

PE in Latin America: How the Rules of the Game May Change Post-COVID-19

A gathering with top Country Heads of Private Equity in Mexico and Latin America to discuss how consumer behavior is changing, its impact in PE, and the opportunities for the sector in a post-COVID world

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After three difficult months in the PE sector, there is more clarity in the horizon. Consensus anticipates a GDP decline of 5 percent for Latin America as a region and up to 10 percent for Mexico. In this context, monitoring the evolution of consumer behavior and its shifts will be paramount to assess the recovery of the PE sector and the emerging opportunities in the months to come.

During this virtual gathering with the PE Country Heads of Mexico and Latin America, we were honored with the participation of Dirk Donath, Latin America Head for L Catterton, who shared with us his perspectives and opened up the discussion to all participants. Overall expectations point to a gradual recovery of confidence levels in Latin America over the next quarters and an eventual recovery by the first quarter of 2021.

Four Areas of Impact in the Private Equity Sector

The PE sector has been impacted in the region, particularly in the following focus areas:

- **Fund Performance:** Mark-to-market valuations of portfolio companies have been negatively impacted. Comparable valuation multiples are down, and FX risk in the Latin America region is a growing concern for LPs.
- **Liquidity:** Exits are becoming more difficult these days. Funds will be expected to extend their portfolio holding periods by one or two additional years on average.
- **New Opportunities:** The COVID-19 crisis is bringing new opportunities for PE, particularly in digital and assets with solid long-term fundamentals but weak balance sheets.
- **Fundraising:** Emerging markets are facing challenges to raise additional funds. Latin America seems to be less of a priority for international investors in the current context, although there are interesting vintages and opportunities for investors who can maintain a long-term view with the right perspective.

Actions PE Shareholders Are Taking at the Portfolio Level

Some PE firms focused on the consumer sector are grouping their portfolio companies according to the impact level of the crisis on them. Three major categories are emerging:

- **Advantaged companies:** This category includes those who have benefited from the crisis. Such companies are taking advantage of their solid online strategies and their robust omni-channel strategy and digital distribution networks that can greatly offset the losses from their traditional channels (e.g. groceries, pet products, digital retailers, digital food delivery, and digital fitness).
- **Moderate negative impact:** Companies that have had minimum to moderate impact (e.g., medical clinics, dental services, liquor and wine).
- **Under near-term stress:** These companies have experienced an abrupt reduction of their revenues (almost to zero) due to social distancing measures and the temporary closure of their services (e.g., gyms, traditional retailers, restaurants, events, airlines, hospitality.).

Each of these categories requires different levels of intervention from their PE shareholders. At the Board level, PE funds are placing special focus on four variables:

sales and clients (online sales, pick-up services); costs and suppliers (renegotiation of leases, continuity plans); profitability (efficiency gains, synergies); and capital structure (ensure liquidity, access to credit lines, tax exemptions).

The overall goal is to prepare their portfolio companies to withstand rough waters until the end of 2020, when a clearer path to recovery is expected.

Consumer Shifts in the Post-COVID World

During the discussion, our Donath shared some insights regarding changes in consumer behavior. Consumers are:

- Increasingly worried about their economic situation and health
- Cutting back on spending and deferring big purchases
- Concerned about their reduction of income
- Worried about losing their jobs

These concerns could motivate some changes in three fronts: societal, technological, and behavioral.

In general, the **societal change** in the post-COVID-19 world is not expected to be profound, despite the overused “new normal” term. The expectation is that social norms, social structures, and demographics will return to similar levels as those observed before the COVID-19 crisis, with no significant changes. We may see a mini baby-boom, but the demographic impact will probably rather be limited in the long run.

However, we may see higher levels of impact in **technology adoption**. The quarantine has accelerated the use of digital offerings and tools, and some are likely to retain new users or shift behaviors, particularly in remote work and learning, e-commerce, convenience driven technologies, e-groceries, home digital fitness, online movies, eGaming entertainment, reduction of business travel, and more.

Behavioral consumer changes may be marginal in a post-COVID-19 context, but the evidence points toward an increase in themes around health and wellness, outdoor

living, and mindfulness. Some brands will need to be aware of these shifts and target specific segments.

Are There Opportunities in Latin America for Private Equity?

Latin America will certainly offer opportunities for PE, particularly in the consumer business sector. The demographics, a growing middle class, consumer credit expansion, a maturing retail sector, and improvements in technology infrastructure are factors that play in favor of the region. While there are some short-term challenges, there are longer-term fundamentals that should not be ignored to fetch the right opportunities.

The current crisis could create opportunities to acquire companies with good fundamentals but that are in need of liquidity, or target sectors that are ripe for consolidation (M&A activity should rise). There are also good prospects for businesses that are taking advantage of changes in distribution channels and are moving into digital business models and online distribution. In addition, there are also good brands out there with solid assets but a balance sheet that has been affected by the crisis. It is not just about distressed investing, but about spotting opportunities that offer attractive valuation levels coupled with the right risk-return profile.

Participants also commented about the varying levels of public health deficiencies in different Latin American countries, which makes their population more vulnerable to COVID-19. Some opportunities could also arise in telemedicine, pharma, R&D, and health facilities with a retail model (e.g., medical labs, dental clinics). Consumers will be less willing to attend large hospitals for regular doctor visits, ambulatory tests, and other minor concerns. Therefore, business models that can enhance the healthcare experience with home delivery, adapt onsite spaces to make them safer, create online offerings, improve packages and safety seals, to name a few, will be better positioned.

The Return to 'Normal'

Participants commented about how the return is likely to play out given that the COVID-19 vaccine is not expected to be ready until early 2021. As government restrictions are lifted in the upcoming weeks, the question is how to keep consumers

safe and build their confidence to resume their normal lives, attend restaurants, visit stores, while they wait for the vaccine to arrive.

There was consensus that the process will be gradual and full capacity operations will not be expected on day one. In Europe and Asia, the experience was positive in gyms, malls, and retail stores. Traffic to those venues is experiencing a positive trend, but the process has rather been gradual. Those geographies saw their capacity at 50 to 65 percent levels just after restrictions were lifted and are experiencing a steady positive increase on a weekly basis.

There are also important differences by geographies within the same country. For example, in the United States, the majority of the COVID-19 cases (~70%) are located in five to seven states. There are regions where gyms and malls have already opened, but in some others it will take much more time.

The fundamental question is not just when, but also how to reopen. Companies are being forced to find creative ways to lure consumers by incorporating additional safety measures, new promotions, and sales. It will be of paramount relevance to make the consumer feel safe and comfortable during the comeback.

How PE Firms Are Planning for Their Own Return

In relation to the *back to work* of teams, PE firms are expecting to plan for a return that spans from July to September 2020. In any case, it is not likely to be a *full return*. Participants talked about creating different teams (e.g., Team A attending at certain hours of the day or only at certain days of the week). In any case, *work from home* is likely to remain until the end of the year. The greatest challenge for PE executives is the travel ban. Not being able to meet in-person with their portfolio management teams and Boards is a challenge. While they are using digital and video conferencing tools extensively, this remains a challenge that is likely to last until year-end.

During the gathering, participants also commented about the need to conduct their own research and gather information from the sources (not just official information) to gauge the real extent of COVID-19 cases to plan the return to normal of their businesses. Overall, participants agreed that the return to normal will be definitely gradual, not abrupt. It will not be catastrophic but certainly challenging, particularly in countries where the official information is not reliable when trying to make important business decisions.

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Covid-19 Micro-Website

We have launched a micro-website where this and other informative pieces are posted. This site will be regularly updated: [click here](#) for further details.

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