

M&A 2011 – Colombia

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1. Has the level of M&A activity picked up, and what are conditions like today? In general terms, what level of activity is foreseen for 2011?

The M&A market in Colombia has been growing during the past few months. The sectors of the economy in which it has more force are still the same, but the participants in this market are changing. Lately, private equity funds have started to become big players in the M&A market and organisations such as Proexport have been promoting the different options there are in order to open the doors to these funds here in Colombia.

Colombia is proving to be an increasingly attractive option for private equity funds. On the other hand, we have also seen some strategic acquisitions particularly in banking, pharmaceuticals and services. Also, co-investments between strategic investors and private equity funds are increasing.

The M&A market is starting to show more movement this year, subsequent to the presidential election; the credit crunch was not so harsh in our economy and companies took measures in order to avoid big losses. Little by little, M&A activity is picking-up and we foresee that it will continue with this tendency; hopefully we will be able to see some big deals before the end of the year.

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

The M&A market is taking over almost all industries right now; however we would be inclined to say that the telecommunications and financial services industries as well as the extractive industry (eg, oil and gas, gold, coal and mining) would be the ones to see more M&A throughout the year. Also, health sector, services, infrastructure, tourism, agribusiness and the pharmaceutical industry should be entering the M&A market soon.

3. What types of deals do you expect to see?

The market is currently growing and picking-up so we expect to see all kinds of deals, but we think that according to the actual political and economic situation, minority investments will be the most prevalent, in part for the increasing volume in private equity funds' investments as well as joint ventures. We also expect to see acquisitions of majority interests, which in the past few months have been common in the M&A market.

Some transactions of stock-for-stock and seller financings were seen during the credit crisis.

4. Discuss the level of M&A activity you have seen over 2010 and expect to see in 2011 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.

In 2010 we saw all types of deals. However, the most common and seen deal was the one in which a foreign acquirer merges or acquires a domestic company. Notwithstanding, there was an increase of pure domestic deals also, being the second most common type of deal. In third place were the deals in which a domestic acquirer merges or acquires a foreign company. This is, as we stated before, a consequence of the growth of the market. There are so many good opportunities in Colombian M&A market that is rare if a domestic acquirer invest in other country. Nevertheless, we have seen those types of deals, specifically in Central America in which domestic vehicles have acquired some companies. On the other hand, we expect to see all kinds of deals this year. Nevertheless, we expect to be the most common deal, the one involving a domestic target and a foreign acquirer, as in 2010. Likewise, we do not expect to see many deals involving a domestic acquirer and a foreign target because the M&A market is still growing.

5. What is the level of private equity activity? Are domestic or international funds involved? What kinds of deals are they doing?

Private equity has increased in the past few years, and this has been possible given the many options for obtaining funds both domestically and internationally. Colombia is positioning itself in the market for being a country with a stable financial sector and positive growth. As a consequence of the foregoing, it has been an important increase in private equity, many local funds incorporated during 2010 and others expected to do so in 2011. For example, last year alone there was a contribution to Credivalores-Crediservicios SAS by ACON Consumer Finance Holdings S de RL, for an amount representing 28.96 per cent of the fully diluted equity of the company and Termoemcali received a contribution from CG-FIC giving away over 90 per cent of the company. However, statistics show that only 2 per cent of private equity investments come from Latin American funds and only 2 per cent of that amount represents Colombian. This shows that the funds involved are mainly foreign funds.

Mainly, the type of deals seen involve infrastructure, but the most important funds coming in are from 'multisectorial' funds, which take advantage of the great diversity of deals available and right now are top of the chart regarding foreign investments.

6. Is acquisition financing available for deals? From which domestic or international sources?

Yes, acquisition financing is available for deals. We have seen the credit crunch's effects subsiding and the M&A market regaining strength each day. The new financial law has eliminated the legal restrictions for local financing of M&A transactions. Law No. 1328 of 2009 modified the Organic Statute of the Financial System by allowing banks to grant loans aimed to buy shares of any company eliminating the prohibition imposed on local banks by means of which they could not grant loans for acquisition of shares.

Financial institutions have financing available, even more than what we were expecting to see. Both Proexport and the Commerce, Industry and Tourism Minister's Office have been working in order to attract foreign and domestic capital and giving businesses support in order to get them to invest in Colombia.

7. Is there still a lot of M&A activity involving financially troubled companies? Do you expect this to be an active area?

Fortunately for Colombian companies, the financial crisis was managed properly. We have seen an increase in M&A activity involving financially troubled companies, but companies that have been on the verge of bankruptcy for a decade or more are starting to be the subject of M&A. The recent crisis, although it did affect many companies, some more than others, was not as intense as it was in the US, so these companies are not currently being subject to M&A.

An indirect effect of the crisis on the Colombian market was the divestiture of the Colombian subsidiaries of multinational companies affected by the crisis. Companies that had been hit by the financial turmoil turned to their Colombian subsidiaries, which were generally doing well, and sold them in order to generate cash. Some examples are the sale by Spain's Gas Natural of its controlling interest in EPSA (an integrated utility) for US\$1.1 billion, the sale by Citicorp of its controlling interest in Citi-Colfondos (a pension fund administrator) and the sale of certain Colombian assets by AIG.

Finally, we do not expect an increase of M&A activity involving financially troubled companies because in general terms Colombian companies are not troubled companies. The market is in a very good condition and the evidence of those conditions is that domestic companies are being purchased for up to 12 times their worth.

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?

Colombia does permit reorganisation as a going concern, but Colombian regulations do not have the 'bankruptcy sale' figure the US does (ie, section 363 of the Bankruptcy Code). As a general rule, Law No. 1116 of 2006 (the Colombian bankruptcy law) does not prohibit the sale by the shareholders of an insolvent company of their shares in said company. However, in respect of sales of assets of an insolvent company, Law No. 1116 of 2006 establishes that such sales are allowed if the sale is within the ordinary course of business of the insolvent company. Otherwise, the bankruptcy judge's authorisation is required.

In the cases of mergers and spinoffs of the insolvent company, the onset of insolvency suspends certain statutory rights granted to creditors (ie, right to demand guarantees) and to shareholders (ie, appraisal rights).

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

Although the M&A transactions have been performed this year through share acquisitions, the economic situation has forced many, if not all companies to create counter measures to avoid bankruptcy but still make profit during the crisis. Some did have to significantly reduce their staff and other operational costs but not to the extent of having to close down.

We have not seen a lot of restructurings so far; however, some sales of non-core business have been seen, both by multinational companies with investments in Colombia as well as local business. However, shareholder activism has been noted, especially in certain pension funds that own portions of companies such as ETB, ISAGEN and Ecopetrol, regarding matters such as access to information and payment of dividends.

10. More generally has there been any increase in hostile takeovers and shareholder activism? What defences and responses are target companies using?

In Colombia hostile takeovers have been rare and uncommon but are beginning to occur. Colombian regulation on the matter is not very flexible which leaves little or no space for this kind of acquisition. This situation makes measures such as poison pills or any other anti-takeover protection unnecessary.

Despite this, there have been certain developments of anti-takeover protection undertaken by listed companies.

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?

Yes, there has been a slight change in their attitude. There is certainly more awareness when it comes to negative publicity, shareholder criticism and liability from potential litigation in order to avoid certain constitutional actions (eg, collective and class actions) that have been seen in the past against M&A deals.

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?

The M&A market is becoming more demanding day by day, and the need to achieve international standards has become a priority. Although each deal has its specific characteristics that make it unique, in general terms, they have started to be standardised in certain aspects, particularly as to share acquisition documents.

Currently, there are no significant differences between domestic and international deals. Modern law firms have achieved an international standard to handle cross-border deals and they see no reason for not using it in the domestic ones.

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 first piece of advice would be to search and use modern legal advice given that certain sectors and activities have very complex and rather specialised regulations and a good law firm could make the difference.

It is very important to have a clear arbitration clause in the agreement and even more important, to be very careful with technical pre-arrangements to settle the dispute as they might affect the validity of the arbitral holding. Besides, a favourable legal framework for international arbitration exists in Colombia.

Finally, from a structuring point of view, it is important to explore, depending on the kind of deal, what choices exist to benefit from tax incentives or to optimise taxes.

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

No, during past years the processes have started to show certain uniformity. As more people achieve and clients demand certain 'international standards', the only option is to keep up with these practice standards transplanted from Anglo-Saxon firms.

15. 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.

In past years we have seen two situations where M&A deals have been affected by our regulation and the regulatory agency in the financial sector. On the one hand, the Financial Superintendency is very strict in the review of acquisition of more than 10 per cent of a financial institution when the buyer is a private equity fund.

On the other hand, the existence of uncertain regulation creates situations of doubt and certain loop holes that foreign investors seem to fear. Such is the case of indirect acquisitions of financial institutions where the regulation is not clear enough. To be specific, in these types of deals, it is uncertain whether there should be a full regulatory filing or not when there are acquisitions of holding companies in which the underlying asset is an entity under the supervision of the Financial Superintendency.

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