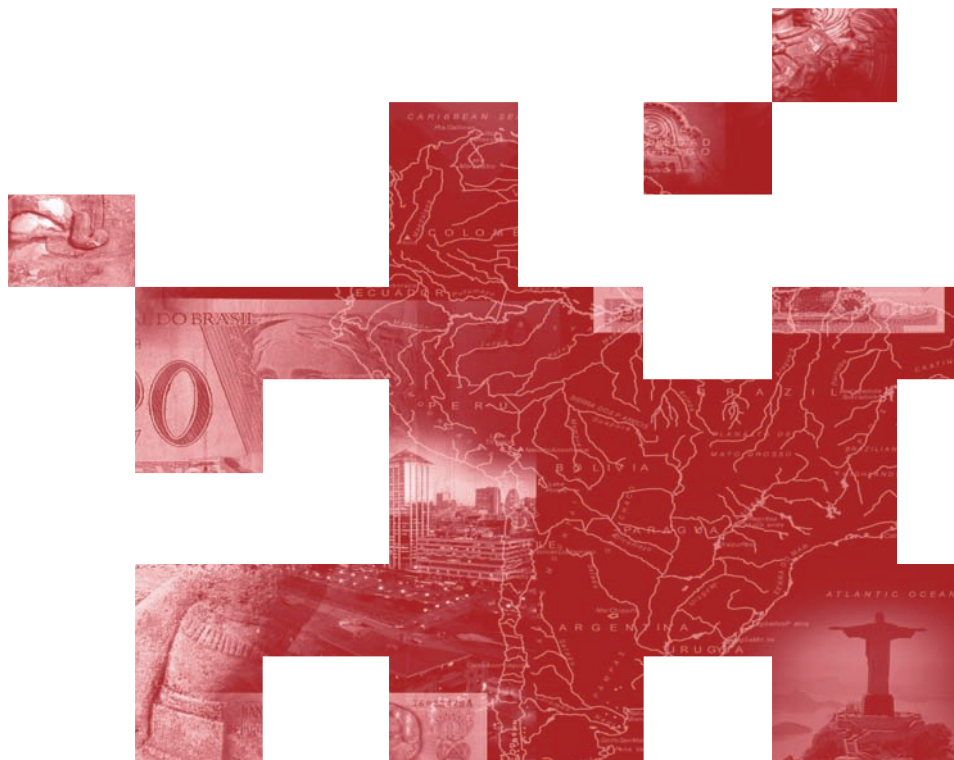


The 2007 guide to

# Debt financing in Latin America

**EUROMONEY**

September 2007





**Santander**

GLOBAL BANKING & MARKETS

**150**  
YEARS

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# Introduction

Latin America is on the move, undergoing an investment and financing boom unprecedented in its history. Latin American companies are acquiring globally, expanding regionally, and investing heavily in productive capacity, and R&D. Infrastructure projects are proliferating throughout the region. These developments reflect the region's positive economic backdrop and corporate confidence in the economic policies and political stability that have come to characterize most of the region for the past few years.

This confidence has been fuelled by global liquidity and economic growth. But it has also been spurred by a growing number of financing instruments and liability management options. Latin American companies can, today, access a wide variety of financing sources. From bonds to loans, domestically or cross-border, the array of financing tools has increased dramatically, enabling companies to source liquidity and tailor their funding needs in ways they never could before.

Santander has been at the forefront of these developments. With 66,000 employees, 4,000 branches and 28 million retail customers throughout the region, Santander is the largest bank in Latin America. Santander's retail strength is complemented by a regionally integrated corporate and investment bank. With its extensive Latin American network, financing capabilities and unparalleled dedication to the region among its global peers, Santander is superbly poised to capitalize on market trends and provide a full array of financing options to its corporate clients in Latin America.

Ignacio Domingues-Adame Bozzano, global head of credit markets at Santander, sums it up: "Latin America is a vital region for Santander...it is in our DNA. With our local presence and global reach we have the unique ability to offer the full range of debt financing solutions to our clients in a seamlessly integrated and competitive way."



**Javier Martin Robles, Head of Project and Acquisition Finance, Latam**  
**Ignacio Bozzano Dominguez-Adame, Head of Global Credit Markets**

# More choices than ever

Access to credit is one of the fundamental drivers of any economy, and over the past few years credit has been cheaper and more abundant than anybody could have dared to predict. Nowhere has this development been more beneficial than in Latin America.

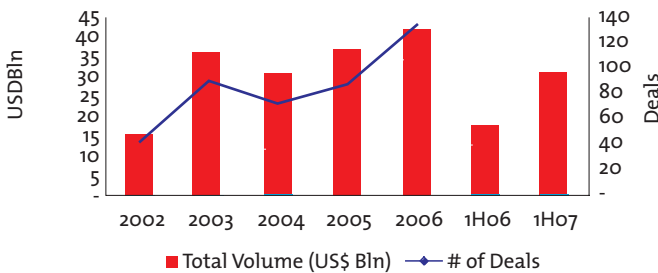
Investors in Latin America generally do not find PIK notes or synthetic CDOs. Rather, they find a maturing but increasingly "mainstream" financial landscape: a healthy domestic loan market; a well defined local government yield curve, extending in some countries as far as 30 years; local corporate finance markets, for both debt and equity, with an increasingly broad and sophisticated domestic investor base; and a new

breed of sell-side professionals who are product-agnostic and can help their clients raise debt from a multiplicity of sources both domestically and around the globe.

Not long ago, the Latin American debt markets were dominated by sovereign issuers selling dollar-denominated bonds to a relatively small universe of dedicated emerging market buyers.

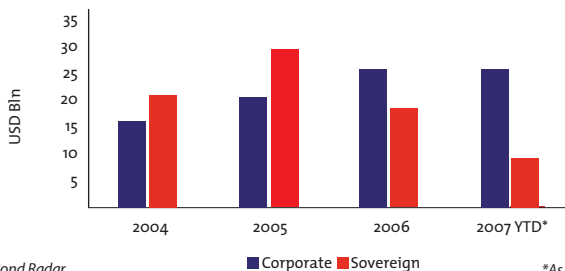
That template has now changed. Latin American governments, buoyed by high commodity prices and fiscally prudent policies, have essentially stopped borrowing abroad. Their absence from the international debt markets has created a void which the

**Latin American cross border bond issuance**



Source: Bond Radar

## Latin American corporate vs. sovereign bond issuance



Source: Bond Radar

\*As of Aug 31 2007

private sector has been quick to fill and which international investors have eagerly sponsored. Hundreds of Latin American companies, both large and small, have issued international bonds; industries as varied as steel, telecommunications, petrochemicals, housing and meat packing have been represented.

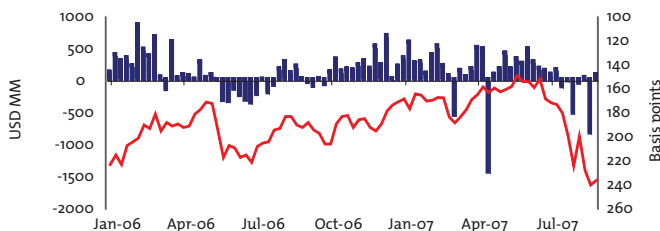
Meanwhile, the investor base for those bonds has grown and diversified dramatically; dedicated emerging market professionals now compete with hedge funds, cross-over buyers and even an Asian retail bid as they

pile into order books for the most sought after Latin bonds.

In addition, these investors have shown increased appetite for differing credits and various types of risk: mid-tier corporates issuing internationally in Argentine pesos or Brazilian reais, private equity firms issuing dollar denominated perpetual notes - who would have thought those financings would be possible just a few years ago?

At the same time, the demand for internationally syndicated Latin Ameri-

## Weekly emerging markets fund inflows vs. EMBIG spread



Sources: EmergingPortfolio.com Fund Research, Bloomberg (based on JPM data), and Santander Investment. Weekly data through August 29th, 2007.

### Latin American cross border loan volume, 2002-1H2007



Source: Reuters Loan Pricing Corporation

can loans has never been larger. When Brazilian miner CVRD bought Canadian rival Inco last year, it had no trouble raising \$18 billion from a consortium of global banks - the order book for that syndicated loan totalled in excess of \$34 billion. Partly as a result of the CVRD deal, the volume of Latin syndicated loans topped \$65 billion in 2006, almost twice the volume achieved in the previous year.

Latin America's biggest corporate borrowers - not just CVRD but also Petrobras, Votorantim, Telmex, America Movil, Cemex and Pemex to name a few - are now treated like all other global multinationals, with equal and often better access to bank credit as that afforded to their developed-country peers.

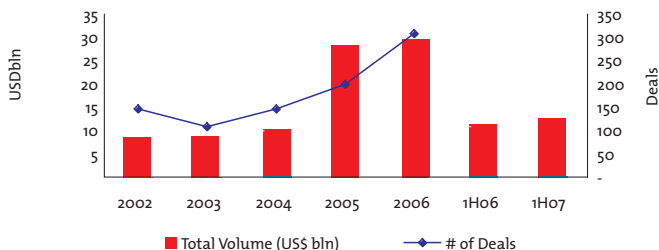
The increased volume of Latin American bonds and loans has been impressive. However, the biggest development in the Latin American debt markets has occurred far from London or New York, in domestic markets and with domestic buyers across the region.

The development of the local capital markets has been a transformational event in the history of Latin American finance.

Local banks can no longer just rely on lending to their governments. As a result, they are now increasingly active lenders in the corporate space. In addition, liquidity has been fueled by the exponential growth of assets under management by

**“The  
development  
of the local  
capital markets  
has been a  
transformational  
event in the  
history of Latin  
American  
finance”**

### Aggregate Latin American domestic bond issuance volume 2002-1H2007



Source: Bloomberg

domestic pension funds and other asset managers.

Local debt capital markets are maturing fast throughout the region. Latin American governments astutely laid out local yield curve benchmarks, led by Mexico, and corporate issuers and their bankers quickly followed in their footsteps. Local market corporate bond new issues grew from \$9.3 billion in 2004 to close to \$28 billion in 2006, a 193% increase, and in the first half 2007 new issues are running 7% ahead of last year's first half.

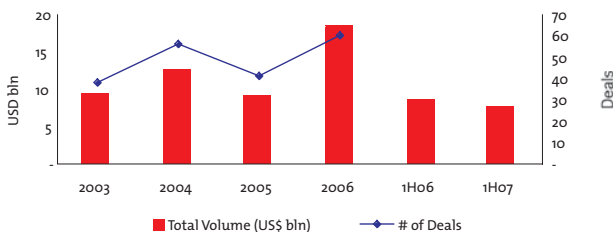
out the region can now raise debt, domestically, without having to rely on the foreign currency risk and/or exogenous volatility of international demand.

Sound fiscal policies and solid economic growth, coupled with a multitude of increasingly sophisticated financial options, have set the stage for a renaissance in infrastructure investment and project finance. This will certainly be one of the signature themes for Latin American debt finance in the years to come.

As a result, companies from through-

Chile pioneered the infrastructure initiative, with other countries soon

### Latin American project finance volume, 2003-1H2007



Source: Dealogic

on its heels. Toll roads and housing are at the top of the Mexican agenda; the Brazilian government has embarked on a massive infrastructure growth acceleration plan. These initiatives have been made possible by increased private sector interest and investor appetite.

The Chilean experience illustrates the growth and maturity of Latin American project finance. The first Chilean toll roads were financed with relatively short-term debt and recourse to the project sponsors. Now, 20 year non-recourse loans have become the norm. In Mexico, the recent \$4 billion toll road privatization was underwritten, in its entirety by



**Santander NY Americas**

**Debt Finance Team:**

**William Donovan, Marcelo Castro**

**Salinas, Dan Vallimarescu,**

**Robert Silverschotz**

Santander, in a mini-perm structure denominated entirely in Mexican pesos, by far the largest local currency Mexican project financing of its kind.

**“Sound fiscal policies and solid economic growth, coupled with a multitude of increasingly sophisticated financial options, have set the stage for a renaissance in infrastructure investment and project finances”**

# Resilience to turmoil

One sign of the fundamental health of the Latin American debt markets, and of their staying power, is the way they behaved in the midst of the market realignment in the late summer and early autumn.

Pricing for Latin American bonds and loans has decreased sharply over the

In the past, Latin America often caused, or was whipsawed by, global market dislocations and credit events. However, the region has demonstrated remarkable resilience during the recent turmoil. While most global credit spreads widened sharply during the past few months, Latin assets prices generally fell later and relatively less

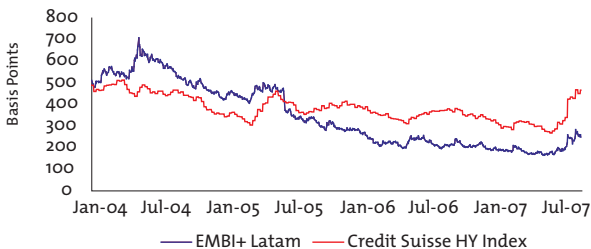
**“The region has demonstrated remarkable resilience during the recent turmoil... Latin assets generally fell later and relatively less than many other asset classes”**

past few years. The Latin American EMBI spread has traded inside the US high-yield spread index for quite some time. The investor confidence which that reflects has been vindicated during the recent market developments.

than many other asset classes.

As importantly, while the market for bond issuance dried up, demand for Latin American loans remained surprisingly resilient.

## EMBI+ vs. high yield bond performance



Source: Bloomberg & Santander Investments

# Borrowing Responsibly

As never before, Latin American companies are enjoying unsurpassed financial flexibility and liquidity.

As they gain economic scale, in some cases on a global basis, and diversify and upgrade their product

“Latin American companies are accessing the financial markets responsibly... refinancing debt - extending maturities...investing in productive assets.”

But where has that financing gone? Latin American companies are, by and large, accessing the financial markets responsibly. They are refinancing debt - extending maturities, hedging exchange risk, locking in rates and spreads. They are investing in productive assets, plant and equipment. And they are funding acquisitions, regionally and throughout the world, as they consolidate their market positions in the global environment.

Despite the increase in debt financing, most companies have improved their creditworthiness, using the opportunity presented by the capital markets to strengthen their balance

offerings. Latin American companies have been investing not only in bricks and mortar, technology and distribution channels, but in IT systems and corporate governance. All of these improvements have been reflected in numerous corporate and bank rating upgrades across the region.

Each country in Latin America faces its own opportunities and challenges. However, on balance, fundamentals throughout the region are very strong. The region and its many market participants, from companies, to banks to investors, are marching in lock-step as they construct and capitalize on what will hopefully be a new and sustainable debt financing paradigm.

# Argentina's private sector comes in from the cold

Argentina is on the mend from its historic debt restructuring. The economy has boomed, growing by more than 8% annually since 2003, and the corporate sector has found renewed access to liquidity, both domestically and abroad. Argentina and its private sector are in need of this debt finance, not to restructure existing debt but to meet the pressing investment demands of a growing economy.

The speed with which Argentine companies returned to the interna-

tional markets over the past 12 months has been remarkable. Even if the government isn't issuing global bonds, it's still attracting many international investors to its local debt issues. But Argentine corporate issuers, and even quasi-sovereigns, found eager foreign buyers for their international debt earlier this year. For example, gas transportation company TGS issued a heavily oversubscribed \$500 million 10-year global bond; the Province of Buenos Aires raised \$400 million in 21-year paper, and Banco Macro issued a \$150 million 30-year callable income bond.

In addition, a number of Argentine companies issued local denominated, internationally distributed global bonds – an impressive demonstration of renewed investor confidence. Santander Rio's three-year Argentine peso bond was 10 times oversubscribed by foreign investors. Other Argentine companies followed suit, including several financial institutions, electricity distributor Edesur

2007 ARGENTINA  
**SANTANDER RIO**



**ARS 450 million**  
11.375% Notes due 2010

**JOINT LEAD MANAGER /  
BOOKRUNNER**



**Santander Argentina credit markets team: Luciano Garcia, Juan I. Ormachea, Fabio Saraniti, Daniel Patron Costas, Augusto Valentinis**

and shopping mall operator Alto Palermo - capitalizing on investor appetite for yield and the perceived range-bound stability of the currency.

Tenaris bought Maverick Tube in a \$3.2 billion deal in 2006, and Hydril for \$2.2 billion in 2007, international banks were willing, for the first time

**“The speed with which Argentine companies returned to the international markets has been remarkable. Even if the sovereign isn’t issuing global bonds, it’s still attracting many international investors to its local debt”**

The syndicated loan market has been slower to revive, but is showing signs of life. When steel company

in years, to accept the Argentine cross-border risk that made up part of the acquisition financing.

Argentina does not, as yet, have a deep or liquid domestic capital market. This should change, as banks gradually increase corporate lending and institutional funds recycle their growing assets under management, which comprise 20% of GDP. The Argentine syndication market can digest deals of as much as \$150 million, with an average life of around three years.

Domestic bonds issues are generally small – no more than \$100 million – and sometimes denominated in US dollars. Local investors prefer floating-rate peso debt, which borrowers are understandably reluctant to issue. In addition, there is a nascent market in asset-backed securities, with mortgages and personal loans being securitized, although for relatively small amounts and short maturities.

Though Argentine assets have suffered disproportionately in the recent global credit market correction, the

2007 LATIN AMERICA  
**ARCOS DORADOS B.V.**



**US\$350 million**  
Senior Acquisition Facility

**LEAD ARRANGER**  
**BOOKRUNNER**

return of Argentina's private sector to capital markets is not about to reverse course. Top tier Argentine companies have demonstrated that they can generate significant cash flow growth and high returns for investors even in a challenging business environment. The October elections should keep investors riveted and looking for opportunities.

**“Argentine companies have demonstrated that they can generate significant cash flow growth and high returns for investors”**

# Brazil: a giant awakens



**Santander Brazil credit markets team: Jean Pierre Dupui, Daniel Kostman, Messias Pedreiro Neto, Ricardo Corradi Leoni, Nadia Elisabeth Scharenguivel**

Brazil's economy has scale, is uniquely rich in natural resources, has dynamic entrepreneurs and some of the most talented financiers in the world. More than a decade of market reforms and the adoption of more prudent financial policies have reduced the country's financing needs and vulnerability to external shocks, foreign capital is flowing in abundance and international reserves top \$160 billion.

Brazil's story is very compelling – GDP growth of over 4%, current account and government primary budgets are in surplus, with inflation in a 3%-4% range and enhanced transparency. Brazil is another country that is poised on the

edge of investment grade and that appears to have the upside momentum to get there in the next 12-to-24 months. Institutional improvements in capital markets including greater corporate governance and reform of regulatory bodies have increased the sustainability of the current growth path. The country has become a magnet for international banks and investors seeking to participate in Brazil's march to fully manifest its tremendous economic potential.

## **Tectonic shift in financing availability**

Mining giant CVRD's \$18 billion syndicated loan last year, used to fund its acquisition of Canada's Inco, was

indicative of the tectonic shift in the quantity of funds and types of options now available to top tier Brazilian companies. The loan was oversubscribed, with over \$34 billion on offer, and was refinanced remarkably easily with a slate of offshore and onshore transactions. CVRD issued \$3.75 billion two-tranche 10- and 30-year dollar bonds, a \$6 billion dollar-denominated loan backed by export flows, and also the single largest local debenture ever in the local market: R5.2 billion, or more than \$2.5 billion. CVRD also recently issued convertible debt, accounted for as equity by rating agencies. By mid-2007, the entire operation had been refinanced in a multitude of jurisdictions, currencies, and financial products.

A multitude of Brazilian companies, from steel giant Gerdau, to fast growing industrial valve company Lupatech are expanding at home and abroad. Brazil-

2007 BRAZIL  
**LUPATECH**



**LUPATECH S.A.**  
TECHNOLOGY THAT MAKES YOUR LIFE BETTER

**US\$200 million**  
Perpetual Bond

**JOINT LEAD MANAGER**

2006 BRAZIL  
**CVRD**



**Companhia**  
**Vale do Rio Doce**

**US\$18,000 million**  
Senior Acquisition Facility

**JOINT LEAD ARRANGER /**  
**BOOKRUNNER**

ian pork and poultry giant Perdigao in May acquired Cebeco Groep BV in the Netherlands for approximately \$40 million and a month later spent about \$50 million acquiring assets in the Brazilian beef sector, diversifying geographically and across product lines.

## Exploiting competitive advantages

Historically, many Brazilian companies and industries have been held back by a lack of access to capital. That constraint simply doesn't exist any more. Apart from minerals and metals, the country has a natural competitive advantage in producing a variety of agricultural products and by-products such as sugar cane and biofuels. Consequently, Brazil leads the world in alternative fuels and related technologies. The industry is now attracting capital from across the globe and is still just getting started. In beef production, Brazilian margins

2006 BRAZIL  
**CVRD**  

**Companhia  
 Vale do Rio Doce**

**R\$5,500 million**  
 Dual Tranche 4-year and  
 7-year Debentures

**LEAD MANAGER /  
 JOINT BOOKRUNNER**

are at least twice as large as those of developed country competitors. The country's largest meat packers have been consolidating the industry domestically and acquiring competitors abroad, financing themselves initially with international bonds. Several, such as JBS, Marfrig, and Minerva have done IPOs this year and others are in the pipeline.

Dollar bonds have been the financing vehicle of choice over the past three years for Brazil's thriving corporate sector and the country took the lead in Latin corporate new issues over that time span. Moreover, Brazil is the leader in Latin America when it comes to financial innovation: Brazilian companies have issued the bulk of Latin American perpetual bonds, including Lupatech's \$200 million 9 7/8% perpetual notes issued in July. Brazilian companies also

pioneered the market for Latin offshore local currency denominated bonds that have now been replicated by companies in other countries around the region. Banco do Brazil and Ambev recently tapped that market, despite the currency's steep appreciation in recent years, demonstrating investor confidence in the country's macro fundamentals, foreign exchange rate stability and interest rate convergence.

For some of the second and third tier local firms that go offshore in order to obtain longer-dated funds in amounts that may not be available onshore, the swap market is now big and liquid enough that it's relatively easy to swap dollar funding into reais, out to as far as 15 years.

The local debt capital markets started opening to mid-tier issuers at the end of 2006 and, for top tier credits,

2007 BRAZIL  
**GRUPO PROVIDENCIA**  
**GRUPO PROVIDÊNCIA** 

**R\$475 million**  
 Acquisition Finance

**LEAD ARRANGER**

the local market is already accommodating transactions stretching out as long as ten years – remarkable for a sub-investment-grade country – though the global credit crunch is making local investors somewhat more cautious these days. The decline in inflation and in local interest rates over the past two years increased the appetite of local institutional investors in corporate debt – the local debenture market reached new heights in 2006 – as did the Brazilian IPO market – though it is having only a slightly less stellar year in 2007. In the first half of 2007, of the R\$7.1 billion issued in the local debenture market, R\$3.2 billion (45% of the total) came from first-time issuers.

Real estate and shopping mall operators have started playing a very prominent role in local capital markets and are expanding internationally. With a housing deficit of some 8 million homes and 1 million new inhabitants added to the population every year according to

2006 BRAZIL

ATE II  
Transmission Line

**ABENGOA**

US\$120 million  
Project Finance Facility

LEAD ARRANGER  
FINANCIAL ADVISOR

government data, rising GDP per capita and a significant increase in availability of credit, this market is expected to grow rapidly for years to come. There is also a growing asset-backed market, dominated for the moment by the securitization of long-term rents from Sao Paulo office buildings.

A major growth area to watch going forward, pushed by the government and by development bank BNDES, is project finance. Improving infrastruc-

**“Historically, many Brazilian companies and industries have been held back by a lack of access to capital. That constraint simply doesn’t exist any more”**

ture is one of the keys to unlocking Brazil's potential to attain higher levels of economic growth. Recently, the federal government announced an approximately \$250 billion investment program, called Growth Acceleration Package (PAC), focusing efforts on energy, logistics and social infrastructure and on providing the legal framework conducive to Public Private Partner-

Petrobras recently announced capital expenditures of more than \$100 billion in its five-year strategic plan – a plan whose objective is to make Petrobras one of the largest integrated energy companies in the world.

Project finance loans have soared, increasing 116% from \$2.96 billion in 2005 to \$6.67 billion in 2006. With the

**“Brazil leads the world in alternative fuels and related technologies. The industry is now attracting capital from across the globe and is still just getting started”**

ships. Some of the infrastructure developments in the pipeline involve big highway projects, including 14 concessions being auctioned. Others involve new energy projects, especially in the hydroelectric sector, where a series of small plants is being built at a cost of \$4 billion apiece on the Madeira river. Then there's the transmission grid, and the railways, and, a bit further down the road, much-needed investment in air traffic infrastructure. There is also an ethanol pipeline in the works. Beyond this extensive list, State oil company

exception of oil and gas transactions – invariably funded in the international markets – most of that volume is accounted for by funds originated by BNDES. International financing has not played a major role but is likely to in the future as the PAC gains traction.

Brazil truly has become one of the leading edges of the global economy's new frontier, in the areas of resource provisioning, new technologies and, of course, the development of financial products to bring it all to fruition.

# Chile: regional leader continues to blaze new trails



**Santander Chile credit markets team:**

**Sebastian Caronni, Nicolas Garcia, Jaime Arriagada and Rafael Carvalho**

Chile has the most advanced economy in Latin America, with a credit rating (A2/A/A) and GDP per capita, a track record of growth and stability that are the envy of its neighbours. Its financial markets and institutional investor base are well established. Central bank, finance and regulatory officials have often been consulted over the years by neighbouring officials for advice, and the corporate and banking sectors have many “best in class” operators. But the country is not large, which means that there was some uncertainty regarding how much money a foreign company would be able to raise in Chilean pesos.

That question was answered when Mexico’s America Movil, which has operations across the continent, including in Chile, came to market with an impressive \$400 million syndicated loan denominated in Chilean pesos. The loan, which would have been unthinkable a few years ago, is proof that it’s not only Chilean pension funds that are driving demand for local debt: domestic banks have a lot of liquidity to put to use as well. The America Movil deal demonstrated that a well-designed financing structure can help a strong company borrow almost as much money as the banking system has capacity to lend: when the loan closed, the banking sys-

tem's aggregated lending limit for any individual corporate credit was \$600 million. Now that lending limit is \$1.3 billion, which means that the America Movil record might well be shattered by an even larger transaction.

Most local loans don't reach that sort of size, but that didn't daunt local cable company VTR, which is owned by Liberty Media. In one uncharacteristically large, innovative dual-tranche transaction it not only raised \$225 million with a peso-denominated loan, but also managed to borrow \$475 million in dollars as well, which was swapped back into pesos. A large part of banking to Chile's biggest companies, in fact, includes providing them with access to foreign capital that can complement the slightly shallower local markets.

### **Impressive evolution**

The loan market has undergone an impressive evolution compared to the situation just five years ago, when Chilean companies typically contracted bilateral loans from their local banks: syndicated loans were unheard of, and tenors never stretched out more than three to five years. In most cases guarantees were required, with corporate borrowers often pledging land or other assets as collateral.

Today, companies have at their fingertips a much wider range of alternatives, including local bonds, securitization of



receivables or other assets, and non-recourse financing within a project. Loans have become a competitive alternative to bonds over the past two to three years, and can stretch out as far as 20 years.

### **Project Finance Pioneer**

Chile is also a leader in project finance, largely as a result of an ambitious and very successful programme of toll roads. In fact, Chile was something of a regional pioneer in development of infrastructure finance. The financing of toll roads evolved from short- to medium-term loans with full recourse to sponsors and asymmetric amortization schedules 15 years ago. In Chile's latest, landmark deal, the "Ruta 60" project, carried out by Spanish construction giant OHL, the financing landscape is altogether different. The financing was structured with a 20-year, non-recourse loan syndicated among local banks up to \$400 million,

with an interest rate swap to fixed rate for the same tenor.

In fact, the swap market is now so big and liquid that a number of foreign companies are issuing opportunistically in Chilean pesos, only to swap the proceeds back into dollars. The converse, of course, means that Chilean companies can borrow in dollars and fully hedge their currency risk at very reasonable cost.

### **A large local investor base**

The bond market is still relatively small, despite the fact that local pension funds now manage about \$100 billion, or roughly 100% of GDP. There are approximately 15 to 20 local bonds issued each year, amounting to \$3 billion to \$4 billion. In addition to this, a handful of international bonds are typically issued in the US by the largest Chilean corporations, such as Codelco, Endesa, Arauco and Soquimich.

More recently, smaller, lesser-known entities have successfully tapped global markets – sugar and food company *lansa*, and chemical and ceramics conglomerate *Pampa Calichera*. In theory, the international issues could be more numerous, but the local pension funds are sufficiently large and hungry for assets that it's generally cheaper for companies to borrow locally, unless they need to borrow amounts that are

2007 CHILE  
CLARO CHILE  
(AMÉRICA MÓVIL)  
  
US\$400 million  
Local Syndicated Loan  
STRUCTURING AGENT

more easily accommodated by international markets.

One limitation of the local bond and loan markets is that they are generally denominated in UF, or index-linked pesos. Inevitably they will move to nominal pesos, but that's likely to take some time, and the few nominal peso bonds that have been issued are no longer than seven years. There are some peso loans up to five years in duration, but loans which are longer than that are still denominated in UF.

So despite its relatively small size, financial markets in Chile continue to develop, broaden, deepen and evolve in ways that will no doubt blaze trails for future products and transactions in markets across the region.

# Colombia is back



**Santander Colombia credit markets team: Alberto Losada Díaz, Khalaf Soleiman Carmona, Juan Carlos Alvarez Barrios, Roland López Briceño**

Colombia is back, growing fast, and, as befits the only country in Latin America never to default on its debt, set on a course to recover its investment-grade credit ratings. As a start, Standard and Poor's raised Colombia's rating to BBB- in June of this year.

The Colombian economy has been growing rapidly, between 5-7% since 2004, led by construction and investment, while Colombians have been repatriating money, bolstering foreign exchange reserves. Foreign direct investment has picked up fourfold from where it was just four years ago, averaging \$8.4 billion in 2005-06, due to improvements in security and the potentially high returns available in a revitalized, dynamic economy.

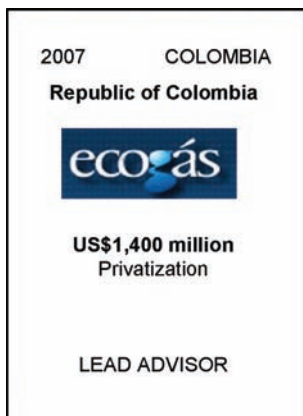
International financial institutions are opening regional offices, M&A activity

has gone into high gear and IPOs have also taken off as the country's companies retake their rightful place in the Latin American pantheon of respected, regionally expanding industry leaders. Companies like Cementos Argos, Organization Corona, Grupo Nacional de Chocolates, Carvajal and Interconexión Eléctrica are buying competitors in Latin America and in the US.

## **Increasing options on offer**

The increase in financing options available for Colombian corporations is largely due to the country's turnaround under President Alvaro Uribe. Recently, one Colombian company that is hardly known outside the country expressed interest in raising \$200 million for capital expenditures; it received no fewer than 11 proposals from various international banks.

Even as international credit markets were in turmoil this summer, the District



of Bogota issued offshore 578mn Colombian pesos \$300 million of 9¾% notes, and gas transportation company TGI was poised to follow quickly with a similar deal. These transactions have been facilitated by the popularity of Colombia's global TES – government bonds issued internationally and denominated in Colombian pesos, which yield about 100bp less than their local market equivalents and are more tax efficient for international investors.

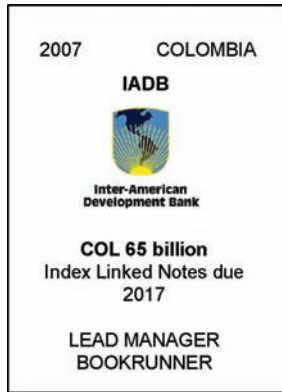
Interconexion Electrica, which bought the State of Sao Paulo's CTEEP transmission company via holding company ISA Capital, issued \$500 million of international bonds in dollars earlier this year, while Bancolombia issued \$400 million of 6.875% notes at the end of May, helping to fund its expansion drive. In the local capital market, the multilateral

agencies are also doing transactions: recently the Inter American Development Bank issued \$40 million in a Europeso deal.

### **Brewer sets a benchmark**

The beginning of the reopening of Colombia to international capital markets can be traced to 2004-2005 when brewer Bavaria decided to raise a landmark \$250 million syndicated loan and issued a benchmark-sized international bond to refinance the debt taken on to finance the acquisition of Peru's largest beer company and other assets across the region. Bavaria went on to grow throughout Latin America before being acquired itself by global brewing heavy weight SAB Miller.

Today, the size of the Colombian financial system limits syndicated loans to an aggregate maximum of approximately \$600 million. In practice loans are limited to about \$250 million. Generally speaking, the loan market in Colombia would likely be stronger if not for the capital controls put in place last year, and the bond market has failed to fill the ensuing vacuum, partly because international bond investors are subject to the same capital controls. Yet the local market for loans continues to generate a lot of activity, much of it driven by M&A-related transactions, capacity expansion and consolidation: the \$1.5 billion transaction for Empresa de Energia de



Bogota in January and \$150 million for Surainversiones in July are just two examples among many.

**“International financial institutions are opening regional offices, M&A activity has gone into high gear and IPOs have also taken off”**

The local bond markets are evolving as well, with local issuers able to come to market with transactions which can reach \$300 million in size.

Moreover, infrastructure investment is set to soar, with major projects in ports and airports as well as the highways linking them. Much of

the money for those infrastructure projects will come from domestic pension funds, which have some \$20 billion under management at the moment, a number which is increasing by about \$200 million a month. In five years' time, they should have \$40 billion.

Mortgages, too, look set to become a major market, with originations growing by more than 30% a year, although an uptick in inflation is feeding through into interest rates, which could slow the housing market down a little bit.

With the economy growing at its current pace - GDP growth accelerated to an 8% rate in the second quarter - the highest figure seen in Colombia since 1970, there is likely to be a very robust demand for funds in the foreseeable future. It appears that there will be plenty of work to do for all of those financial professionals moving to Bogota.

# Mexico: enormous potential still to be unleashed



**Santander Mexico credit markets team:  
Pablo García, Gerardo Freire, Octaviano Couttolenc**

Mexico is Latin America's outstanding "convergence" story. The NAFTA partner's industrial sector has become highly integrated into the North American economy and Mexico's central bank has institutionalized independence and transparency, lending credibility to the country's efforts to achieve higher growth rates with inflation stable at between 3-4%. The new reform-minded government of President Felipe Calderon has already advanced reforms more quickly than anticipated and appears poised to pass critical tax and political reform legislation in the very near term. Even some form of energy sector improvements look achievable under the current administration. The advancement of a number of legislative projects and structural improvements could trigger upgrades to Mexico's Baa1/BBB/BBB credit ratings.

Though Mexico is still, technically, an emerging market country, its domestic fixed-income market looks and functions more like that of an industrialized nation. Of all the emerging markets, Mexico has been one of the most successful in creating a broad and deep market in local-currency fixed-income issues, including an increasingly sophisticated market for asset-backed securities.

## **Active on the acquisition front**

In terms of international bonds, Mexican companies remained among the most prolific in the region this year, until the recent bout of credit market volatility dampened activity. Mexican companies were among the very active Latins on the acquisition front, at home and abroad. Cemex purchased Australia's largest cement company, Rinker for over \$14 billion, and consequently issued an extraordinary



array of bonds totalling close to \$5 billion in dollars, euros and pesos, in a variety of structures, mostly in perpetual notes, some with fixed-to-floating coupon options. Mexican telco Axtel successfully placed \$275 million in 10-year bonds to help cover its highly accretive acquisition of Avantel in the first of what is expected to be a series of transactions by domestic and international players to consolidate the sector.

Other standouts included glass company Vitro's oversubscribed, upsized \$1 billion two-tranche notes and the issuance of perpetual notes and cross-border mortgage-backed securities by a number of financial institutions, including specialized construction and mortgage lenders called "sofoles". Market participants also embraced bond issues this year from some companies with more aggressive financial profiles, such as Maxcom, Industrias Unidas and DeMet.

Even the buoyancy of international capital markets, however, has paled in comparison to the financing terms available to top-tier Mexican companies in the domestic peso market – a market which has grown dramatically in the past five years, since the creation of the “certificado bursatil” local debt instrument. As the government led the way in establishing longer-dated benchmarks and institutional funds grew, the domestic market's appetite for larger, longer-dated corporate issues grew commensurately. Pemex, for example, has been placing an increasing percentage of its bonds in the domestic Mexican market. The local market has also made great strides in sophistication and diversification: asset-backed securities have grown in number, size and duration, in lockstep with the rapid development of the country's secondary mortgage market.

## Pesos in demand

International issuers such as insurance company AIG, General Electric and even the province of Quebec have been keen to issue in pesos, due to the attractive cost of funds available in the market. The Mexican peso is a fully Euroclearable currency, which means that such an issuer can place peso-denominated paper listed in the UK, for example, rather than asking investors to buy the bonds in Mexico. That said, a lot of the demand for such bonds does come from Mexican pension funds, which have difficulty finding sufficient domestic paper of the quality they want.

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So, in Mexico, while big foreign companies can issue long-dated bonds in benchmark size with relative ease, mid-tier Mexican companies with lower credit ratings are limited to maturities of five or six years. The entrance of international institutional investors to the market might change that: it was they, after all, who led the way in purchasing 30-year local-currency government bonds, with very profitable results. For the time being, however, mid-tier local companies are more likely to borrow money from banks and issue debt in international bond markets.

Mexico, like Brazil, is in the midst of an immense infrastructure programme. Between the public and the private sector, spending on projects including roads, railways, airports and sewage systems will total more than \$85 billion between 2007 and 2012, while a further \$140 billion is slated to be spent on energy projects

during that period. Most of the proposed infrastructure schemes are based on a system of public-private partnerships, with the Mexican government alone increasing spending on infrastructure by 1-2% of GDP. In most cases the government is assuming that a good portion is going to come from the private sector.

### **Making connections**

Highways are a priority for the Mexican infrastructure investment programme, especially the roads that connect Mexico's main cities to the US, and some highways that run transversally from ocean to ocean. Once those are finished, the multi-modal projects, especially the ones relying on connections from Atlantic to Pacific ports, can really get started. The government is engaged in an effort to privatize toll roads. The first of the new slate of toll road concessions up for auction was sold in August for approximately \$4 billion to a consortium led by Goldman Sachs Infrastructure Partners and ICA, Mexico's largest construction company, in a very competitive process. Santander underwrote the entire transaction, which represents the largest Mexican peso transaction of its kind.

Elsewhere on the infrastructure front, the government's electricity company, the CFE, auctioned the La Yesca hydroelectricity project for \$768 million. In addition, there are three train lines to be built in Mexico City. There are also vast demands for water and sanitation investment at the federal, state and

municipal level. Then, of course, there's energy: state oil company Pemex needs to ramp up its investment programme significantly if Mexico is to remain a net oil exporter over the long run.

While infrastructure investment is hot, the domestic syndicated loan market in Mexico has yet to fully defrost. There are only three big banks in the country, and so far they've shown little appetite in terms of syndicating large loans between themselves and the handful of smaller banks. The international syndication market is a completely different ball game, however, and is dominated by Mexico's largest entities executing large refinancing operations such as Pemex's \$2.5 billion transaction earlier this year. Pricing on these deals tends to be very tight. At the peak of the liquidity cycle, Iberdola Mexico was able to raise \$1.2 billion to refinance existing sponsor debt that defied conventions and established new benchmarks for pricing and tenors.

Of course Mexican company M&A activity also helped drive bank deals this year – not just for Cemex (\$1.9 billion) and Axtel (\$514 million), but also for some new names such as Mexichem, Dine, Pilgrims Pride and Industria Hierro. Grupo IMSA began a remarkable set of transactions with a leveraged buyout that ended up with the financing of Ternium's \$3.75 billion refinancing and acquisition of the group. The emergence



of new classes of investors has helped drive these and other "story credit" deals such as PIMSA's \$355 million loan in January.

The syndicated loan market has remained more resilient than bonds to the recent credit market jitters, though more attention to credit fundamentals, a hard look at pricing levels and renewed calls for market flex features are making a comeback. Pemex closed at the end of August an oversubscribed syndication at the announced price, and the CFE is expected to test the waters with as much as \$3 billion soon.

Typical of Mexico's "where there's a will, there's a way" track record, many innovative transaction ideas are emerging to keep deals moving through the pipeline, such as dual-currency structures that use the Mexican market as a stepping stone.

# Peru: enviable fundamentals, too good to ignore

Peru's economy has been one of Latin America's best performers on almost every measure over the past five years, growing at a 6% annual average rate. That rate accelerated to the 7.5-8% range in 2006-07, while inflation remained around 1-2%. In the past five years, the exchange rate has been stable, international reserves have risen significantly and exports have almost doubled. Both the fiscal and the current accounts were in surplus of more than 2% of GDP in 2006 and the outlook remains bright.

It's not surprising, then, that Peru's credit ratings have been notched higher over the past 12 months, to BB+ by S&P and Fitch; Ba2 by Moody's - investment grade appears to be within reach in 2008. The Peruvian government is actively pursuing free trade agreements with the US, Canada, the Eurozone, China, Singapore and Mexico. As a result of this new environment, the Peruvian stock index rose 168% in 2006 and over 70% during the first half of 2007. The government recently issued an oversubscribed 6.9% sovereign bond

in local currency for a total amount of approximately \$1.5 billion equivalent, with a 30-year maturity. The funds were used to prepay debt with the Paris Club, at the same time generating important savings in debt service costs, improving duration from 9.6 to 11.9 years, and reducing foreign exchange risk. Moreover, Peru's foreign exchange reserves have now surpassed its overall external debt, reducing the country's vulnerability to external shocks.

## Santander opens bank

It is with this backdrop that Santander announced plans to open a new bank in Peru, expected to launch operations in the fourth quarter of 2007. The bank will focus on institutions, corporations and mid-size businesses, offering value-added treasury and investment banking services, trade finance and traditional banking. In fact, this year, Santander has already arranged structured trade finance transactions of over \$130 million for Peruvian companies and participated as mandated lead arranger for a loan syndication of \$165 million. Eximbank this year recognized Santander as the best financial institution

covering Peruvian operations.

Overall activity in the local Peruvian debt market has grown consistently, both in the public and private sectors. The stock of public bonds in local currency has grown 63% this year, to \$6.7 billion, of which 39% is owned by local pension funds, 30% by local financial institutions and 28% by non-resident investors.

Though corporate finance is principally provided by local and international banks, Peruvian companies are also increasing their funding via the Peruvian bond market, fostered by the local pension funds, which now have over \$20 billion in assets.

The stock of private sector bond issues amounts to \$4.7 billion, 75% of which are corporate bonds or securitizations, and 25% of which are issued by financial institutions. Of this total, 40% were issued in local currency and 60% in foreign currency, and 60% have tenors exceeding five years. New private sector bond issues during the first half of 2007 amounted to \$530 million. Few Peruvian companies have been active in the international bond market, and they are represented mainly by investment-grade mining giant Southern Peru Copper and by BB+ rated Banco de Credito del Peru.

### **Infrustrature in the pipeline**

Proinversion, the government's agency promoting private investment, has regis-

**“Santander announced plans to open a new bank in Peru, expected to launch operations in the fourth quarter of 2007”**

tered investment projects of \$3.9 billion, most of which are for infrastructure improvements. Moreover, the government's execution in public investment is lagging, while tax collection is outstanding – suggesting that a lot of spending is in the pipeline without jeopardizing the country's strong fiscal and current account balances.

A leading local economic consultant published a report identifying investment projects in excess of \$16 billion, mostly in mining, oil and gas, and public infrastructure, so that infrastructure finance is likely to remain in high gear for the foreseeable future. Meanwhile foreign direct investment has picked up to more than double the levels attained in 2003-04. It appears that, with investment spending driving growth, the economy firing on all cylinders, abundant financial resources available from pension funds and credit ratings upside, opening a

# Venezuela: choosing its path

Venezuela has been largely absent over in the past few years from the international capital markets.

Earlier this year, the Venezuelan national oil company PDVSA issued the largest ever series of Latin American corporate bonds, raising a total of \$7.5 billion, in 10, 20 and 30 year tranches. The notes, rated BB-/BB-, were reportedly twice oversubscribed. However, those bonds were placed almost entirely with domestic institutional and retail investors. Apart from that, due to the Venezuelan exchange control regime, the corporate sector has financed itself almost exclusively in the domestic market.

Venezuela's economy is fueled by oil – historically high prices have led to a consumption boom and GDP growth of 10% or more annually. This growth, combined with increased liquidity in the local financial market and negative real interest rates, have led to an increasing number of domestic financing transactions. A variety of companies have financed themselves in the domestic market, including the Fondo de Valores Inmobiliarios, Toyota Financial Services

Venezuela and multilateral lending agency, CAF.

Bond issues in the domestic market have been for relatively short maturities (5 years) and amounts (\$100 million equivalent). They have been priced at variable interest rates and benchmarked to TAM, the average lending rate of the country's six largest banks. The FVI and Toyota transactions were priced, for example, at 80% and 68% of TAM respectively, underscoring the investor appetite for corporate debt.

Venezuela's most significant financing needs are in the infrastructure and energy sectors. A number of projects, particularly in the petrochemicals sector, are in process and expected to come to market in the coming years. In particular Brazil's Braskem, the largest petrochemical company in Latin America, is embarking on two significant joint ventures with the Venezuelan state petrochemical company, Pequiven, with estimated investments of over \$2.5 billion. These projects will provide a real test to determine the depth and liquidity of the domestic financing markets.

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