

# Latin America Q&A

## 'MILA' Explored & Explained



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Stacy Steimel, Managing Director, Head of Latin America Equity and Rafael Mendoza, Portfolio Manager for Latin America Equity, discuss the stock market integration between Colombia, Chile and Peru, how this development is expected to benefit local markets and the investment opportunities that are likely to follow.

### Introduction

**In response to the growing interest in cross-investment between three South American countries; Colombia, Chile and Peru, their respective stock exchanges have been working towards a plan to integrate. This 'Mercado Integrado Latinoamericano', or 'MILA', is an exciting development and will create the second largest stock market in Latin America, after the BOVESPA stock exchange in Brazil. Integrating will allow each market fresh access to a much wider pool of companies across the Andean region, as well as to some larger companies that are listed in specialized exchanges outside of the region.**

### Why is MILA so attractive to investors?

It is important to emphasize that these markets are not merging, but rather integrating – a less complex and time consuming process. A merger usually involves more complicated issues such as the harmonization of the tax, legal and commercial codes, which could seriously delay or threaten implementation.

Investors will be attracted to the enhanced level of liquidity and diversity that MILA will bring, as well as the greater market coverage, including access to smaller companies listed individually on the three exchanges, and lower overall costs.

Markets that have integrated in the past, such as the Nordic exchanges of Copenhagen, Stockholm and Helsinki into the NASDAQ OMX Nordic, and the Amsterdam, Brussels, Lisbon and Paris exchanges into NYSE Euronext, have shown a subsequent increase in trading volumes and in the number of issuers. The increased number of market participants can lead to greater diversification for investors.

### What benefits has MILA had on the region so far?

Since the integration plans were announced more than a year ago, local investment seminars have been turning their focus towards companies within these markets, raising the level of information available overall. Consequently, analyst coverage in the region has deepened impressively. In each country there is a greater pipeline of companies waiting to list than there has been in the recent past.

Other improvements that have been made over the past months and years in anticipation of this integration include a cost reduction in dealing on the Colombian exchange via local brokers, brokers integrating across all three countries creating a single access point for trading, experienced asset managers launching local funds, and a longer list of IPOs. Further, the exchanges have been preparing for this event in advance. As an example, four years ago, Colombia launched a program to educate several small and medium companies to list – providing assistance in terms of corporate governance and how to communicate with the market. There have also been cross listings and even the long-awaited list of privatizations in Peru such as Petro Peru, as well as the creation of an "Andean 40" ETF fund, which is now listed on the New York Stock Exchange.

### Are more companies likely to come to market under MILA?

Since the announcement of the creation of MILA in early 2010, we have seen increased issuance interest in the Andean markets. Colombia had two IPOs in 2010 and the pipeline for 2011 looks very promising, with several listings on the way, some of these significantly large. Another interesting trend in Colombia is that the increased liquidity we have seen in the local market to date, predominantly driven by pension funds and a very active retail market, is attracting back Colombian companies that have listed abroad on specialized exchanges such as the TSX in Canada. To date, Pacific Rubiales and Canacol Energy have listed on the Colombian Exchange and have been a resounding success. Oil company, Pacific Rubiales is now the largest by market capitalization in the exchange and Canacol Energy is currently the 12th largest<sup>1</sup>. In 2011, there are eight more companies waiting to list and market participants suggest that there are a couple more waiting to announce their listing.

In Peru, the list of primary and secondary issues is more subdued than in Colombia. There are several state privatizations that have not yet been completed in the energy sectors and at least two IPOs are being discussed in the local markets. Presidential elections this year could slow down market issuance.

In the case of Chile, 2011 is set to be an intensive year, with almost US \$5bn issuance, compared with US \$400mn in 2010<sup>2</sup>. New issues will include several Chilean government investments, such as newly privatized water and electric companies, capital increases from banks, as well as between three to six IPOs in the health care, agribusiness and fisheries sectors.

<sup>1</sup> Source: Bolsa Valores de Colombia, February 2011

<sup>2</sup> Source: Superintendencia de Valores, Bolsa de Comercio de Santiago

## Does the integration of these markets now represent a more compelling investment opportunity vs other Latin American markets?

The integration of these markets makes for a compelling investment case for many reasons, such as the liquidity improvements, better access to a greater number of smaller cap companies listed individually on the three exchanges, greater market coverage, lower brokerage costs, as well as improved diversification.

By focusing on diversification and comparing MILA to Mexico as an example, we can see from the charts below that the combined markets of Colombia, Chile and Peru have wider sector exposure as they have two additional sectors that are not represented on the Mexican stock exchange; energy and utilities. While materials are larger and telecommunications much smaller in the integrated market, Mexico's telecommunications sector is dominated by just one large company. With respect to market capitalization, the Mexican market is dominated by large companies, whereas the integrated markets contain a far greater number of smaller capitalization companies.

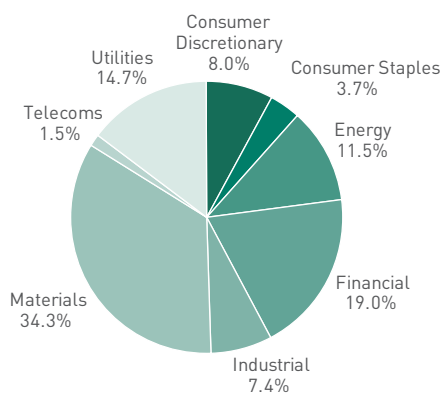
In this sense, given the smaller size, the growth profile is better, diversification is higher and there is hidden value to discover, as these companies remain under researched and relatively uncovered by brokers.

### Conclusion

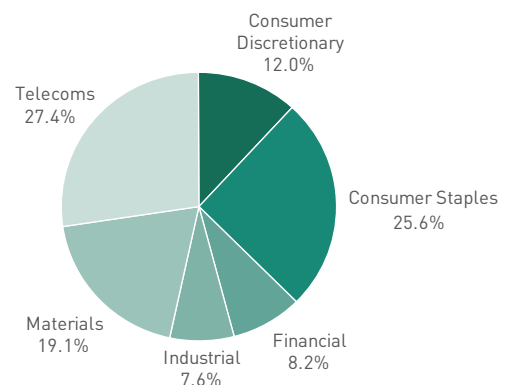
We are excited about the creation of this integrated marketplace and the broadening investment opportunities that it will create in the Latin America market. We believe that MILA will provide investors with an alternative investment platform that differs in both composition and size from the Brazilian and Mexican markets. Moreover, market integration is a trigger for the deepening of capital markets and that is always good news for investors. Finally, the fact that this area is under-owned can offer an important first mover advantage to those investors with experience in these markets ■

## Sector Exposure

### MILA

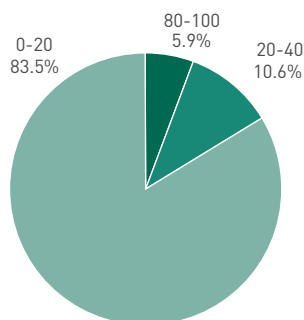


### Mexico

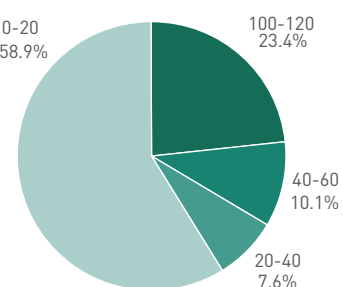


## Market Capitalization (US\$ mn)

### MILA



### Mexico



Source for charts: Bloomberg as of February 2011. Sector exposure is by market capitalization.

Past performance is not indicative of future results.

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