

The Henry Kravis of Argentina

Juan Navarro's Exxel Group is on a buying binge in Argentina and will soon be heading elsewhere in South America.

By Miriam Bensman

Exxel's Navarro:
"I wanted something new,
big, entrepreneurial
and dynamic"



Juan Navarro was a trailblazer in search of a destination. A fast-rising young Citibanker, he had spent three years at treasury in New York and served a stint as chief of staff in Argentina when, in 1986, he refused a promotion to head Argentinean corporate banking. "I wasn't interested in a corporate job; I didn't want hundreds of people to support," explains Navarro, an impatient Uruguayan who favors Cuban cigars. "I said, 'Give me a secretary and an office while I figure out what I want to do.' I wanted something new, big, entrepreneurial and dynamic."

That something would be buyouts. But at the time, Navarro barely knew what the buyout business was. "Equity investing in Argentina was unheard-of then," he says. "There was [virtually] no stock market and no M&A."

A few months later fate — in the form of twin mandates from New York — pointed him on his way: chairman John Reed's injunction to "redeploy" \$15 billion in bad loans to Latin America and investment banking chief Richard Huber's order to look at extending Citibank's U.S. venture capital business abroad. The Argentinean heads of commercial and investment banking asked Navarro to develop a joint plan. Well before Argentina had established a debt-to-equity swap program, Navarro proposed using Citi's \$1 billion in bad loans to Argentina to buy local companies.

"It was astonishing that this guy, in that environment, was talking about the benefits Citi could reap four years down the road. During hyperinflation no one planned for longer than one month," recalls Gerardo León, a colleague who later became head of Citi Argentina's investment bank. "Thinking about venture capital in Argentina in 1987 was like thinking about walking on the moon," adds Horacio Scapparone, then treasurer of Citi Argentina. "But Juan said, 'It's what I want to

do. That was either crazy or visionary."

It wasn't crazy. Citicorp Capital Investments, the venture group Navarro founded and ran for four years, had the jump on competitors. In 1991 President Carlos Menem introduced Argentina's first official debt-for-equity swap plan and the currency convertibility scheme that pegged the peso to the dollar and quashed inflation. Soon after that announcement the prospects for stability and growth appeared so good to Navarro that he quit CCI to start Exxel Group, an independent firm dedicated to private-equity investing in South America.

Since its founding Exxel has raised \$650 million in equity funds, mostly from U.S. institutions, and purchased 19 Argentinean companies. Only two small early deals have so far realized returns. But the deals have come fast and have been increasingly large. Last year Exxel's \$410 million acquisition of Cadesa, which owns the prestigious Supermercados Norte supermarket chain and is the country's 20th-largest company, earned Navarro an Argentinean magazine's businessman of the year award.

Navarro has become the Henry Kravis of Argentina, if one can imagine Kravis with virtually no domestic competitors. Exxel's few rivals in Argentina are mostly U.S.-based; the only well-established Latin American buyout firm is GP Invermentos, an affiliate of Brazilian investment bank Banco de Invermentos Garantia. Exxel has taken the basic buyout firm model and adapted it to fit conditions in Latin America. Exxel is a leveraged buyout firm that uses leverage sparingly, if at all. It is a restructuring firm that buys undercapitalized and undermanaged businesses that are, with a few exceptions, among the best in their industries. It ruthlessly cuts costs and lays off workers (on average, one third of each company's staff) but injects capital generously. Finally, Exxel doesn't break up firms; it merges them into operations with the scale to win in newly competitive sectors within a rapidly growing economy.

Operating-oriented

Navarro says Exxel had to take an operating focus. "The source of value in Argentina is from operational, not financial, plays," he contends. After being protected for 40 years in a closed economy, all Argentinean companies, not just recently privatized firms, need to be streamlined for competition.

So Navarro assembled a team heavy with operating and strategic planning experience. Most important is executive vice president Jorge Demaría. A strategic planner at various corporations early in his career, Demaría in 1978 joined a turnaround firm that restructured 22 debt-ridden enterprises; he then served as undersecretary of privatization in Raúl Alfonsín's administration in the mid-1980s and as consultant to CCI. Demaría is Exxel's house intellectual, a Ph.D. in economics who in the 1980s developed an analytical tool for predicting cash flows. An introvert who sets strategy while the more dynamic Navarro wows potential investors, Demaría plays a crucial behind-the-scenes role.

"These guys are distinctive," says Paul Tierney, a managing member of New York-based Development Capital, an investment firm that is a successor to Coniston Partners, one of Exxel's earliest investors. Though Exxel's financial analysis skills are as good as any U.S. firm's, as locals, its partners have a reality quotient outsiders can't have, Tierney says. "They're right there. They

know what numbers to question or not to believe."

As hometown boys, Exxel's deal makers also know the turf and the players — or know someone else who does. "This is a small community where everyone knows each other, and getting their confidence is difficult," says Exxel director Jorge Hector Romero. The firm can suss out which local companies are worth buying and the most effective approach to completing a particular deal. Exxel has seldom participated in a bidding war or relied on investment bankers shopping deals.

Navarro himself brings considerable financial analysis skills to the firm. When he took on the task of linking Citi's loan redeployment to the bank's venture capital mandate, he signed up for training in New York. "Over several years we brought in perhaps a dozen bright individuals from overseas," recalls Huber, the former Citi investment banking chief who is now vice chairman at Aetna Life and Casualty Co. "Only two really grasped the concepts, learned the techniques and made it work. Juan was one of them."

His two big successes at CCI were the acquisition of Juncadella, an armored-truck and security company, and the founding of Movicom, the largest cellular company in Argentina. Both were cash transactions. The one swap deal Navarro pulled off, the purchase of Rio Platense, Argentina's largest meatpacking company, for more than \$30 million in loans, has not been as successful.

After Menem announced his debt-for-equity plan, CCI bought Cellulosa Argentina. Navarro, planning to liquidate the troubled paper company, had lined up a prominent Argentinean turnaround expert to sell its pieces, but Citibank yanked him from the deal and installed a Citibanker to manage the company without breaking it up. Events proved Navarro right, notes former colleague León: Cellulosa has been a big money-loser for Citi. Navarro quit Citi before the deal closed.

Cellulosa was the final straw. Friends and former colleagues say Navarro had been butting heads with Citi bureaucrats who came out of lending and didn't understand the buyout business. A particular sticking point was his insistence that his staff and general managers be compensated according to the value they created. "I had studied the business in New York," Navarro says. "It was obvious that the whole industry ran on participation in capital gains and alignment of interests."

Shaking off the suggestion that perhaps his often-obvious impatience may have been counterproductive, Navarro says: "The success story for groups like Exxel in the U.S. is that they see life



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as an obstacle race. They don't say, 'Sorry, we can't do that.'

Navarro's goal in striking off on his own was to attract U.S. institutional funds, but in 1991 few people inside or outside Argentina believed Menem was committed to change. In mid-1991, however, Navarro met Antonio Fernandez, CFO of Oppenheimer & Co. Fernandez had become convinced that Latin America was going to be the next place to invest but that, given the limited number of listed companies in Argentina and the scant information available on them, private equity was the way to go. "Everyone I met in



Eduardo Gil/Black Star



Exxel's Demaría:
"We'd love to buy a company larger than Norte, but there aren't many"

Norte's Pereyra, Guil, Oriz de Roa (left to right):
Managing Argentina's first big, leveraged buyout

Buenos Aires told me to speak to a guy named Juan Navarro, but I couldn't find him," recalls Fernandez, now Oppenheimer's head of Latin American investment banking. "He had left Citi but not yet started Exxel."

A mutual friend arranged an introduction. In early September Navarro came to New York for a get-to-know-you lunch. By dessert they had a deal. Oppenheimer would raise \$30 million from U.S. private investors. It did better, picking up \$47 million by March 1992. Subsequent fund offerings also went well. In 1995 Fund II brought in \$155 million mostly from institutional sources; four deal-specific funds raised \$325 million over several years, and this spring Fund III garnered \$150 million.

Setting up Exxel proved more difficult. Private-equity investing didn't exist in Argentina, so it was hard to find lawyers, accountants or consultants who understood the business. There

was also little industry research available. Exxel developed an informal method of identifying industry experts, sometimes signing them up as board members in return for stock options. Later Exxel forged a near-exclusive relationship with Buenos Aires-based Hermes Management Consulting, which researches industries, analyzes deals and monitors the companies in Exxel's portfolio.

Navarro also restructured Exxel. On the advice of McKinsey & Co. in New York, in 1995 he designed specialized roles for each banker, fired one junior staffer and offered three — including his own brother — less demanding jobs at portfolio companies. "Juan is very driven and brilliant," says Betty Fagan, director of private equity at the Ford Foundation, an investor in Exxel. "But I'd rather have him work for me than work for him."

The firm decided to focus on the small companies that make up the backbone of Argentina's private economy. In January 1993 it simultaneously bought and merged two small consumer-products companies, and within little more than a year added three more. For a total of \$22.8 million, including \$5.8 million in debt, it had formed Poett San Juan, a household cleaning products company with \$480 million in sales. Says Navarro, "We love consolidation plays."

Exxel slashed head count, rationalized management and improved packaging. It was preparing to take the firm public when Mexico's peso devaluation triggered the so-called tequila effect across Latin America's capital markets. So Exxel sold Poett to Clorox Co. in December 1995 for \$95 million, achieving a 67 percent internal rate of return.

But Exxel's July 1993 purchase of 23 percent of Papelera del Plata, a manufacturer of paper goods with \$96 million in sales, failed. Protisa, a Chilean paper goods company, entered Argentina and began a price war. Exxel's ability to respond was hampered because it didn't have control, and its industrial partner, papermaker Massuh, couldn't borrow to make needed investments. In March 1996 Exxel and Massuh sold out to Protisa at a small loss. Exxel took the lesson to heart: Never again would it do a deal in which it didn't have control.

Into power

The group would, however, continue to do deals that focused on key industry sectors, aiming for growth through consolidation and new investment and for improved productivity. Finding seasoned, talented managers (not easy in Argentina) and fostering an entrepreneurial spirit by offering incentive pay at almost

all staff levels were also key elements in the strategy.

Take electricity. In 1991 Argentina began the world's most sweeping deregulation of the power industry. While many U.S. and European investors flocked to the generating business, Exxel aimed at the less sexy local distributors, seeking to participate in Argentina's rapid growth in GDP (nearly 6 percent a year since 1989 and forecast to average 7 percent annually until 2000) while enjoying the stability typical of utilities.

In March 1993 Exxel won the first auction for a provincial distribution company, Edesal, in San Luis province, paying \$13 million for 74 percent ownership. Edesal distributes just 1 percent of Argentina's electricity, but Exxel saw it as the key-stone to building a much larger company. In May 1995 it bought 80 percent of Edelar, in La Rioja province, for \$13 million; in July 1996 it bought 80 percent of Edesa, in Salta province, for \$60 million. The all-equity purchases were later refinanced in part with bank loans.

"The companies were a mess. There were too many workers, underinvestment, no productivity and big energy losses," says Carlos Alfredo Marozzi, the general manager for the trio of utilities. In San Luis alone Exxel invested nearly three times the purchase price in new technology. The result: Service interruptions dropped from 800 minutes per month in October 1993 to 4.6 this spring.

Collections have also been improved. For years the utilities had given away electricity to the poor, small farmers and favored sectors; many customers they did bill didn't pay. But cutting off service wasn't an option, says Jorge Joaquín Vives, an outside director of Edesal. "If a whole town doesn't pay, or a hospital or a school or a local government, how could we cut them off? It would be a political problem." Edesal launched a public education campaign to explain to people why they had to pay their bills. Remarkably, it worked. Energy losses plunged.

The utility also slashed head count from 450 unionized workers to 115 nonunion employees in San Luis. To do so, Edesal applied an outsourcing technique Demaría had developed in the mid-1980s: It organized 11 separate maintenance companies and offered everyone not needed for the in-house team a job in one. Demaría bet correctly that at least half would take severance because the new companies would require them to work more than the six hours a day their union contract allowed. "We negotiated the outsourcing and layoffs with the union leaders," Demaría says. "We paid what the law says we have to pay for severance."

Exxel is still seeking other utilities to buy but is preparing to go public within a year or two. As a first step, it is merging its three electric utilities into one large regional player. Says Navarro, "Equity investors prefer \$200 million IPOs to \$20 million IPOs."

In health care Exxel seized upon the financial crisis that the end of hyperinflation had created for Argentina's small, private insurance companies, many of which own hospitals. Since their launch in the late 1960s, the *prepagas* — or pre-paid plans — had prospered by playing the float. "You collected premiums on the fifth of the month and paid bills on the 16th," explains Albert Sassoon, marketing director for Exxel's health care company. With 30 percent monthly inflation, the float created big money. Costs, marketing and good recordkeeping were strictly secondary concerns.

Once Argentina licked inflation, however, the *prepagas* ran into trouble. Galeno, formed by a group of doctors in 1971, put itself on the auction block in 1994. Exxel snapped it up simultaneously with a *prepaga* named Vesalio and bought two others, Life and TIM, in 1995 and 1996, to create Sistema de Protección Médica, for a total of \$71 million.

In January 1997 Menem signed legislation that allows the *obras sociales*, the union-run health plans that serve most Argentines, to compete with one another. Next year the *prepagas* will be able to go head-to-head with these plans. SPM, which now battles for the 2.5 million people in the Buenos Aires area that belong to *prepagas*, will soon contend for the 8.5 million in the *obras sociales*. Now the largest private insurer in the Buenos Aires area, with the most hospital beds and second-highest revenues, SPM plans to develop networks of doctors in working-class areas and less expensive benefit packages suitable for workers with less generous employer-paid plans, says John Cuny, who

Exxel's shopping bag

- **January 1993**, Exxel Group buys and merges two small consumer-products companies, later acquiring three other companies to create Poett San Juan. After paying \$22.8 million for the five companies, Exxel sells Poett to Clorox Co. in December 1995 for \$95 million.
- **March 1993**, Exxel pays \$13 million for 74 percent of Edesal, an electrical-distribution company. It also purchases 80 percent of Edelar for \$13 million in May 1995 and 80 percent of Edesa in July 1996 for \$60 million.
- **July 1993**, Exxel buys 23 percent of paper goods maker Papelera del Plata. In March 1996 Exxel and its partner Massuh sell out to Chilean paper goods company Protisa at a small loss.
- Exxel buys health maintenance organizations Galeno and Vesalio in November 1994, Life in April 1995 and TIM in August 1996 to form Sistema de Protección Médica.
- **April 1995**, Exxel buys 56 percent of credit card company Argencard from Banca Nazionale del Lavoro for \$80 million.
- **November 1996**, Exxel pays \$410 million to acquire Cadesa, owner of the 25-store supermarket chain Supermercados Norte.

joined SPM as CEO in January, after building health maintenance organizations in the U.S.

SPM has also been sinking big money into information technology, quality control, hospital equipment and construction to lure wealthy people who can afford the best as well as workers with new choices. Today SPM's Sassoon can identify the best surgeons in the area in terms of mortality and infection rates when choosing doctors to accept into SPM's managed-care plans. SPM medical director José María Avendaño points with pride to a first-class neonatal lab and some of the world's most advanced surgical equipment.

Betting on retail banking

With Argencard, Argentina's second-largest credit card company, Exxel bet that retail banking would rebound once inflation waned. Indeed, banks that used to ignore consumers are now fighting to offer checking accounts and cross-sell credit cards.

Exxel paid Italy's Banca Nazionale del Lavoro \$80 million in April 1995 for a 56 percent stake in Argencard. The exclusive licensee for MasterCard since 1977, with \$140 million in revenues, Argencard had a 42 percent market share, just behind Visa, but distribution was weak. The tequila effect had hurt many banks that issued its cards, and the three fastest-growing Argentinean banks issued only Visa.

Navarro brought in Carlos Adamo, whose turnaround of Banco Vansud had made him a banking legend, to serve as a board member and devise a strategic plan. Argencard, says Adamo, was "absolutely fat" and poorly managed. His prescription: Boost distribution, cut the number of brands, and slim down.

In January the three banks affiliated with Visa started to distribute Argencard; Adamo expects it to match Visa's market share next year. The company is discontinuing the Argencard brand by converting all expiring members to MasterCard. Arthur D. Little, Inc. is designing a business process reengineering plan that will cut head count by 30 percent and costs by 20 percent.

Argencard has also doubled its computer capacity to launch three new business lines, including a pilot project with SPM, which uses Argencard's credit authorization system to approve health care insurance coverage. The company is also boosting volume with a new affinity card program that allows Argentina's many fanatical soccer fans to earn points with every purchase toward lunch with their favorite team, says Hugo Chiera, the new CEO.

Argencard could go public at a profit today, Adamo says, but Exxel plans to wait until at least late 1998. "We're trying to restructure and expand for the highest price-earnings ratio at the time we go to market," he explains.

The deal that really put Exxel on the map was Cadesa, owner of Supermercados Norte. CEO Alberto Guil had built Norte up from a single small outlet to a 25-store supermarket chain with \$1.25 billion in sales and one of the best names in its industry. When Exxel floated \$220 million in high-yield bonds in the U.S. to pay down a bridge loan used in the \$410 million

purchase, the deal gained notoriety as Argentina's first big leveraged buyout.

In fact, debt makes up only half of Cadesa's total capital, which is far below LBO levels. And though Norte has more debt than Argentinean competitors like Disco, it owns its stores. If debt to cash flow is computed on an after-rent basis, Demaría says, the two companies' leverage is similar. American bond buyers clearly weren't concerned: Cadesa's offering of seven-year, 10⁷/₈ percent notes was oversubscribed 3-to-1.

Some outsiders thought that Exxel paid too much for Cadesa.

But Carlos Oriz de Roa, a Norte board member and strategic adviser, notes that Disco is now trading at a multiple of earnings that would make Norte worth twice what Exxel paid. Exxel is aiming to double Norte's sales and triple its corporate value in three to four years, when it would go public, he adds.

Norte will grow for three reasons, Oriz de Roa contends: Argentina's vigorous economic growth; the self-service sector's even faster growth; and the knockout punch that big supermarkets and hypermarkets are delivering to small stores. To boost

market share, Norte plans to increase sales space by 25 percent a year by buying regional chains and building eight stores a year. Other strengths include a state-of-the-art warehouse that speeds goods in and out with minimal labor, and a private-label program, launched before the buyout, that delivers 28 percent margins, compared with the 18 percent for name brands.

Victor Pereyra, who began the private-label program and is now chief operating officer, was one of the few managers to survive Exxel's takeover. In the old regime 15 family members were shareholders with managerial positions in a confusing division of line responsibilities. "Some were good, some not so good, to put it mildly," Oriz de Roa says. A condition of the sale was that all had to go, except for Guil, who was needed to guide the expansion. Although he pocketed \$95 million in the deal, Guil agreed to stay for three years.

Today the chain of command is clear. Pereyra supervises both buyers and store managers. All are being switched to an incentive pay scheme designed to instill an entrepreneurial spirit. Store managers, who received \$40,000 base salary under the old regime, will keep that and earn a multiple of improved cash flow that can boost their earnings without a ceiling. If they increase cash flow to 120 percent of current levels, they'll make \$55,000, Pereyra notes. If cash flow declines, they'll be fired.

Exxel has outgrown Argentina and is now turning its sights on neighboring countries. "We'd love to buy a company larger than Norte," Demaría says, "but there aren't many." Also, Argentina's economic borders are starting to dissolve. Chilean companies are buying up Argentinean firms; the Brazilians may be next. Total trade with Brazil, now Argentina's largest trade partner, shot up to \$11.2 billion in 1996, from \$2 billion in 1989. Argencard is looking across the borders for new bank issuers, Edesal for acquisition candidates. Norte may follow suit.

Look out South America. Juan Navarro has chosen his destination. ■

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if at all.**