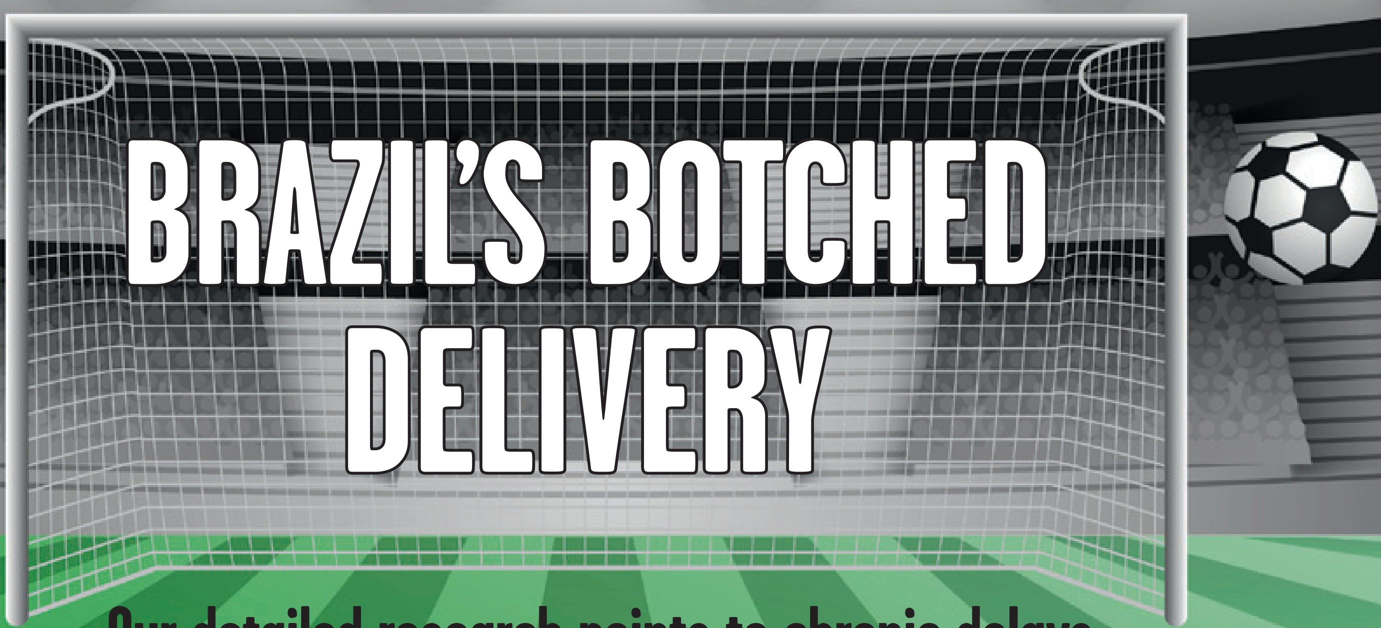
LATAM CONFIDENTIAL

PREMIUM INVESTMENT RESEARCH

JUNE 2014



BRAZIL'S BOTCHED DELIVERY

Our detailed research points to chronic delays and cost overruns

CONSUMER: DEBT DIFFICULTIES

RESOURCES: NEW FARMING FRONTIERS

FINANCE: PRIVATE EQUITY LOOKS TO MEXICO

INFRASTRUCTURE: OLYMPIC CONCERNS RISE

JUNE 2014

*Based on a survey of 1,500 respondents in Brazil and 1,000 in each of the other countries
Source: LatAm Confidential

3.0 RESOURCES AND TRADE

Farming opportunities are opening up in Paraguay, where the government is planning extensive infrastructure investment

IN THIS REPORT:

1.0 MACRO VIEW
Brazil's lost opportunity

2.0 CONSUMER
The shadow of debt lengthens

3.0 RESOURCES AND TRADE
Farming's new southern cone frontiers ● **3.5** Cartes plans to boosts investment

4.0 FINANCE
Private equity poised to ride out funding challenge ● **4.5** Private equity heads to the Pacific

5.0 INFRASTRUCTURE
Brazil underachieves on World Cup projects ● **5.8** 14 years in the making – Salvador's metro finally opens ● **5.10** Olympics concerns rise ● **5.12** 2Q14 Infrastructure Project Tracker

6.0 METRICS THAT MATTER

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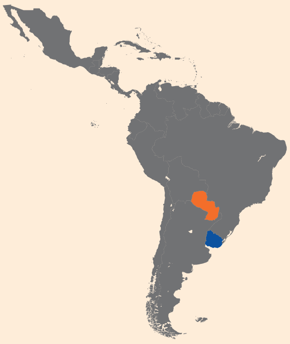


3.5 CARTES PLANS TO BOOSTS INVESTMENT IN PARAGUAY

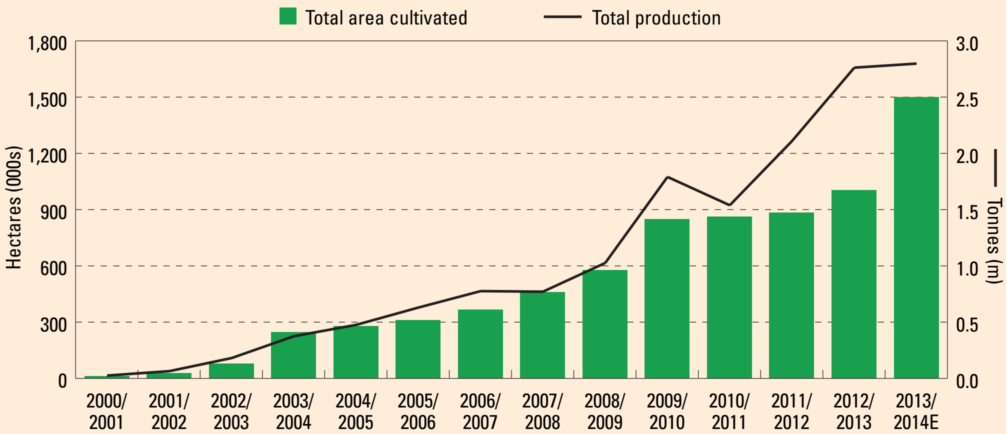
FARMING'S NEW SOUTHERN CONE FRONTIERS

» It has become increasingly difficult for international investors to access agribusiness opportunities in Brazil and Argentina, either because of land ownership limitations or punitive tax and trade restrictions. We examined opportunities in two smaller but more open Southern Cone economies that enjoy similar comparative advantages as food producers: Uruguay and Paraguay.

» We visited both countries during April and May in order to assess local agribusiness trends. We found that consolidation in Uruguay, prompted in part by the withdrawal of stretched Argentine investors, has created opportunities for a number of local groups. Some are beginning to expand into Paraguay, where the government is seeking to open up swathes of uncultivated land and is planning extensive investment in infrastructure that should, in the longer term, make the country more attractive to international business.

Uruguay began its push into forestry in the late 1980s. With 1m hectares (ha) of timberland, now boasts a sizeable paper and pulp industry, with revenues from wood, chips and pulp and paper generating about 10% of total incomes. The drive into soyabeans came in the late 1990s, with farmers beginning to convert large quantities of relatively cheap pastoral land along the Uruguay River. In the early 2000s, Argentine agricultural companies – such as Grupo Los Grobo – made investments in cheaper tracks of arable land along Uruguay's west coast. Grown on just 12,000 ha in 2000, soyabeans covered 1.5m ha by 2013. Output has increased at an even faster pace, rising from 27,600 tonnes in the 2000/01 harvest to an estimated 3.67m tonnes by the end of the current harvest (see chart 1). Soyabeans generated 19% of Uruguay's total export revenue in 2013. Reflecting this development, land prices in Uruguay have increased sevenfold over the last two decades, rising from an average of less than $500/ha in 1996 to more than $3,500/ha

Uruguayan soyabean production soars



Sources: MGAP, DIEA

$170m Amount for which Argentina's El Tejar sold out its Uruguayan interests to UAG in February, giving it control over 67,000 additional ha of land in Uruguay

in 2013 (see chart 2).

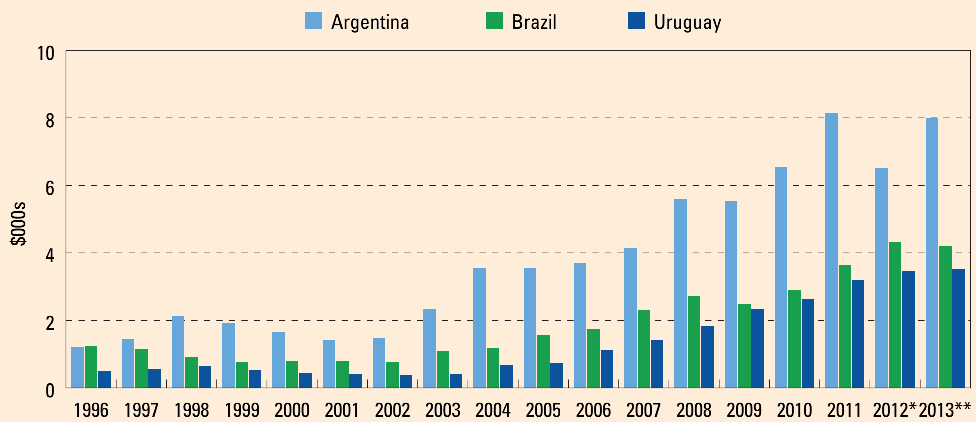
Paraguayan agribusiness is longer established, with the 350,000 individuals forming a strong Brazilian or *Brasiguayo* farming community in the east of the country producing the bulk of the most recent harvest of 8.5m tonnes. However, the election of a business-friendly government last year has opened up new possibilities in the less developed lands of the Paraguayan Chaco. We visited both countries over the last few weeks, interviewed farmers, agribusiness companies, consultants and government ministers. We believe the new agribusiness cluster emerging in Paraguay and Uruguay represent a potential opportunity for investors.

URUGUAY'S AGRIBUSINESS ELITE

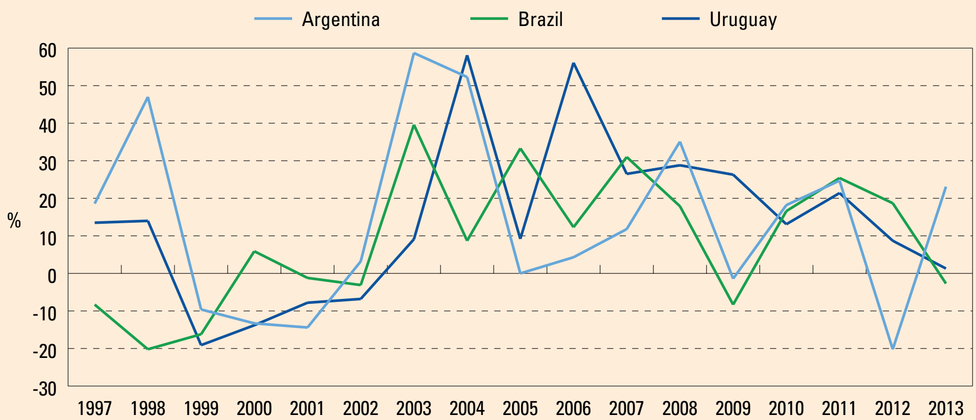
Although Uruguay's forestry industry is dominated by foreign players including Weyerhaeuser (WY:NYSE) of the US and UPM (UPM1V:HEX) of Finland (see map), we noted the emergence of a number of Uruguayan groups in the soyabean and grains sector. Led by the Montevideo-listed Union Agriculture Group (UAG), these businesses have expanded relatively quickly in recent years, buying up smaller farms and more recently picking up assets from regional and international investors. In February, Argentina's El Tejar sold out its Uruguayan interests to UAG for $170m, giving it control over 67,000 additional ha of land in Uruguay (32,000 ha owned vs 35,000 ha leased). El Tejar is one of the world's largest farm companies backed by London-based hedge fund Altima Partners, and private equity firm Capital Group (LCG:LSE). Adecoagro (AGRO:NYSE), one of the largest owners of

2. Southern Cone land prices surge

Average annual land price per hectare



YoY change



*Argentina's 2012-2013 prices are for the Province of Buenos Aires. Brazil's 2012 price is for 1H12, **Brazil's 2013 price is an estimate

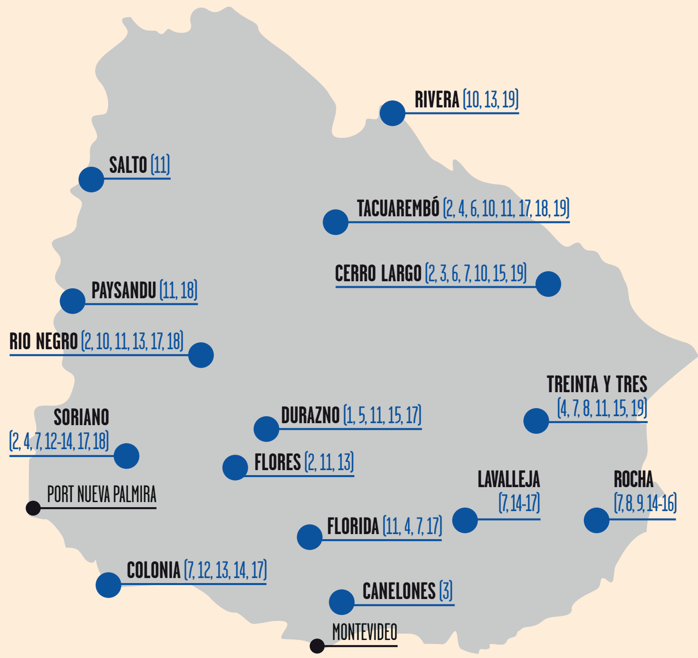
Sources: DIEA, FGF-IBRE, Fischer & Schickendant , IGP-DI, OPYPA (Oficina de Programación y Política Agropecuaria), World Bank

> Adecoagro is another investor to have exited recently, selling two of the three farms it initially bought in Uruguay

productive farmland in South America, is another investor to have exited recently, selling two of the three farms it initially bought in Uruguay. New Zealand Farming Systems, the South American dairy unit of Singapore-based Olam International (O32:SES), has also made several sales within their Uruguay land portfolio. In April, the company sold 7,771 ha to local interests for $53.7m. Since 2010, it had bought more than 28,000 ha of land in the states of Florida, Rio Negro and Rocha.

As well as UAG, we have identified eight other local participants who have begun to engage in large-scale intensive agriculture. These groups are adding value to land by increasing productivity on existing farms, or by converting uncultivated pastoral land to produce a variety of crops including wheat, maize, and rice, as well as soyabeans. Some are majority owners of the land they cultivate and closely allied with international players. Others use a leasing model, where they rent land from smaller producers and sell on what is cultivated to national and international trading groups for export. "Today there's a

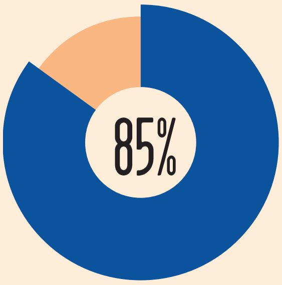
Uruguay's agriculture groups consolidate



Agriculture — Dairy — Corn — Grains — Forestry — Soybeans — Wheat — Meat — Rice — Olives

MAP NO.	NAME	WHAT THEY PRODUCE	NATIONALITY	HECTARES (000S)
1	Adecoagro	Corn, Grains, Wheat, Soybeans	Brazilian	45
2	Agronegocios del Plata*	Grains, Soybeans, Wheat	Uruguayan/ Argentine	100
3	AGRA	Grains, Soybeans, Wheat	Uruguayan	20
4	Barraca Jorge Walter Erro	Grains, Soybeans	Uruguayan	94
5	Calix Agro	Agriculture	French	11
6	Ernesto Correa	Meat, Soybeans	Brazilian**	100
7	Fadisol	Corn, Grains, Wheat, Soybeans	Uruguayan	83
8	Forestal Atlántico Sur	Forestry	Chilean	45
9	Galperín Group	Agriculture	Uruguayan	15
10	GMO Renewable Resources	Forestry	US	18
11	Hillock Capital Management	Agriculture, Forestry, Meat	Argentine	20
12	Kilafen	Wheat	Uruguayan	30
13	Montes del Plata	Forestry	International	250
14	NZ Farming Systems	Dairy	Singapore	20
15	RMK Timberland Group	Forestry	US	38
16	Sieraas Calmas^	Forestry	Spanish	30
17	Union Agricultural Group	Dairy, Meat, Olives, Soybeans, Rice, Wheat	Uruguayan	181
18	UPM	Forestry	Finnish	200
19	Weyerhaeuser	Forestry	US	138
ACROSS THE COUNTRY	Global Forrest Partners^^	Forestry	US	140
ACROSS THE COUNTRY	Manuel Santos Uribelarrea	Agriculture	Argentine	55

*Part of Los Grobo, Argentina. **Businessman (single investor). ^Part of Ense. ^^Includes Forestal El Arriero (26,000 hectares), Forestal Oro Verde (50,000), Forestal Tekoayhu (50,000), Forestal Tierra Verde (14,000)
Sources: Company websites, Uruguay Ministry of Agriculture, El Observador



Of UAG's land is dedicated to crop cultivation, but the group also manages livestock and dairy units

lot of local expertise in the mix, especially when compared to ten years ago," said Pedro Arbeletche, an agronomist at Uruguay's Public University.

UAG

Starting with a small blueberry farm in the west of Uruguay, UAG's land portfolio has multiplied from a modest 8,000 ha to the 181,000 ha they currently hold after the El Tejar takeover, 31,000 ha of which is leased. UAG was founded in 2007 by Montevideo-born Juan Santori, now executive chairman, who, having worked in the financial sector in Europe, returned to his home country to focus on buying enough land to acquire the scale needed to achieve efficiencies in the agriculture sector. 85% of UAG's land is dedicated to crop cultivation, but the group also manages livestock and dairy units, selling to food companies such as Conaprole, Marfrig (MRFG3:SAO), and Saman, mostly for the export market. In May last year, the company listed on the Uruguayan stock exchange for $420m.

UAG's main priority is integrating the land they have acquired in order to boost productivity. "We've had five years of very rapid growth, now is the time to consolidate what we own," said Romualdo Varela, the chief executive, in an interview with LatAm Confidential. Although positive about Paraguay, there are no solid plans to move into that market yet. The Uruguayan company for now is sticking to what it knows – the local market.

ADP

Agronegocios del Plata (better known by its acronym ADP) was established by the Guigou family in 2002. Unlike UAG, the group uses a leasing model, cultivating 75,000 ha of land, 50,000 of which it leases from roughly 100 different smaller producers. The reason why cultivation size varies is because some of the farms produce two crops in a single year, rotating between wheat in the South American winter and soyabeans in summer. 43,000 ha were dedicated to soyabeans during the most recent harvest, 58% of their land portfolio. Since 2004, ADP has partnered with the Grobocopatel family, now Grupo Los Grobo, a firm based in Argentina and run by Gustavo Grobocopatel, known locally as 'The King of Soya'. Los Grobo is the majority shareholder of ADP and also adopts a leasing model across the rest of the Mercosur region. The company does not own a single shovel or acre, instead it leases machinery and land from others. Its focus today is on increasing the productivity of existing farms rather than buying or leasing more land. "Economic viability is about large scale cultivation of soyabeans," said Marcos Guigou, ADP's president, in an interview with *El País*, the Uruguayan daily newspaper. This year ADP will produce 200,000 tonnes of soyabeans for export.

BARRACA ERRO

Barraca Jorge Walter Erro, is the third largest exporter of grains in Uruguay after Cargill and Cereoil Uruguay. It introduced soyabeans to Uruguay in 2001. It produced 14.5% of Uruguay's overall grain exports in 2013. The company – which was set up to transport grains in the late 1940s – also operates as Villa Trigo. Like ADP it has focused on increasing productivity on existing land, partly through the development of new seed varieties. It has an agreement with Donmario Seeds of Argentina, which specialises in genetically modified varieties. In the early 2000s, it cooperated with ADP on some projects, but now works separately, cultivating its own land and partnering with local farmers and cooperatives. Barraca Erro is present in 18 of Uruguay's 19 states, across 94,000 ha.

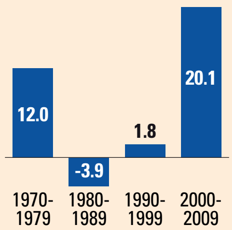
FADISOL AND OTHERS

Fadisol is a privately owned wheat and soyabean trader, based in the western state of Colonia. Like Barranca Erro, it partners with local farmers rather than growing on its own or leased land. The group started to farm in Paraguay in 2009 and has funded and managed several projects there.

Galperín Group – that purchased 1,769 ha of land from New Zealand Farming Systems this year – is a holding company established in Uruguay in the early 2000s with various Uruguayan and Argentine interests. The agricultural arm, known locally as Galfarm,

HOW LAND PRICES HAVE INCEASED IN URUGUAY

Rate of land appreciation (%)



Sources: DIEA, OPYPA, World Bank

currently has 15,000 ha under cultivation in Uruguay. 52% of the Galperín Group belongs to Paycueros, an Uruguayan leather manufacturer based in the Paysandú that exports mainly to China. Other shareholders include Ernesto Galperín head of Mercado Libre in Uruguay – the number one e-commerce site and E-bay's Latin America partner.

Nalmer, based in Young – in the northern state of Río Negro – purchased land from New Zealand Farming Systems in the same state where it is based.

Agra Corporation is a partnership between Marcos Marín, a Peruvian-Uruguayan businessman, and Jorge Francomano, an Argentine agronomist. The group manages 20,000 ha of land, on which it produces soyabeans for export. Mr Francomano previously managed over 40,000 ha in Uruguay for the Argentine farming group, MSU Agro. Their company is looking for opportunities to expand and is watching potential withdrawals by Argentine groups. "I wouldn't say there's been an outright mass exodus of Argentines from the market, but there's certainly stuff for sale with room to negotiate," said Mr Marín, the company's chief executive.

Hillock Capital Management is a farm management company based in Montevideo. It started life in Argentina as a property broker, but expanded into Uruguay in the early 2000s. Backed by wealthy individuals and institutions, the group has bought more than 20,000 ha in nine different states. It grows soyabeans and other crops on 12,000 ha. "There's still a lot of opportunities to convert arable land for crop cultivation," said Martín Otero, its chief executive.

GOVERNMENT POLICY

Government policies have been generally supportive, although there is some frustration about the poor quality of infrastructure and the slow pace of improvement. On the plus side, Uruguay's fiscal and legal framework is more transparent and predictable than that of Argentina and Brazil. There is a flat 25% income tax, and tax breaks on farm machinery and supplies. No sales tax is levied on farm products – with the exception of a 1% municipal sales tax on livestock. For smaller farms with annual revenues of less than $238,000, tax is capped at $5,125 per year. In addition, government agricultural policies are arguably conducive to sustainable development. In particular, the government has been keen to promote measures limiting over farming: a soil protection plan has been introduced since 2010 – 1.5m ha are currently protected – and crop rotation became mandatory in 2013. Uruguay's official agricultural research unit, Inia, established in 1914, is considered a global innovator in developing new seed varieties and conservation techniques. The government is also keen to ensure agribusiness complies with food sanitation laws, allowing the industry less complicated access to overseas markets. However, Uruguay's transport network is seriously deficient and agribusinesses complain that energy costs are expensive. Although logistics are easier than in Argentina, Brazil and Paraguay, farmers criticise that it still typically takes 30 days between harvesting and loading grain on ships. Marcos Guigou told a recent interviewer that "energy and transport costs in Uruguay are among the highest in the world. Infrastructure problems are an obstacle."

Ports are a priority: plans are afoot to bring into operation two new deep sea ports at La Coronilla, in Rocha state, and at Fray Bentos in the west of the country, supplementing three existing facilities at Colonia, Montevideo and Nueva Palmira. But according to the ministry of transport, the port of Rocha will not be fully operational in 2025. Railways have suffered from decades of underinvestment. Over half of the country's rail system has been abandoned since nationalisation in 1952. And roads are heavily congested. A project to revive nearly 1,500 km of railway is in place, but progress has been sluggish. A $74.8m contract for Focem Uno, linking Montevideo with Rivera near the Brazilian border, was awarded to the National Railway Corporation (CFU) in November 2011, but relatively little has so far been done. The winner of a second project, Focem Dos, to rebuild the west coast railway line that runs from Fray Bentos to Salto Grande in Argentina, will be announced in July this year. Carlos León, head of infrastructure for the national railway association (AFE) told LatAm Confidential that the China Railway Construction Corporation is a potential bidder. Progress has been equally slow in improving Uruguay's network of navigable rivers, although ministers claim that investments have been made. Given these failures, Fadisol plans to build a port terminal on the Tacuarí River that borders Brazil, in the eastern state of Cerro Largo.

With opportunities for land acquisition limited at home, a number of Uruguayan-based agribusiness groups have begun to expand into Paraguay

MOVING TO PARAGUAY

With opportunities for land acquisition limited at home, a number of Uruguayan-based agribusiness groups have begun to expand into Paraguay, focusing in particular in the Paraguayan part of the Chaco region. The election in 2013 of the business friendly President Horacio Cartes should help support this trend.

Uruguayans have bought nearly 1.5m ha in the northern Chaco region, according to Jorge Gattini, Paraguay's agriculture minister. We have identified a number of Uruguayan groups that have moved into Paraguay. Agra Corporation, which manages 20,000 ha of agricultural land in Uruguay,also currently holds 10,000 ha in Paraguay's western region, and UAG's Juan Santori signalled he is considering some of Paraguay's investment options. Everdem (Estudio 3000 S.A), which began buying land in Paraguay in 1999, now raises cattle on 8,000 ha, and is planning to start cultivating grain. "For the first time we have a government with a clear plan for our sector and transport infrastructure is a priority; the reconstruction of the Transchaco highway that runs [the 460km] from Asunción to the Filadelfia [the state capital of the Gran Chaco] has already been approved," said Rodrigo Artagaveyta, director of Everdem. The road is one of the 14 road projects that will be auctioned to the private sector as PPPs in 2014.

Although the Chaco is predominantly cattle-raising country (see map), the land is fertile – with roughly 80 particles per million (ppm) of phosphorous, compared to an average of 3ppm in Uruguay – and Paraguay's Grain Export Association (Capeco), with researchers in the US, is exploring new heat resistant varieties and is carrying out tests in the northern state of Alto Paraguay. However, much of this will take time. The association reckons it could be eight years before commercial scale cultivation can begin. A long-term irrigation plan to redirect fresh water from the Paraguay River to the drier salt water Alto Paraguay region close to the Brazilian and Bolivian border is also in place, but is unlikely to be fully operational before 2030.

CARTES PLANS TO BOOSTS INVESTMENT

President Horacio Cartes, who took office last August, has been keen to attract private capital to the country's infrastructure and resource-based industries, in order to improve access to international markets. In an interview with LatAm Confidential, he outlined his infrastructure plans for the country and signalled the governments support for the agriculture industry.

Paraguay is famed for having a simple and low tax rate of 10% across all sectors, with an addition 10% VAT. The cost of production vs other LatAm countries is also low – primarily due to the country's cheap and abundant electricity supply, young population (74% of Paraguayans are under 34) and relatively efficient export system. Mr Cartes claims that low production costs give Paraguay a competitive edge and wants to take full advantage. "We want to industrialise the country further. Paraguay is one of the lowest-cost producers in the region and this has to be maintained," he said.

Paraguay recently eliminated the 10% export tax on soyabeans, replacing it with a value-added tax of 5% on the sale of all agricultural products as of January 1 2014. In addition, if an agricultural product is processed, a 2.5% rebate is offered to exporters, providing an incentive for businesses to locate giving a further incentive to treat raw materials in Paraguay itself. "Agribusiness is an established system in Paraguay. We are more competitive than the US in terms of soyabean production at farm level, but the transport and logistics system in place today lets us down," said Jorge Gattini, the agriculture minister.

The government is already going ahead with its plans to invest in its transport infrastructure, following the approval in October of a new law on PPP. In April, the Korean construction company Ilsung was awarded the PPP to rebuild the Route 8 highway that runs from Caazapá to Yuty in the south-east. Paraguay's public works and communications ministry plans to auction a further 14 transport projects this year totalling $500m, increasing to over $1bn in 2015. Like Uruguay, making use of the river network is also high on the government's agenda.

"The Paraguay River is where we breathe commercially, it needs to be more navigable," Mr Cartes told LatAm Confidential. With 84% of total soyabean exports transported by river, the government plans to dredge the Paraguay River to increase capacity and reduce shipping costs. A bidding date for the PPP project is yet to be confirmed. The river is navigable up through Asunción for vessels of up to 11 metres draught, but droughts occasionally cause problems. In 2012 importers and exporters lost roughly $250m in potential revenues due to interruptions in traffic.

"There's still a lot of land. Within the next ten years I'd estimate up to 300,000 ha could be cultivated on the western side," said José Berea, head of Capeco. "Alto Paraguay is what Alto Paraná was twenty years ago." The eastern state of Alto Paraná, whose capital Ciudad del Este borders Brazil, is where the majority of Brazilian soyabean producers are based today. Sugarcane plantations have also been introduced in Alto Paraguay since 2009 through small-scale farming and local cooperatives and with successful results. Paraguay exported organic sugar to 17 different countries in 2013.

On the eastern border with Brazil, business continues to boom. The agriculture minister estimates that farmers of Brazilian origin cultivate more than 85% of the 3m ha of land currently under soyabeans. However Paraguay's relationship with its *irmão mais velho* (big brother) to the east continues to be an occasional source of tension.

Paraguay's uncultivated Chaco region looks set for investment

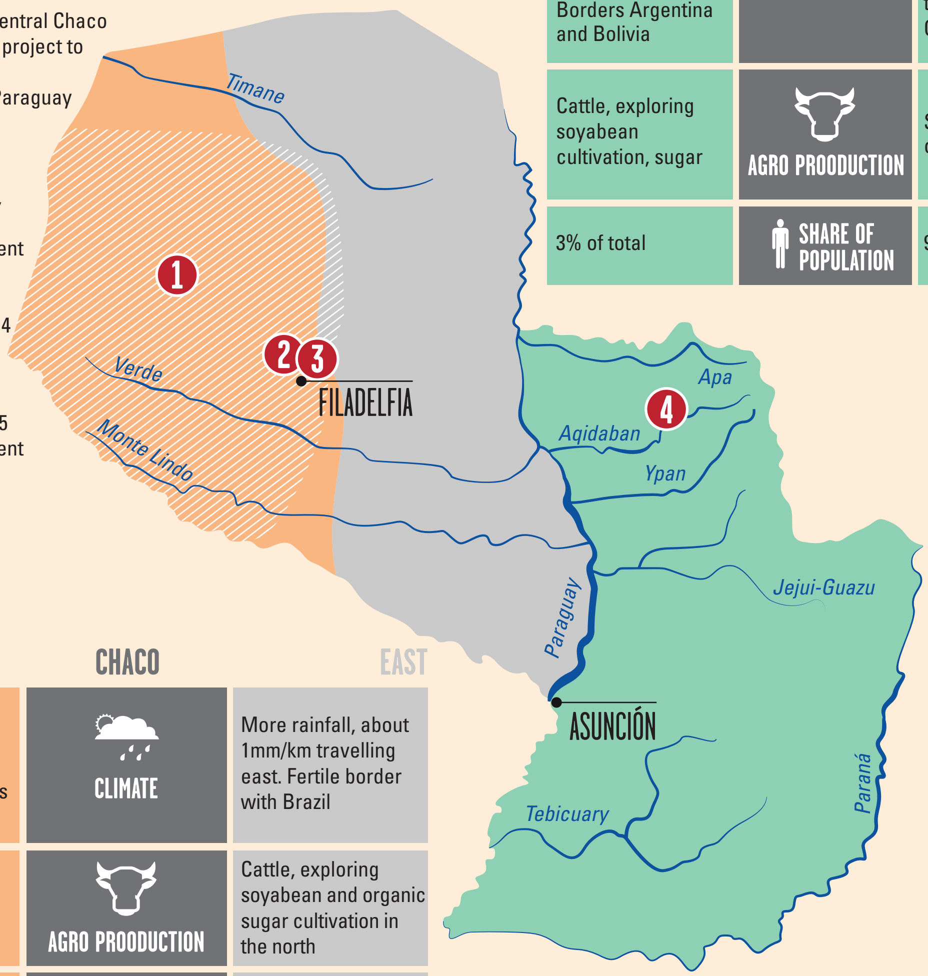
MAIN INFRASTUCTURE PROJECTS:

1. **Project:** Route 9 Transchaco highway
   Type: Road refurbishment
   Bidding date: 2014

2. **Project:** Aquaduct in Central Chaco
   Type: Water sanitation project to provide water for the region from the River Paraguay
   Work started: 2013

3. **Project:** Southern Line, Filadelfia
   Type: Road refurbishment for accesss roads in central Chaco region
   Work complete: Oct 2014

4. **Project:** Route 3, connection with route 5
   Type: Road refurbishment
   Bidding date: 2014



WEST	PARAGUAY	EAST
Arid, less rainfall but has large water reserve, the Yrenda water reserve, in the state of Gran Chaco. Borders Argentina and Bolivia	CLIMATE	Evenly distributed rainfall, average annual rainfall 1,500mm compared to 800mm in the Chaco
Cattle, exploring soyabean cultivation, sugar	AGRO PROODUCTION	Soybean, rice, corn, wheat
3% of total	SHARE OF POPULATION	97% of total

WEST	CHACO	EAST
Arid, less rainfall but has large water reserve, the Yrenda water reserve, in the state of Gran Chaco. Borders Argentina and Bolivia	CLIMATE	More rainfall, about 1mm/km travelling east. Fertile border with Brazil
Mainly cattle	AGRO PROODUCTION	Cattle, exploring soyabean and organic sugar cultivation in the north
Mainly Uruguayan and Paraguayan producers	WHICH AGRO PRODUCERS ARE BASED THERE?	Uruguayans and internationals exploring

Sources: Ministry of Communication and Public Works, IIRSA, LatAm Confidential