INDUSTRY BRIEFING

By Philip Peters

"Small Means Big"

ZAGADA

Brazil technology

IT suitors come knocking

Recent IT acquisitions in Brazil highlight its potential to become a leader in technology-related services

Several recent deals have shone a spotlight on Brazil's potential as a leader in technology-related services and innovation. In early September **Capgemini**, Europe's largest IT technology and outsourcing services consultancy, announced plans to secure a 55% controlling stake in Brazil's market-leading **CPM Braxis** for almost US$300m. This came in the wake of the purchase by **Apax Partners** (a private-equity firm) of **Tivit**—another Brazilian information technology outsourcing service company—for approximately US$1bn in May. Also in May, **GE** (US) announced it had selected Brazil for its fifth global research and development centre—an investment estimated at US$150m.

Latin America's IT companies are scaling up, making them attractive to suitors from abroad

Other transactions also attest to Brazil's emergence as an attractive investment site for the IT industry. **Darby Technology Ventures Fund**, a unit of **Darby Overseas Investments**, the private-equity arm of **Franklin Templeton Investments** (US), recently sold **Atvi**, a Brazilian prepaid payments processor, to Nasdaq-listed **Euronet Worldwide** (US), a leader in processing secure electronic financial and payment transactions.

Capgemini grows

The CPM Braxis deal gives Capgemini an additional 5,500 workers to bring its total team in Brazil to 6,200. CPM Braxis's enterprise value is estimated at around R970m (US$553m). The transaction will be secured with cash—funded through a combination of a share capital increase in CPM Braxis (R287m, or US$164m) and a share buyback from existing CPM Braxis shareholders (R230m, or US$131m). The transaction is expected to close in October.

Brazil is the best example of the future potential for the IT industry in Latin America

Capgemini will have the option to acquire the remaining 45% of the company's stocks from existing shareholders within a three- to five-year window. Brazilian bank **Bradesco** will become CPM Braxis's second-largest shareholder after the operation is completed, with ownership stake or around 20%. Capgemini's consolidated presence in Brazil will become its sixth-largest centre among its global locations. The CPM Braxis acquisition will tip the company's global workforce to more than 100,000, and its revenues just north of US$12bn. CPM Braxis anticipates improving its 2009 growth rate of 12% to 20% this year.

Luring suitors

Global competition is heating up to secure increased market share in the estimated US$1.5trn IT outsourcing trade—of which US$270bn represents business process outsourcing (BPO). As a result, more attention is being paid to middle-income countries in the Latin American region as potential sites for growth. Besides Brazil, companies have been looking at Mexico, Argentina, Chile, Colombia, Costa Rica, Jamaica and the Dominican Republic.

While Brazil continues to chalk up the largest share of IT merger and acquisition (M&A) transactions in Latin America, the other countries mentioned above have between them secured important deals, including 13 recent M&A deals involving BPO companies, worth close to US$600m in value combined. However, companies in Brazil tend to offer higher-value services: the BPO component of CMP Braxis's and Tivit's businesses generally involves enterprise resource planning (ERP) functions and payment processing transactions.

By contrast, Colombia, Mexico and countries in the Caribbean and Central America mostly offer voice-based BPO services (call centres) serving the US. Mexico, however, does offer both IT and BPO services to its US customers.

Globally, IT- and BPO-based service providers in emerging markets are scaling up, growing to sizes that make them sufficiently attractive to suitors from abroad. However, whereas outsourcing markets like India, China, Russia and the Philippines are single

Brazil: Software and services expenditure

	2006[a]	2007[a]	2008[a]	2009[b]	2010[c]	2011[c]	2012[c]	2013[c]	2014[c]
IT services spend (US$ bn)	8.1	9.1	10.1	9.7	11.6	12.4	13.1	14.2	15.2
IT services spend (R bn)	17.7	17.7	18.5	19.3	20.8	22.9	25.3	28.0	30.7
IT services spend (R; % growth)	14.4	0.0	4.4	4.5	7.6	10.3	10.4	10.5	9.8
IT services spend (% of GDP)	0.7	0.7	0.6	0.6	0.6	0.6	0.6	0.6	0.6
Packaged software sales (US$ bn)	3.3	3.9	4.4	4.1	4.9	5.2	5.6	6.2	6.7
Packaged software sales (R bn)	7.1	7.6	8.1	8.2	8.8	9.7	10.7	12.2	13.6
Packaged software sales (R; % growth)	13.0	7.4	6.6	0.9	7.5	10.0	10.8	13.7	11.3
Packaged software sales (% of GDP)	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3

[a] Actual. [b] Economist Intelligence Unit estimates. [c] Economist Intelligence Unit forecasts.
Sources: International Data Corp; Economist Intelligence Unit.

brands in the eyes of corporate service buyers, the US "nearshore" market (that in close proximity to the US) is comprised of multiple Latin American and Caribbean countries that have economic dissimilarities and governments that exhibit varying levels of policy support to the sector. Brazil, however, because of the size and relative sophistication of its local industry, offers an appealing nearshoring and outsourcing option.

Brazil's relative size and sophistication make it an ideal outsourcing option

Indeed, within Latin America, Brazil is clearly emerging as a future giant. Some analysts estimate the country represents almost 50% of the total US$23bn IT spending across the region. And its IT-BPO service exports are projected to reach US$3.5b in 2010, an impressive improvement from US$2.2bn in 2008.

Brazil promotes IT

Seeking to replicate India's National Association of Software and Services Companies (NASSCOM), that country's successful industry chamber, in 2008 Brazil's IT and BPO industry leaders formed the Brazilian Association of Software and Service Export Companies (Brasscom) to brand and promote Brazil's IT strengths.

Strategically, Brasscom complements the Brazilian Association for Promoting the Export of Software (SOFTEX), a non-governmental organisation created in 1996 which works closely with government agencies. There are two additional IT industry organisations, the Brazilian Association of Software Companies (ABES, which represents software companies) and Assespro (which represents software and Internet companies). These entities aim to grow the sector and its activities both domestically and internationally.

Meanwhile, after its selection to host both the World Cup in 2014 and the Summer Olympics in 2016, Brazil has formulated an estimated US$344bn four-year investment strategy focused on modernising its infrastructure. IT and IT-related education spending will get a fair share of that expenditure. With an estimated 15% of the Brazilian population attending university, significant increases in educational spending will be necessary to produce the talent needed to meet the demands of the growing IT services industry.

Major international sporting events will boost IT spending over the next five years

Companies such as Capgemini, Tivit and other Brazilian IT majors such as **Stefinini** hope to secure some of the business generated by this enhanced government spending. However, they are not guaranteed sympathetic contracts. Other aggressive competitors will include global heavyweights such **Tata Consultancy**, India's outsourcing giant; the US's **Accenture**; the US's **Hewlett-Packard** (fresh from winning its US$2.4bn bid to acquire purchase utility storage company **3Par,** also US-based, after a bidding war with US computer makers **Dell** and **IBM.** The latter US giant already has close to 13,000 employees in Brazil and a global delivery centre in Hortolandia.

Private equity jumps in deeper

Brazil is the dominant private-equity market in Latin America, accounting for 79 venture capital and buy-out deals worth US$2bn last year, according to the Latin American Venture Capital Association. Mexico was the second largest with 25 deals worth US$423m. Several of the world's biggest private-equity groups, such as **Carlyle**, **Blackstone** and **KKR**, have stepped up their search for investment opportunities in Brazil in a variety of sectors. In August, **First Reserve**, another US private-equity group, committed US$500m for investment in **Barra Energia Petróleo e Gas**, a Brazilian start-up that will seek exploration and production opportunities in the country's oil and gas sector.

In addition to Apax Partners and Darby, other private-equity firms actively engaged in nearshore IT-BPO investments in Brazil include **HIG Capital**, **One Equity Partners**, **Eaton Park** (all US), **HSBC** (UK) and the World Bank's IFC Group.

As Brazil and other Latin American and Caribbean markets compete for a larger stake in the global service outsourcing trade, it appears that locally owned IT-BPO companies will continue to skirt the IPO route and either embrace private-equity firms or large global service providers as partners. Correspondingly, while modernisation of physical and communication infrastructure is a critical priority throughout the region, deepening human capital investment also will be equally needed if these countries are to compete at a sustained level.

This article was written by Philip Peters, a principal with Zagada, a business development advisory firm that helps companies with sourcing and site selection decisions (see www.zagada.com).

IT spending, international comparison

(US$ bn)

	2005[a]	2006[a]	2007[a]	2008[a]	2009[b]	2010[c]	2011[c]	2012[c]	2013[c]	2014[c]
Brazil	16.4	21.9	26.0	31.1	28.0	35.6	38.2	40.4	43.7	46.6
US	429.6	463.4	504.3	523.6	504.6	528.0	558.1	589.5	621.0	650.5
Japan	111.9	115.7	118.3	133.7	131.3	133.4	133.1	134.1	135.2	136.9
China	39.6	48.7	60.6	68.5	77.5	94.5	111.1	124.4	143.9	166.8
Germany	71.3	74.7	84.7	92.2	81.2	75.6	73.0	72.9	75.5	80.2

[a] Actual. [b] Economist Intelligence Unit estimates. [c] Economist Intelligence Unit forecasts.

Sources: International Data Corp; Economist Intelligence Unit.