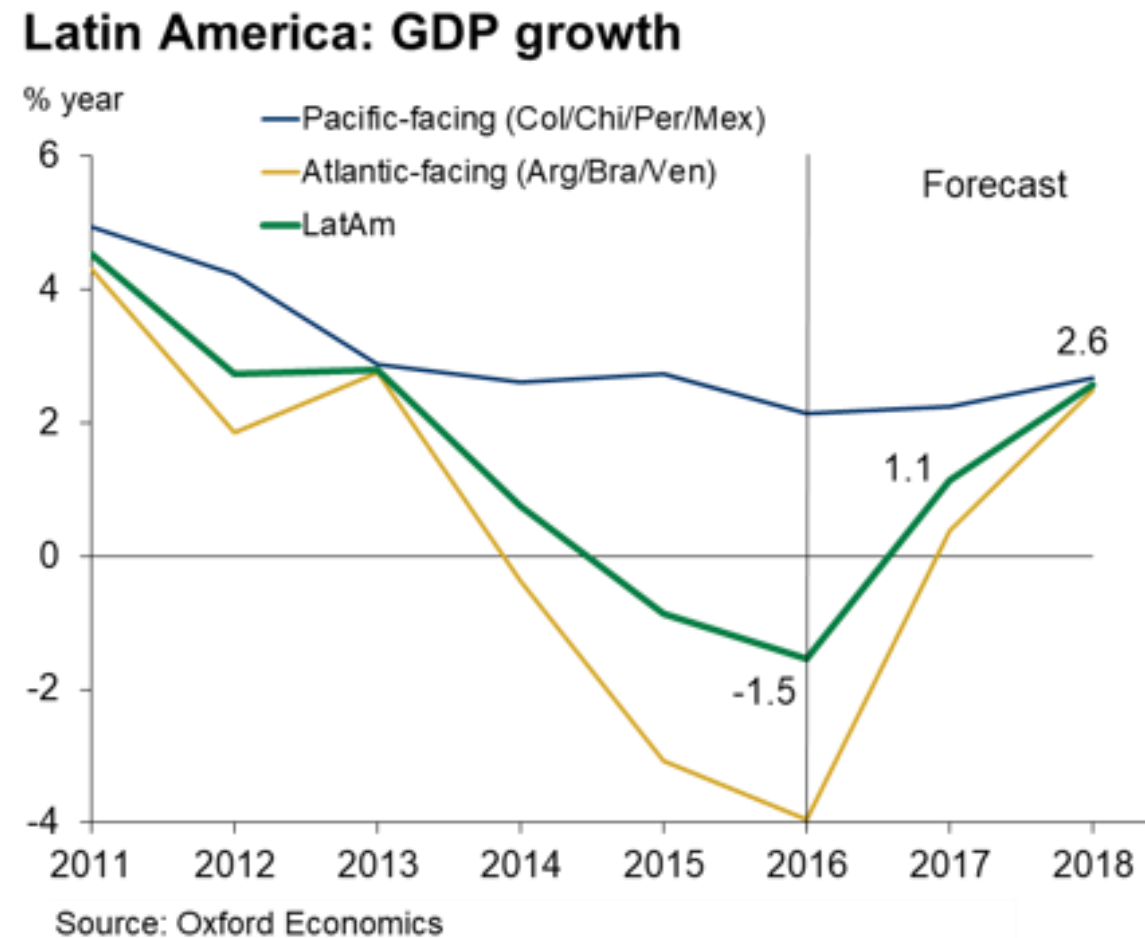
This time is no exception: soft USD and recovery in ToT to help LatAm growth “mean revert”



Source: Haver/Oxford Economics

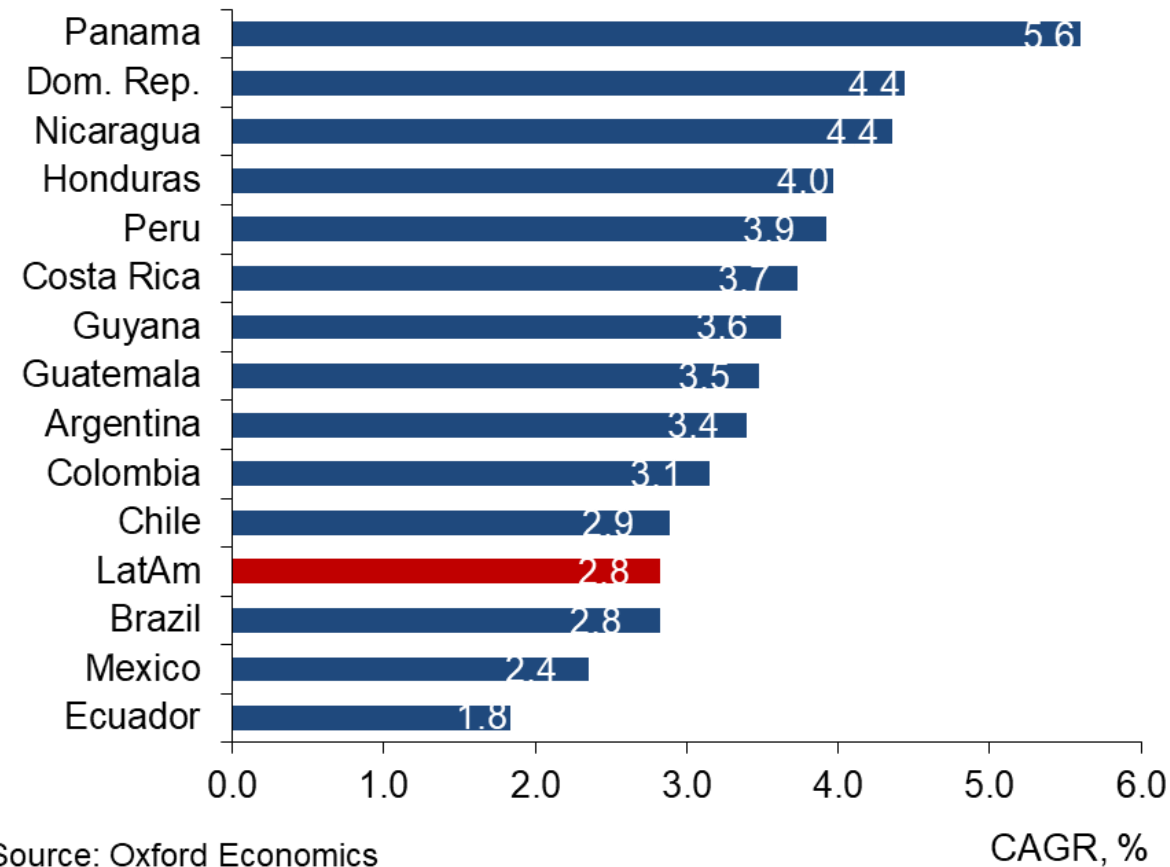
▶ Economic outlook: Latin America in a “sweet spot”

As a result, region is transitioning from “adjustment” to “convergence” in terms of growth



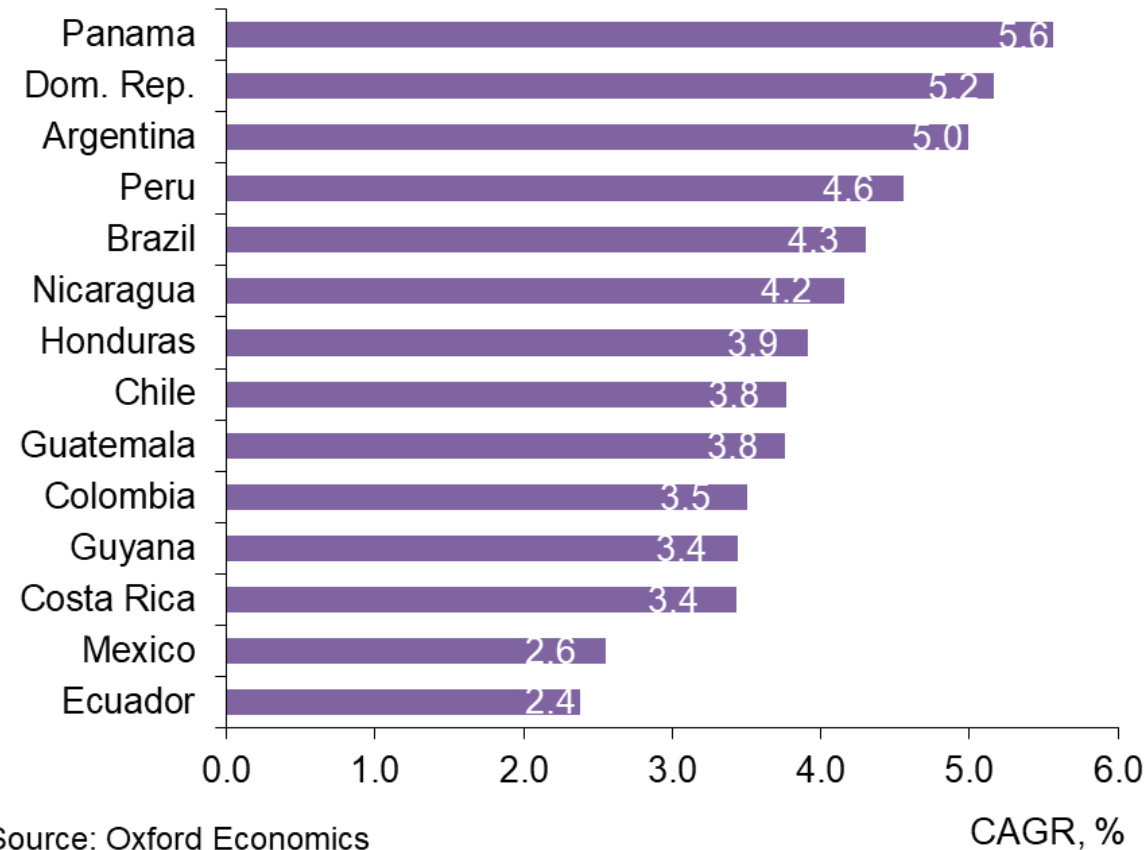
- ▶ Economic outlook: Which will be the fastest growing markets in the next 5 years?

LatAm: GDP growth (2018-22)

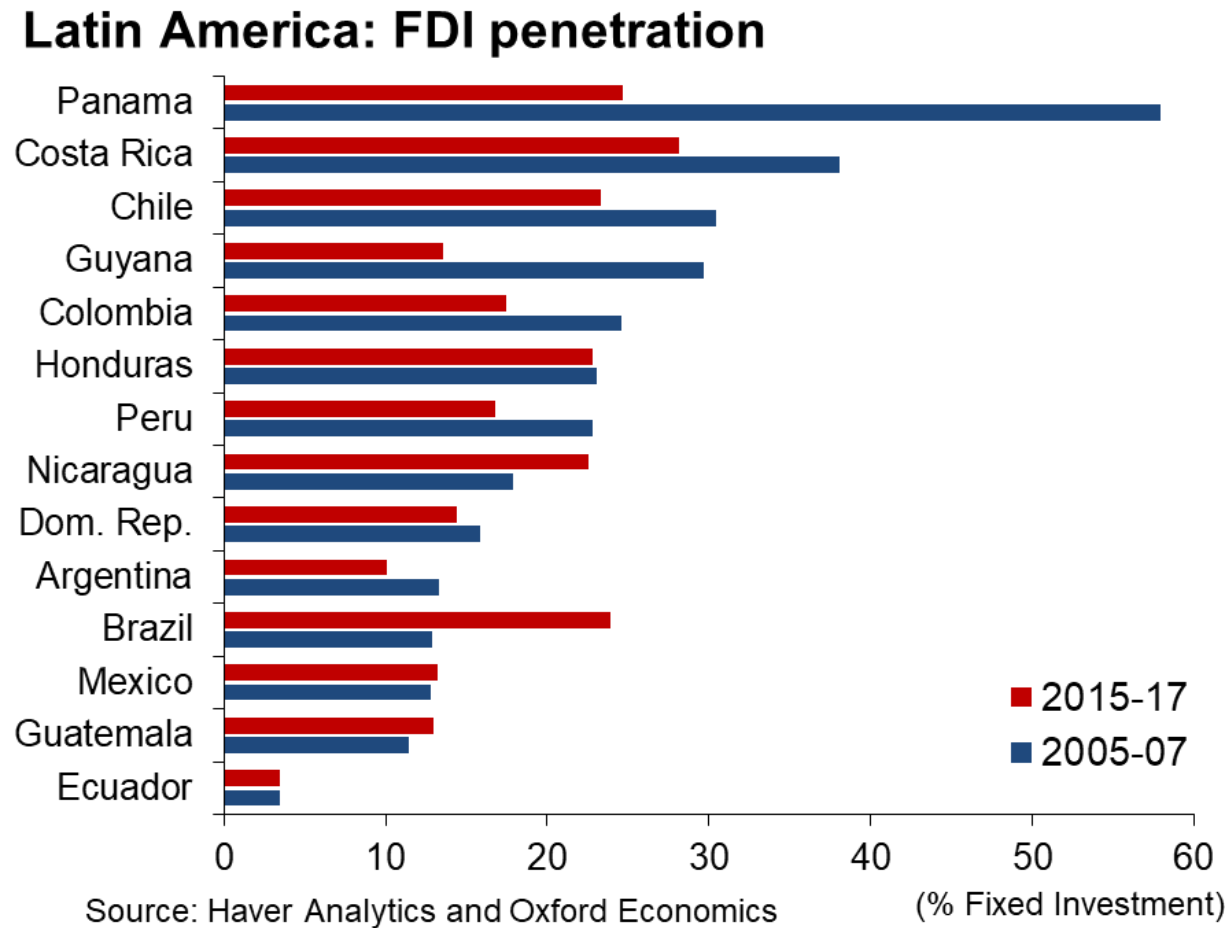


► Economic outlook: Where are the key opportunities for fixed investment in LatAm?

LatAm: Investment growth (2018-22)



▶ Economic outlook: Where is investment mostly funded by foreigners?





Mexico, Central America and the Caribbean

Gavin Strong

Associate Director, Control Risks

Mexico City

► Infrastructure in Mexico, Central America and the Caribbean

Opportunities

- Development of the power sector is a policy priority across the region
- Governments are actively seeking foreign investment/multilateral support to address broadly deficient transportation infrastructure

Risks

- The risk environment in the region is complex for both project operators and project financiers
 - ◆ Insecurity and social activism
 - ◆ Political risks, including:
 - Possible contract scrutiny in Mexico
 - Heightened integrity risks across the region
 - Increasing non-payment risk in Central America's renewable energy sector

► Infrastructure in Mexico, Central America and the Caribbean

Forecast

- Mexico:
 - Short-term uncertainty
 - Overall country risk environment to remain stable
- Central America and the Caribbean:
 - Increasingly complicated risk environment in key markets
 - Opportunities outweigh risks (at this stage)





IV

The Andean Region

Laura Sharkey
Analyst, Control Risks
Bogotá

► Infrastructure in the Andean Region: Colombia

Major post-conflict impetus hindered by implementation capability?

- Colombia 30% behind its infrastructure development goals
- Government's long term post-conflict policy and economic plan will focus in particular on expanding network of tertiary roads
- Redevelopment incentives for companies investing in zones most affected by armed conflict (ZOMAC)

HOWEVER...

- Local communities will prove a major challenge
 - ◆ Continued efforts to block projects by legal means or through protest action, etc.
- Security threats will remain in a number of regions



► Infrastructure in the Andean Region: Peru

Significant opportunity but investors cautious

- Infrastructure a pillar of President Pedro Pablo Kuczynski's reform plans
 - ◆ Recognition that development is desperately needed
 - ◆ Focus on ports and airports
- 2017 saw events that increased this necessity:
 - ◆ Floods caused major damage to existing infrastructure
 - ◆ Projects with previous Odebrecht involvement to be auctioned off in 2018 (e.g., Southern Peru Pipeline)

HOWEVER...

- Kuczynski hindered by congressional minority
- Legislation and business-friendly measures on a case-by-case basis
- Unlikely that Kuczynski will be able to meet full promises
- Investor caution following Odebrecht scandal – uncertainty in political and operational sphere



► Infrastructure in the Andean region: Other markets to watch

Chile: All eyes on new president

- A number of projects to come online in 2018...
- New president likely to further impulse infrastructure investment. Expansion of Santiago Metro will be the priority

Ecuador: Political polarization preventing investment

- President Lenín Moreno has not been as anti-investor as anticipated, economy needs infrastructure spending
- However, in-fighting and increased polarization to slow projects and detract investors

Guyana: Change necessary, but will it be forthcoming?

- Infrastructure development required to service nascent oil sector
- A number of challenges for investors including:
 - ◆ Corruption
 - ◆ Security issues
 - ◆ Dealing with bloated govt. entities



Brazil and the Southern Cone

Thomaz Favaro
Associate Director, Control Risks
São Paulo

► Infrastructure in Brazil and the Southern Cone: Brazil

Opportunity and risk

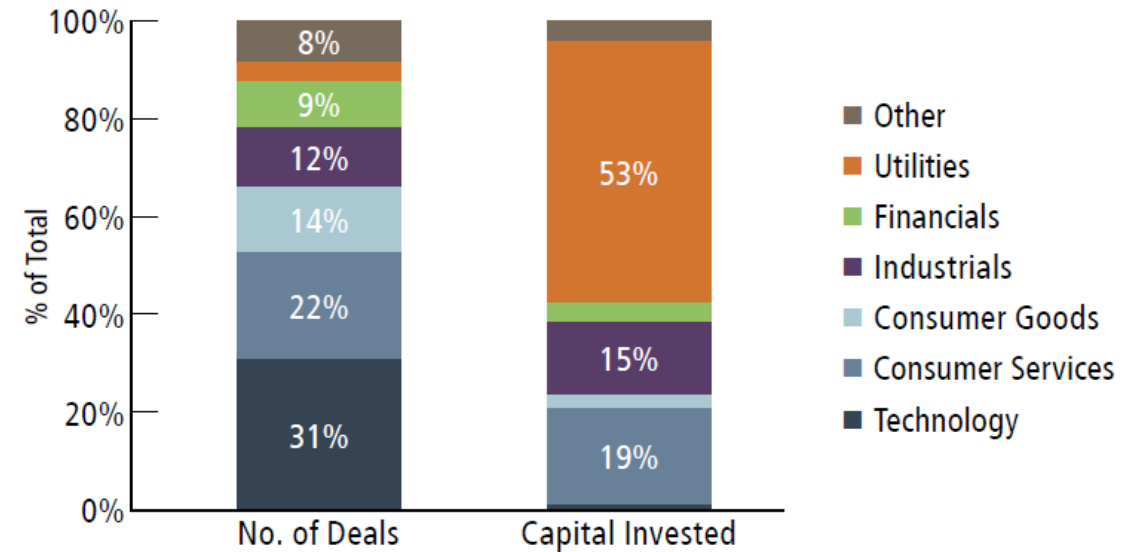
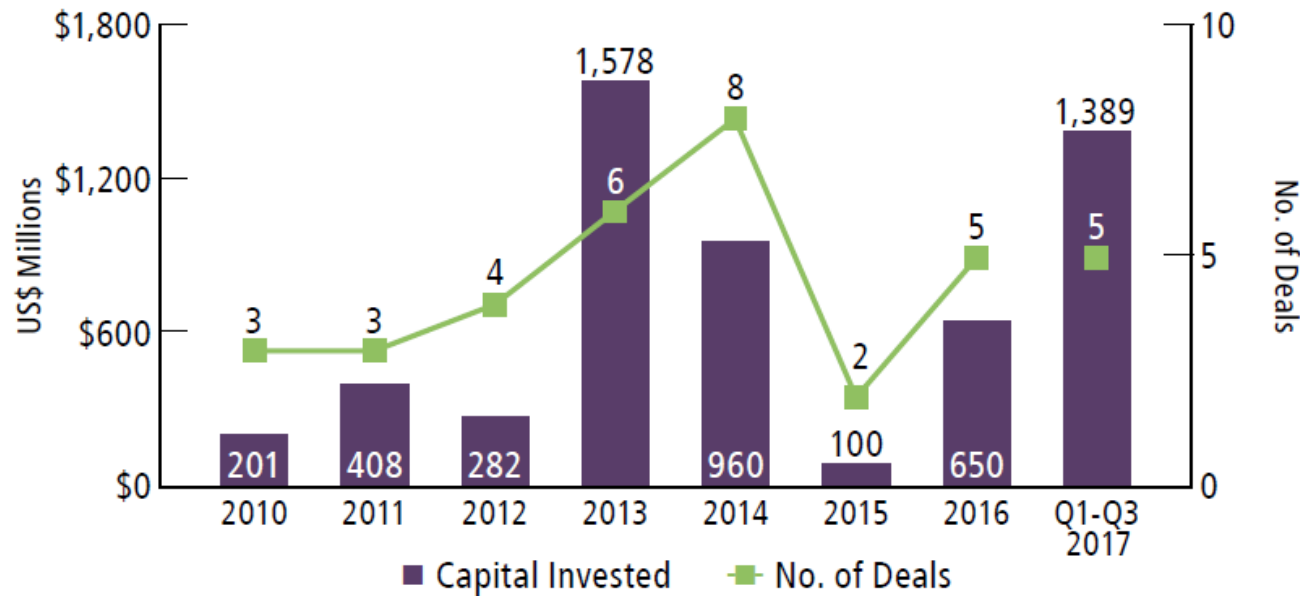
- Economic recovery in full swing – 0.8% GDP growth in 2017, followed by 2.4% in 2018
- Fiscal position/debt trajectory remains a source of concern
 - ◆ Pension reform unlikely to be approved by the Temer administration
- The Investment Partnerships Programme (PPI), the government's flagship privatization initiative, will bring plenty of opportunities for private investors
 - ◆ Very likely to continue regardless of election results
 - ◆ Transport, power generation and distribution, oil and gas and mining concessions
- Investors need to constantly monitor for regulatory changes and auction delays
- Public financing to remain a concern in the short term, but lower inflation (and expectations) will allow Central Bank to keep interest rates low



► Infrastructure in Brazil and the Southern Cone: Brazil

Capital invested in infrastructure deals in Brazil is on track to reach a record high in 2017

More than half of capital invested went into utilities, led by large wind power investments



Data and charts courtesy of EMPEA
www.empea.org

► Infrastructure in Brazil and the Southern Cone: Argentina

Opportunity and risk

- Administration of President Mauricio Macri expected to advance its reform agenda following a positive performance in the mid-term elections
 - ◆ Tax, fiscal, labor and pension reforms, among others
- Government in November announced plans to attract USD 26.5 billion of infrastructure investments via PPPs through 2022
 - ◆ 59 projects, from roads and railways to transmission lines and sanitation systems
- Although the business environment has substantially improved under Macri, Argentina remains a difficult place to do business (high taxes, high inflation, strong unions, expensive in USD terms)
- Financing opportunities remain limited and local capital market will take years to fully develop, though multilateral institutions are likely to provide additional support



Seizing the opportunities

Iain Donald

Senior Partner, Control Risks

New York



► Implications for investment due diligence

Country risk due diligence

Don't forget the broader political and regulatory risk context!

- ▶ Seek to understand the political and regulatory environment surrounding the asset(s)
- ▶ Analyze and forecast the country's political trajectory – impacts for the investment fundamentals
- ▶ Connect the political forces at play with regulatory environment (prospects for future ABAC enforcement)
- ▶ How will political forces drive change in other regulatory areas (taxes, environment, foreign investment)

Economic feasibility

Past performance does not determine future results!

- ▶ Ensure you understand the key economic drivers that determine the performance of the asset
- ▶ Beware of economic forecasts based on simple trend extrapolations – structural changes have implications for the outlook
- ▶ Understand how economic performance may be affected by changes in the external environment
- ▶ Examine alternative economic scenarios and the potential impact on performance of the asset

Integrity due diligence

Still a place for traditional integrity due diligence, but be prepared to receive bad news!

- ▶ Review books and records: policies and procedures related to ABAC
- ▶ Management interviews: focus on actual practices – the reality on the ground
- ▶ Evaluate accounting system: for sophistication and structures to flag malfeasance
- ▶ Risk-based transaction testing: government approvals, payments to third parties, expenses, accounting policies, internal/external audit

▶ Join the next webinar in our LatAm infrastructure series...

Building security, compliance & resilience into LatAm infrastructure projects

Date: Tuesday, December 12, 2017

Time: 8:00 AM PST | 11:00 AM EST | 4:00 PM GMT

Contact americas@controlrisks.com for details

Q&A

For more information or to speak with one of our featured experts, please contact americas@controlrisks.com

