Shopping spree

By Staff Reporters

Retail, mining and processed foods are investors' favorites according to *LatinFinance's* survey of six industries. Andean countries come out on top and Argentina, at the bottom

Buyers put in for about $2 billion of stock when Mexican retailer Sanborns raised $950 million in its IPO in February, one of the new year's most anticipated equity sales. The same week, Brazilian IT firm Linx drew more than $4 billion of orders in its $265 million sale – mainly because international buyers liked the firm's retail focus.

These deals won't get done at any price, as Sanborns showed by landing near the bottom of its range. But the demand demonstrates the broad confidence in Latin America's retail sector.

This theme stands out in a survey of investors' and equity analysts' views on six sectors, jointly conducted by Itaú Unibanco, Management & Excellence (M&E) and *LatinFinance*.

The Itaú 2013 Investor Perception Study on Latin American Industrial Sectors polled 32 investors and strategists from 14 countries around the world between November 2012 and January 2013. They were asked about the retail, mining, processed foods, real estate, oil and gas and healthcare sectors in six countries: Argentina, Brazil, Chile, Colombia, Mexico and Peru.

The survey judges the industries on perception, expected performance, risks and likely drivers of value. It also examines the best means to invest in each industry. Respondents were asked to rank their views on each sector on a scale of one to 10, with 10 being the most favorable. Retail topped the survey, with an average perception rating of 6.9.

The retail bet

Robust GDP growth, rising incomes and better access to credit across LatAm make retail a popular bet. Although Brazil's economy has cooled, Mexico and the Andean countries offer investors the next frontier to play the sector.

Investors are snapping up retail in LatAm

Chile tops the survey when the results are broken out by country, followed by Mexico and Brazil. The Chilean, Mexican and Brazilian retail sectors all rank in the top five of the 36 possible individual country-sector combinations examined in the survey.

"The Chilean and Andean consumer is going to have increasing disposable income because of their countries' increasing economic growth," says David Ross, managing director at Chevy Chase Trust. Chilean retailers are viewed most favorably, given their scope to expand into Colombia and Peru; retail in Chile is already well regarded and offers less value, Ross says.

Two of his top picks are Chile's Cencosud, which bought Carrefour's Colombian operations last year, and Colombia's Éxito. Chilean supermarket operator SMU is another to watch and is expected to launch an IPO in the next year, he says.

Brazil, however, triggers less excitement. "We are less enthusiastic about Brazil, because of the macro conditions and because of the over-leveraged consumer," Ross says. He expects Brazil's GDP growth to come in lower than most expectations this year.

"The valuations in retail are now more competitive, in terms of picking new investment ideas," says Ed Kuczma, EM equity analyst at Van Eck. "I think you are seeing a little more weakness in Brazil, in terms of consumption."

Colombia and Peru are up and coming markets for retail investment, a fact that Chilean retailers are already using to their advantage, Kuczma says.

As the interest in Linx – a provider of cloud-based and on-premises support and outsourcing for retailers – demonstrates, growth in LatAm retail will increasingly come from online businesses.

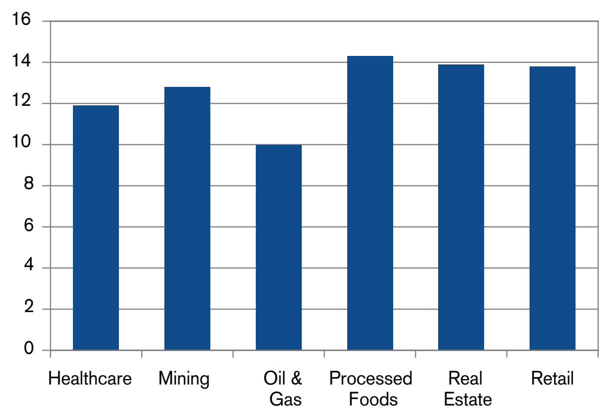
At $29.7 billion in 2011, online sales are still a small part of the total LatAm retail market, which hit $952 billion in 2011, according to Itaú. LatAm's share of the $200 billion-plus world e-commerce market is increasing and is estimated to grow to $62.4 billion by 2016.

Larger retailers such as Cencosud are competing with peers and the informal sector by increasing scale through organic growth and acquisitions, Fitch Ratings says. But the agency says that retailers in Chile, Mexico and Argentina with credit businesses are of concern. Fitch expects profitability in that part of the business to be flat this year.

Inflation, most notably in Brazil, and regulatory and political risks are the biggest worries for survey respondents. Equities are seen as the best way to play retail.

Processed foods highest

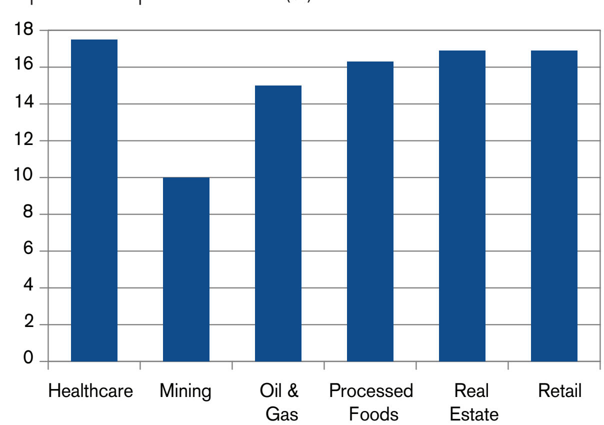
Expected P/E per sector, LatAm (x)



Source: Itaú, Management & Excellence

Healthcare tops

Expected ROE per sector LatAm (%)



Source: Itaú, Management & Excellence

Digging the Andes

Mining follows retail with a 6.3 average score. Chilean and Peruvian miners are the highest rated, finishing in the top five of the survey's sector-country combinations. Chile and Peru are likely to see the highest investments in the next years. According to Sonami, Chile's national mining association, investors will put $280 billion in six LatAm countries between 2012 and 2020.

There are few stocks available for exposure to mining in Chile and Peru, where large multinationals still dominate, Ross says. Similarly, in Colombia the best picks are mostly small-cap or privately held.

Commodity prices and sustainability are most frequently cited by survey respondents as risks for mining firms. Again, equities were voted the best way to play the sector.

Processed foods also rate highly, with an average 6.2 out of 10. Investors prefer the industry in Mexico, putting Brazilian food processors second and Chileans third. Sales of food and drink in Mexico grew impressively in 2012 and the projections are even more optimistic, UK Trade & Investment figures show. Food consumption per person there grew 3.4% in 2012 and should grow a further 11.5% by 2016. Alcoholic drink sales grew 7.5% last year and are forecast to grow 27.1% by 2016.

"In each of these countries, it is distribution that makes the company," Ross says. In Chile, the proliferation of large retailers diminishes the need for distribution, whereas in Colombia, it still matters. Food products conglomerate Nutresa is a top pick here.

Private equity, bonds and stocks are the best ways to gain exposure to the sector, according to survey respondents. In Mexico, foreign exchange, regulation and interest rates are seen as the main risks for processed foods, and risk management is the main performance driver.

In Brazil, Kuczma identifies Brasil Foods and Cosan – for its sugar business – as two of the top food plays. Forex risk, liquidity risk and inflation were the biggest concerns for survey respondents looking at the Brazilian processed food segment.

Bonds trump equities

Investors preferred corporate bonds across the countries and industries. An average of 43% of respondents indicated this was their preferred means of investing in a given country-sector combination.

LatAm corporates sold record amounts of bonds in 2012. The asset class is becoming an increasingly common way to get exposure to industries in Chile, Colombia and Peru. Previously, there were few issuers from these countries, leaving the bond market overwhelmingly represented by Brazil and Mexico.

Private equity is the second most preferred investment approach, with an average of 39% of respondents picking it in country-sector pairings. Here, too, there are more offerings beyond Mexico and Brazil, as international firms look at markets like Colombia and Peru. The interest follows a record fundraising year in 2011, and a pick-up in investment in 2012.

Private equity funds invested $4.4 billion in Brazil last year, up 78% from the year before. They raised $2.6 billion, which followed the record $7.1 billion raised in 2011. Total private equity investment in LatAm reached nearly $5 billion in 2012, up from $3.2 billion the year before.

Large-cap equities are third, followed by small-caps and managed country funds. Mexico's IPC index was up 17.5% in 2012, reflecting improving economic forecasts. It beat the S&P's 12% rise. Brazil's Bovespa was also up last year, gaining 7.5%.

Drilling woes

Oil and gas scores 5.4 out of 10. The industry's average is weighed down by Argentina's abysmal ranking – the lowest individual score among industry-country combinations. Colombia's oil and gas sector scored highest, followed by those in Brazil and Mexico. Respondents ranked executive quality and risk management among the top drivers of value in the sector across LatAm. Corporate bonds and equities are seen as the best way to invest in oil and gas.

Investors are primarily focused on Brazil because of the large pre-salt exploration. Yet many of its issuers and would-be issuers have suffered.

"There have been a lot of IPOs that have fallen short of guidance and expectations once they actually were listed," Kuczma says.

The list of disappointments includes Brazilians like HRT and OGX. Petrobras has long been criticized for the way it treats minority investors, and in mid-February, company officials expected rising debt levels.

In early February, Queiroz Galvão Óleo e Gás, a drill ship operator, postponed its US IPO having failed to find enough investor interest. It had been seeking about $600 million. The company joins a list of pulled deals in a sector that has not had an IPO in more than two years.

Despite the fact that real estate is an asset class that offers exposure to rising incomes and growth in a number of industries, survey respondents are less confident on the sector. Its 5.8 out of 10 score puts it fourth out of the six industries surveyed.

Part of this may come down to the difficulty of getting exposure to the assets. Brazil's real estate fund market has only taken off in the past few years, and remains primarily a domestic retail product. Listed homebuilders and developers have struggled recently. And Mexico's real estate trusts are a young asset class, and have only seen significant international participation since 2012. Survey respondents cite private equity as the best means to play the sector.

Chile, Colombia and Mexico have the highest-rated real estate markets. The risks varied by country, and included taxes, foreign exchange, regulation and uncertainty in the financial markets. Management of these risks is seen as the best means to drive value.

Inflation, liquidity and regulatory risks have affected the image of healthcare, which scored the lowest average mark across sectors, 5.3 out of 10. Chile is the highest rated country for healthcare investing, followed by Brazil, Colombia and Mexico.

Argentina worries

Management quality plays the most important part in determining value across all sectors, respondents say. Risk management and sustainability are other important elements, particularly in the mining and oil and gas industries.

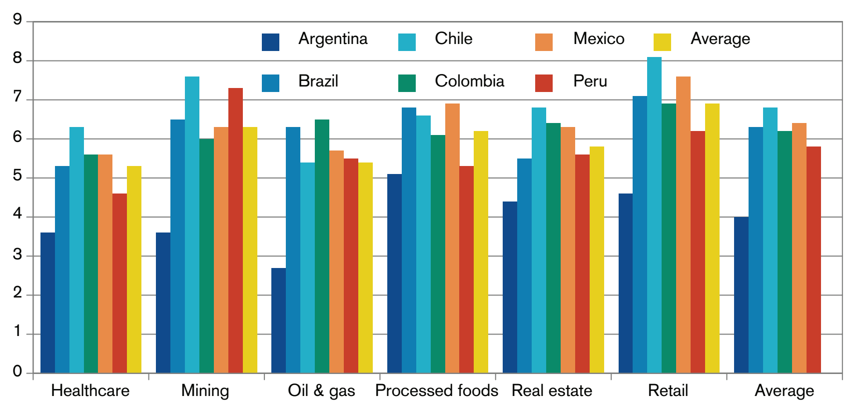
Argentina stands out as the riskiest country in the pack — risk levels at the other five were judged to be similar. Inflation and political risk are investors' two biggest concerns. Both were highlighted in Argentina in February, when the IMF reprimanded the country for inaccurately reporting inflation and other economic data. It has a few months to address its shortcomings or face an unprecedented expulsion from the IMF.

"Argentina is becoming more of a concern, in terms of hyperinflation and murky inflation reports," Kuczma says. In retailing, the government's caps on supermarket prices are also scaring off investors.

Political risks are well documented. The highest profile recent case was the government's nationalization of a controlling stake in oil company YPF in 2012, expropriating most of the position of Spain's Repsol. Indeed, most of surveyed investors' worries were to do with the extent the government intervened in certain sectors. Oil and gas and mining are the most troubling of Argentina's industries for survey respondents. **LF**

Retailers and Chileans are the favorites

Image of LatAm sectors per country



Source: Itaú, Management & Excellence