

Understanding Cash Management Practices in Brazil and Mexico

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Agenda

Economic overview - Brazil

Doing Business in Brazil

Treasury Practices in Brazil

Foreign Exchange market in Brazil

Economic overview - Mexico

Doing Business in Mexico

Treasury Practices in Mexico

Treasury Trends and Their Application in Latin America

Brazil

Brazil at a glance

Overview

A large country...

- **Population:** >190 million (World's 5th largest)
- **Area:** 3.4 million miles² (World's 5th largest)

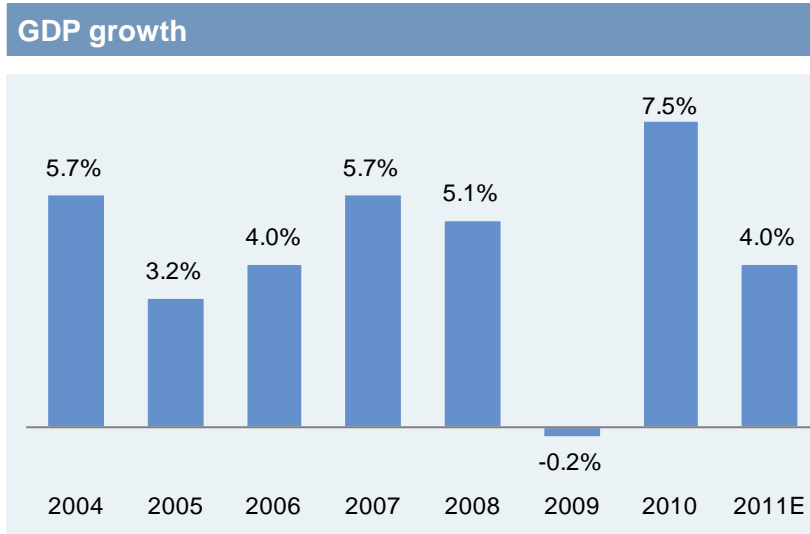
... with a strong economy

- **Nominal GDP:** US\$2.02 trillion (2010, World's 5th largest)
- **Nominal GDP per head:** US\$10,816 (2010)
- **Real GDP growth:** 7.5% (2010)
- **Inflation:** 5.9% (2010)
- **Rating:** Upgraded in 2008 and 2009 to BBB- (S&P), BBB- (Fitch), Baa3 (Moody's)
- **Foreign direct investment:** \$49 billion (2010)
- **International Reserves:** \$300 billion in 2011

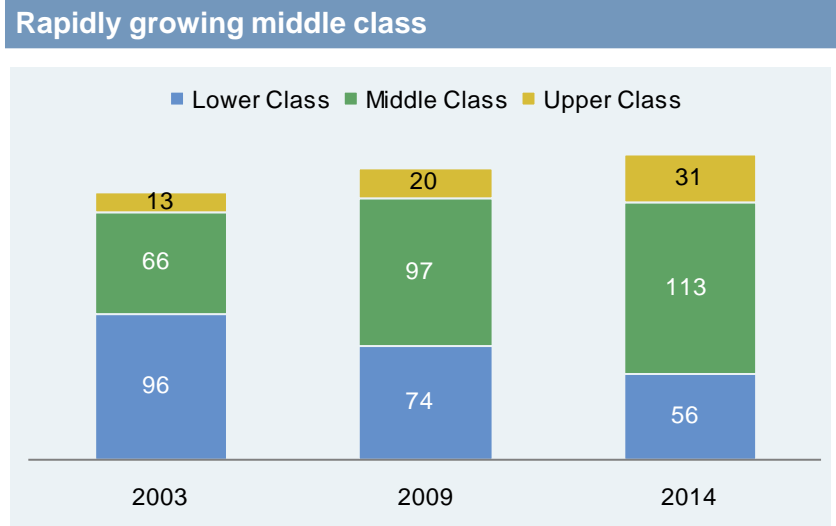
Sources: IMF; J.P Morgan



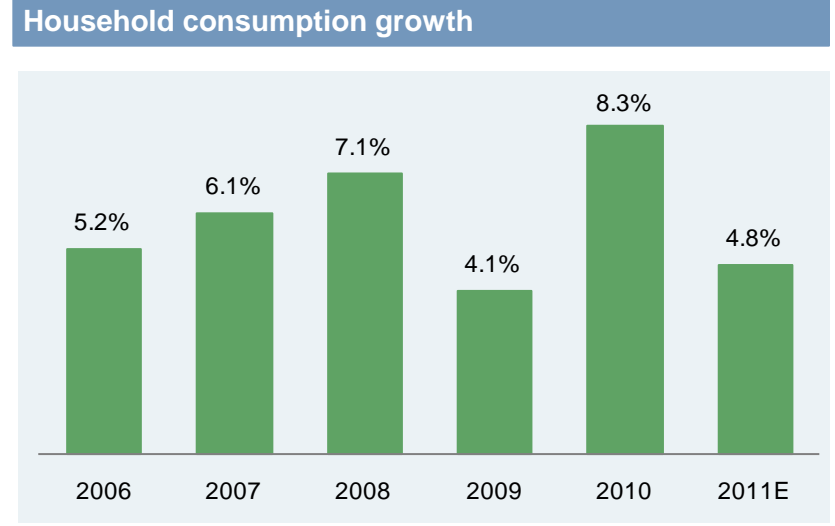
Why Brazil?



Source: J.P.Morgan



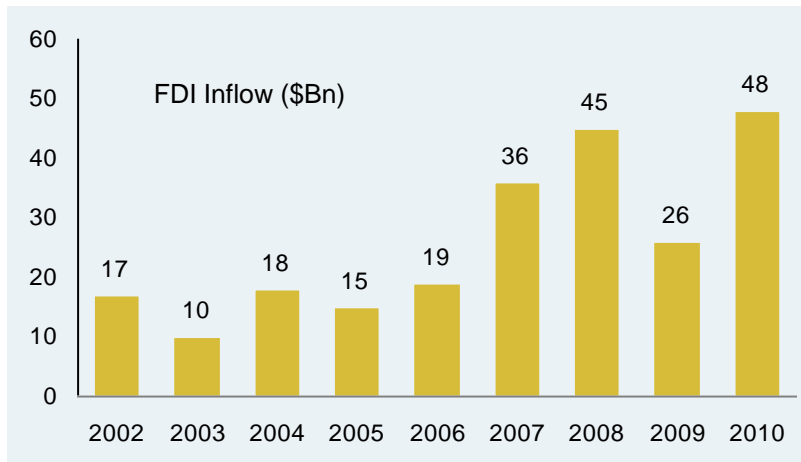
Source: IBGE



Source: J.P.Morgan

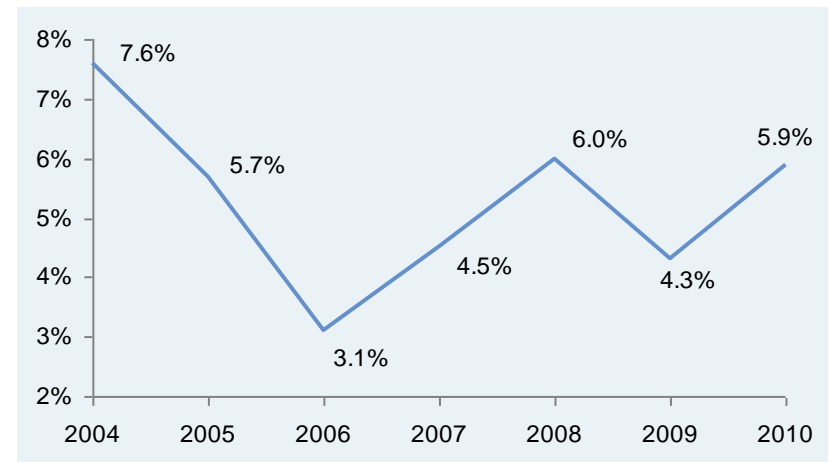
Economic landscape

FDI flows have been very robust



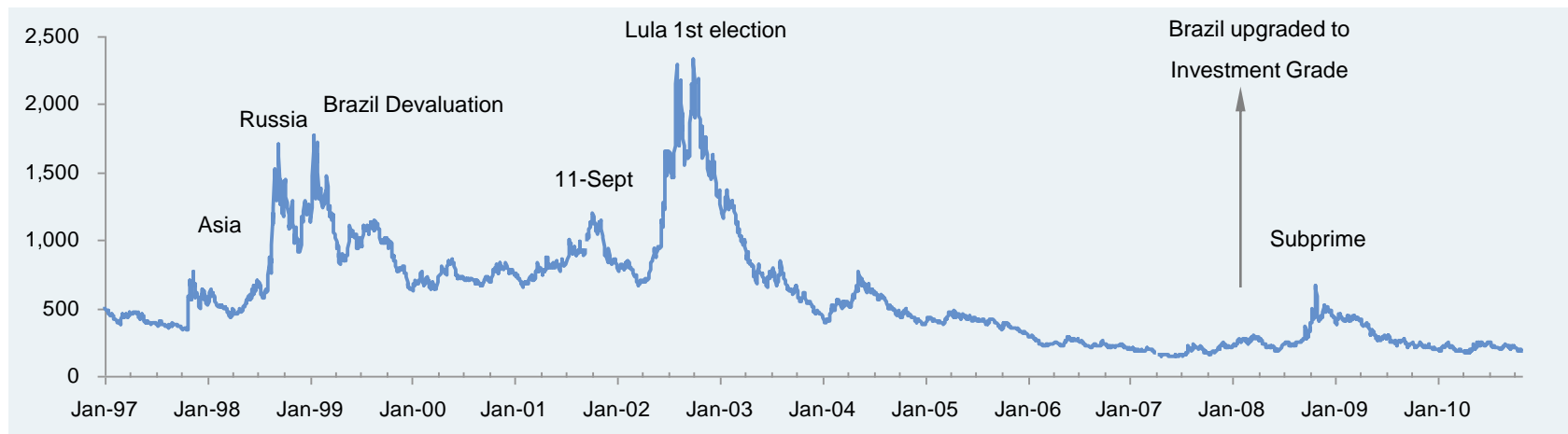
Source: Brazilian Central Bank

Inflation (IPCA) - Brazil



Source: J.P.Morgan

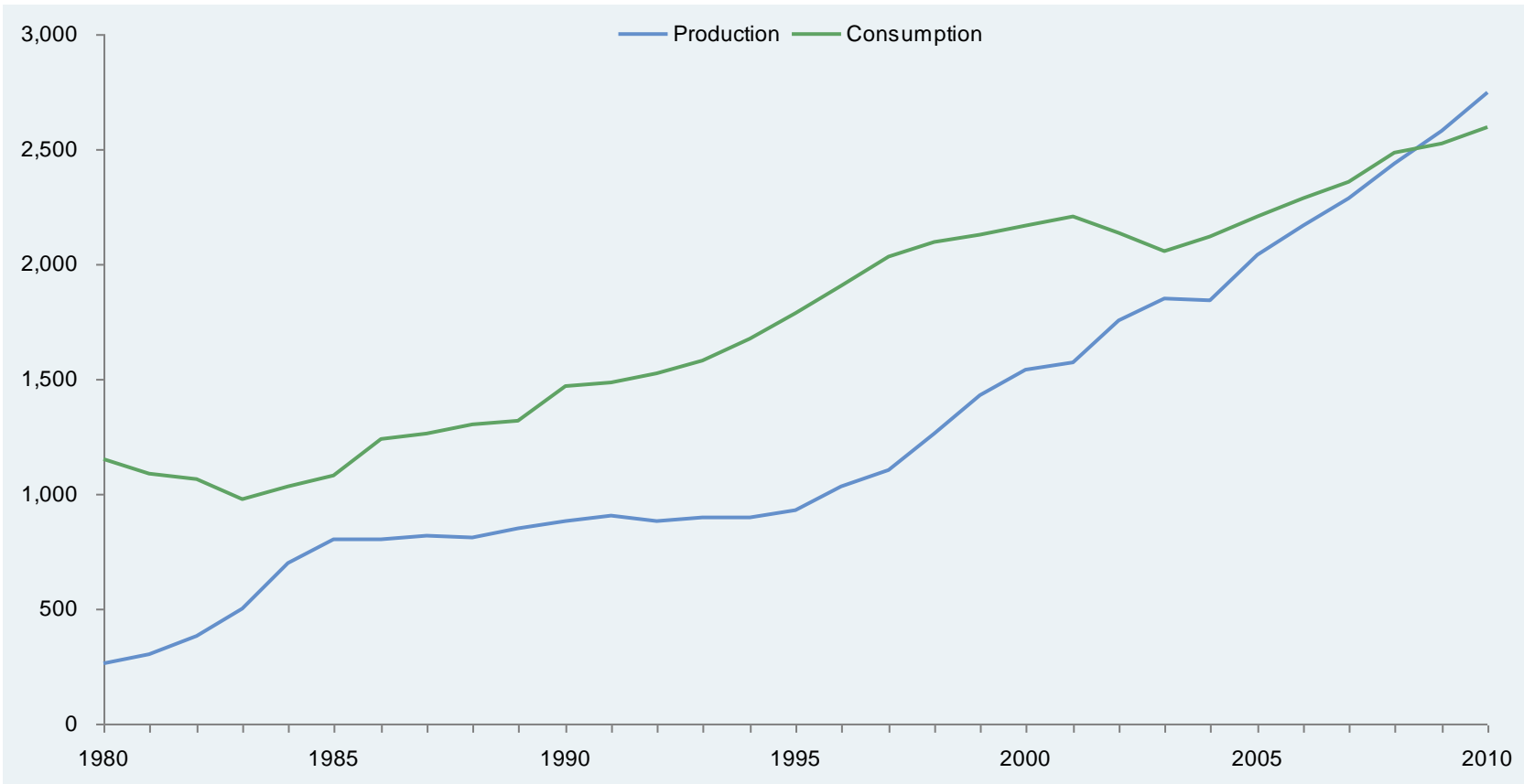
Country risk measured by EMBI+ Brazil spread over US treasuries (in bps)



Source: JPMorgan EMBI+ Brazil index

The Changing Face of Energy in Brazil

Brazil became a net exporter of petroleum in 2009



Source: US Energy Information Administration

Brazil: Overview – Currency, Tax Structure and Payments



<p>Currency</p>	<ul style="list-style-type: none"> ■ Accounts are opened in local currency and are non-interest bearing ■ R\$ accounts not offered outside of Brazil ■ Brazilian exporters are allowed to establish offshore accounts to receive export proceeds and to keep 100% abroad; funds cannot be lent but can be used to pay the entity's own obligations abroad ■ R\$ FX transactions require FX agreements with banks that are authorized to operate in the FX market in Brazil ■ Notional pooling is not permitted in Brazil ■ Zero balancing is a widely used cash management technique for some legal entities
<p>Tax Structure</p>	<ul style="list-style-type: none"> ■ Complex Tax Environment <ul style="list-style-type: none"> ■ Investments – decreasing rate from 100% to 0%, for respective timeline of 1 to 30 days. <u>New change:</u> This is not applicable for public and private bonds, but still applicable for investments funds, since 12/31/2010 ■ Cross border loan – <u>New change:</u> Since 04/07/2011, a 6 % IOF tax is levied on cross border loans with maturities less than 720 days. This is an opportunity for local lending products (Conta Garantida) ■ Overdraft in R\$ - Flat fee of 0.38% on the amount that increased the OD balance from previous day's level. Charged on the day of occurrence, plus 0.0041% over the negative balance (daily)
<p>Payments</p>	<ul style="list-style-type: none"> ■ Sophisticated electronic payment and clearing system <ul style="list-style-type: none"> ■ Same-day e-payment system for TEDs (payments higher than R\$ 3,000) ■ Next-day e-payment system for DOCs (payments up to R\$ 2,999), <i>Boletos</i> and Checks ■ Corporate payment process is highly automated and based on a local standard file exchange format or internet banking

Overdraft (Conta Garantida)

Definition

- It is a short term loan, in Brazilian Currency (BRL), used to prevent unpredictable shortfall and working capital needs
- Credit limit is set up in an internal account linked to a customer's DDA
- Revolving facility: once the credit limit is approved and set up on the system, the customer may use or withdraw funds up to this approved credit limit. The amount of available credit decreases and increases as funds are borrowed and then repaid. Customer is free to repay before maturity date
- Withdraw is automatic and the repayment needs to be commanded by the Customer

Characteristics

- Maximum Contract Tenor: 180 days
- Index: only CDI: % CDI and CDI + spread
- Fixed Rate (known locally as "pre fixada") is not available
- Committed Credit Line
- Tax:
 - IOF Flat Rate – 0.38% charged over any withdraw amount
 - IOF Daily Rate – 0.0041% per diem, calculated at the month end, considering the sum of daily average amount utilized by the client.

The Boletto

“Boletto” - bar coded electronic slip

Collection instrument with instructions - issued and distributed via post-office by banks on behalf of customers to drawees. It may be paid electronically or at any bank until the due date.

Bank Name Bank Code		Barcode numerical information			
XPTO BankCorp. 555-5		55501.30001 70001.540001 00409.440001 3 00010000002490			
Drawer	Local de Pagamento PAGÁVEL EM QUALQUER BANCO ATÉ O VENCIMENTO			Vencimento 10/05/2009 - Due date	
	Cedente HOSTHOSTHOST LTDA			Agência/Código Cedente 0222/222225/4	
	Data do Documento 04/05/2009	No. do Documento	Espécie Doc. RC	Aceite A	Data do Processamento 04/05/2009
	Uso do Banco	Carteira	Espécie R\$	Quantidade	(X) Valor
	Instruções (Todas as informações deste bloquete são de exclusiva responsabilidade do cedente)				Valor do Documento 24,90 - Amount
	Serviços de Hospedagem Cobrar multa de 2 por cento após o vencimento. Cobrar R\$ 0,15 por dia de atraso. Contato pelo telefone (00) 1177-1177 ou email financeiro@				(-) Descontos/Abatimento
					(-) Outras Deduções
					(+) Mora/Multa
					(+) Outros Acrescimos
					(=) Valor Cobrado
Drawee	Sacado Laboratório de Comunicação S/A Co Rua Vila Nova Conceição 128 517 Vila Nova Conceição S/A Co São Paulo SP			CNPJ/CPF: 00010049000100	
	Ficha de Compensação / Autenticação Mecânica				
 Barcode					

Federal bank association launched a project to allow the Electronic Boletto Presentment. Although the payment process is already effected electronically using the bar code information, this project will allow a full electronic collection and payment flow, with no need to issue a paper slip

Nuances of Brazil's Unique Cash Management Environment

	US	BRAZIL
Checks	<ul style="list-style-type: none"> ▪ Checks used by companies and individuals 	<ul style="list-style-type: none"> ▪ Checks use is in decline, not common in companies, decreasing for individuals
	<ul style="list-style-type: none"> ▪ Post-dated checks not a common practice 	<ul style="list-style-type: none"> ▪ Post-dating checks is a common practice in Brazil – especially by individuals
Electronic Transfers	<ul style="list-style-type: none"> ▪ ACH, CHIPS, Fed wire 	<ul style="list-style-type: none"> ▪ FX transactions require FX agreements with banks authorized to operate in the FX market in Brazil ▪ Funds transfers above R\$ 5,000 (TEDs) are settled in the same-day clearing system ▪ Funds transfers below R\$ 4,999.99 (DOCs) are settled in T+1 ▪ <i>Boletos</i>, electronic payments based on bar code invoice information, are settled in T+1 for any amount
Receivables	<ul style="list-style-type: none"> ▪ ACH network supports Direct Debit 	<ul style="list-style-type: none"> ▪ Direct Debits are commonly used only by individuals for low-value recurring payments (mainly utilities); originator must have an agreement with collection banks
	<ul style="list-style-type: none"> ▪ Lockbox service supports receivables – (paper) 	<ul style="list-style-type: none"> ▪ <i>Boletos</i> (bar-coded bill issuance) are the most important collection product in Brazil <ul style="list-style-type: none"> ▪ Payments can be made electronically or at any bank branch ▪ Collection banks send daily files to corporate customers detailing all the <i>boletos</i> that have been received, enabling companies to update their account reconciliation records
Liquidity	<ul style="list-style-type: none"> ▪ Physical pooling is primary practice ▪ Notional pooling allowed 	<ul style="list-style-type: none"> ▪ Physical sweeps (Zero Balance Account) allowed only among accounts owned by the same legal entity ▪ Notional pooling not allowed due to tax regulation
Investment Instruments	<ul style="list-style-type: none"> ▪ DDA, CD's, CP, Time Deposits, MMF, Treasury Bills/Bonds 	<ul style="list-style-type: none"> ▪ DDA, CD's, CP, Time Deposit, MMF, Treasury Bills

Inflows/Outflows to Brazil

- It is important to note that **any time** funds are sent to Brazil they are converted onshore into the local currency.

The most common reasons for sending money to Brazil

- Capital injection
- Payment of expenses incurred in the country
- Loan under the Law 4131
- Note issuance in the form of Commercial Paper or **Fixed or Floating Rate Notes (FRN)**
- Foreign investment under resolution 2.689 (not covered here)
- Exports from Brazilian companies

The most common reasons for moving money out of Brazil

- Dividend payment
- Capital repatriation
- Royalty payment
- Notes payment (principal and interest)
- Loan repayment (principal and interest)
- Imports to Intercompany/3rd Parties in Brazil

Brazilian Foreign Exchange Considerations and Common Terms

Account Opening

- To execute a FX transaction, the Brazilian Central Bank (BCB) requires clients to provide official documents (certified copies, in Portuguese).

Taxes

- All FX transactions are subject to federal taxes and tax rate may differ depending on the type of transaction. Clients should contact their own tax advisor to determine effective tax rates.

Additional considerations

- Onshore forward and option contracts require a CGD document. A CGD document (similar to an ISDA agreement) is a securities agreement through which the client and authorized bank agree to secure financial exposure to derivatives.

Common Terms

- **IOF:** Financial Operation Tax, federal tax applied to almost all inflow/outflows of funds, currently at 0.38%.
- **Withholding Tax:** 15-25% on interest payments to foreign entities.
- **IED:** identification number provided by Brazilian Central Bank (BCB) to the local beneficiary to receive capital injection for up to a certain limit.
- **RDE:** A foreign company must register any capital injection in the BCB for up to a certain amount. BCB provides a RDE number which only expires when funds reach the approved limit.
- **ROF:** Registro de Operacao Financiera. A Brazilian company may borrow funds abroad in USD and must register the loan and loan conditions with the BCB, which provides ROF number valid for 60 days. The company must execute the FX transaction before expiration or a new ROF is necessary.
- **RE number:** proof that a local company has boarded its goods/material and already exported them. It is required to support export FX deals.
- **CGD:** derivative agreement similar to ISDA agreement through which client and authorized bank agree on specific conditions in case of financial distress on either party
- **Tainted capital:** Capital injection that a Brazilian company has in its books which has not been totally registered with the Brazilian Central Bank. In this case, capital repatriation goes through a special treatment called International Transfer of Reais (ITR). Documentation requirements are similar to the Capital Repatriation case shown in slide 5.

Mexico

Mexico at a glance

Overview

A large country...

- **Population:** >112 million (World's most populous Spanish speaking country)

... with a strong economy

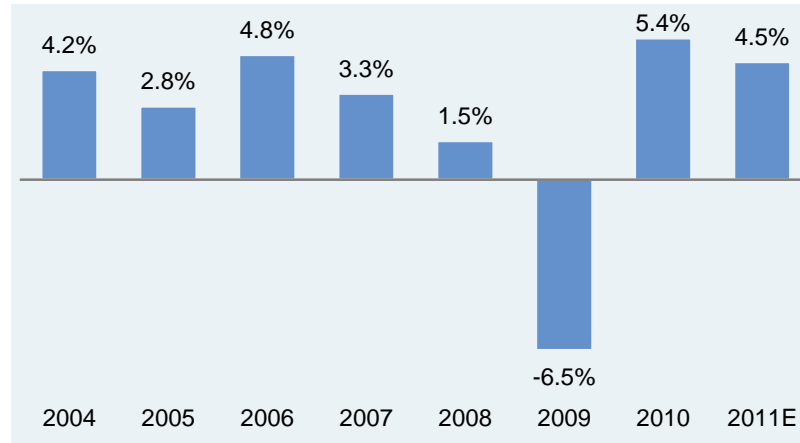
- **Nominal GDP:** US\$1.06 trillion
- **Nominal GDP per head:** US\$ 9,608 (2010)
- **Real GDP growth:** 5.5% (2010)
- **Inflation:** 4.1% (2010)
- **Rating:** BBB (S&P), BBB (Fitch), Baa1 (Moody's)
- **International Reserves:** \$128.299 billion in 2011



Sources: IMF; J.P Morgan

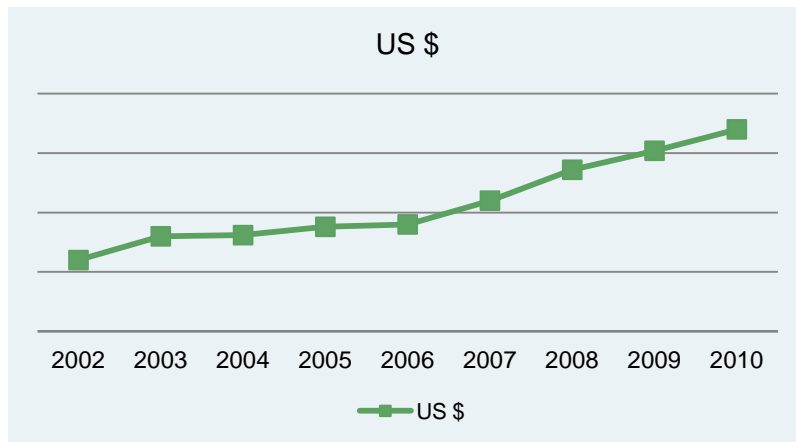
Why Mexico?

GDP growth



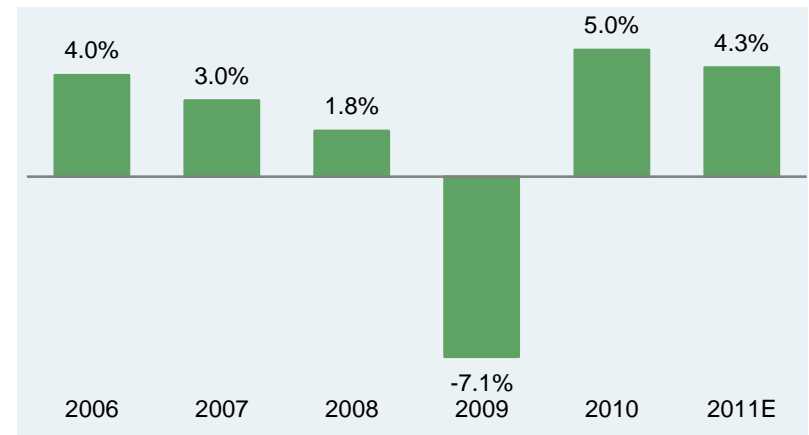
Source: J.P.Morgan

Wages in the Manufacturing Sector



Source: IBGE

Household consumption growth



Source: J.P.Morgan

Mexico: Overview – Currency, Tax Structure and Payments



<p>Currency</p>	<ul style="list-style-type: none"> ■ MXN accounts can be opened by Residents and Non-residents ■ Foreign Exchange Demand Deposit Accounts allowed in-country – Residents only ■ Demand Deposit Accounts (DDA) in MXN peso and USD can be interest bearing ■ DDAs cannot be overdrawn on a regular basis – arranged overdrafts (Intraday and Overnight) are allowed ■ Notional pooling is not permitted in Mexico ■ Zero balancing is a widely used cash management technique for some legal entities
<p>Tax Structure</p>	<ul style="list-style-type: none"> ■ Tax Environment <ul style="list-style-type: none"> ■ Withholding tax – ISR (Impuesto Sobre la Renta) on interest paid on DDAs: <ul style="list-style-type: none"> ■ Resident: 0.60%(annually) over average balance ■ Non-Resident: 4.9 to 40% on the interest paid – rate depends on various factors such as country of origin of account holder, tax treaties, etc. ■ Cash Deposits totally over \$15,000 MXN (or USD equivalent) within a monthly period (30 days) are taxed at 3% (i.e., Deposits \$16,000 MXN, there will be a tax of 3% on the \$1,000 MXN that exceed the limit) ■ For Corporations, federal taxes can be paid only through electronic means
<p>Payments</p>	<ul style="list-style-type: none"> ■ Well-Defined Payment and Clearing System: <ul style="list-style-type: none"> ■ Same-day electronic payment system (SPEI) ■ Next-day electronic payment system (Cecoban/TEF); payroll can be done as any other electronic funds transfer ■ Paper clearing – next-day settlement (CECOBAN) ■ Direct Debit transactions – next-day settlement (CECOBAN)

Nuances of Mexico's Unique Cash Management Environment

	USA	Mexico
Checks	<ul style="list-style-type: none"> ▪ Checks widely used by corporates and individuals 	<ul style="list-style-type: none"> ▪ Checks use declining for payments and collections
	<ul style="list-style-type: none"> ▪ Double endorsements permitted 	<ul style="list-style-type: none"> ▪ Double endorsement highly regulated.
	<ul style="list-style-type: none"> ▪ Checks clearing schedules determined by location of drawer bank 	<ul style="list-style-type: none"> ▪ All local MXN Peso & USD checks clear next day
Electronic Transfers	<ul style="list-style-type: none"> ▪ Payroll supported by Direct Deposits. 	<ul style="list-style-type: none"> ▪ Payroll Programs supported by electronic credit transfer, stored money cards and payroll cards
	<ul style="list-style-type: none"> ▪ ACH, CHIPS, Fedwire 	<ul style="list-style-type: none"> ▪ Domestic Same day MXN Peso wires settled through SPEI ▪ Domestic USDs settled through correspondence banks in the US ▪ TEFs – Transferencias Electronicas de Fondos – local form of ACHs credits with a T+1 settlement. MXN Peso only. ▪ Corporate Cards not a common payment method
	<ul style="list-style-type: none"> ▪ Accounts structures differ among banks 	<ul style="list-style-type: none"> ▪ All DDA accounts use country standard account numbers – CLABE – 18 digit account structure
	<ul style="list-style-type: none"> ▪ Back valuation and use of funds is standard practice 	<ul style="list-style-type: none"> ▪ Back valuation nor use of funds are standard practice (only done on extreme circumstances)
Receivables	<ul style="list-style-type: none"> ▪ ACH network supports Direct Debit 	<ul style="list-style-type: none"> ▪ Domiciliaciones – local form of direct debits – are increasing in use for regular payments, such as utilities
	<ul style="list-style-type: none"> ▪ Lockbox service supports paper receivables 	<ul style="list-style-type: none"> ▪ Lockbox does not exist due to lack of reliable postal service. A Reference Deposit Service – using bank branches and an OTC deposit is used instead
Liquidity	<ul style="list-style-type: none"> ▪ DDA is NIB, but automatic sweep can be used to pay interest 	<ul style="list-style-type: none"> ▪ Demand Deposit account can be interest bearing
	<ul style="list-style-type: none"> ▪ Notional pooling allowed and widely used 	<ul style="list-style-type: none"> ▪ Only Physical sweeps (ZBA) allowed ▪ Notional pooling not allowed

Overdrafts



- Can be on current accounts (though expensive)
- Working Capital Loans mostly used:
 - Tend to be 28 days or more
 - Interest rates based on inter-bank money market rates
- Other instruments used:
 - Discounted Trade Bills
 - Factoring
 - Commercial Paper (for highly rated companies only)
 - Supplier Credit

Treasury Trends and their Application in Latin America

Treasury Trends in 2011 and Application in Latin America

Centralization

- Migrating from a decentralized environment to more centralized

People

- Identifying, hiring, retention of strategic leaders
- Project management focus
- International background, knowledge

Process and Efficiency

- Continued migration from paper to electronic
- Development of long term strategic plans for Treasury, in sync with Corporate objectives
- Process improvements from transactional standpoint (i.e., STP)

Treasury Trends in 2011 and Application in Latin America

Technology

- Increased integration with banking partners to automate payments and receipts
- Greater reliance on ERP systems and treasury workstations

Visibility and Control

- Automated view of cash balances, leveraging multi-bank reporting when required
- Rationalizing/Optimizing bank relationships and structures to improve and streamline cash positions
- Adopting global standards across regions for internal process and audit for better control

Treasury Trends in 2011 and Application in Latin America

Expanded Role of Treasury

- Control or Strong influence over all aspects of working capital
- Increased responsibilities and oversight for Risk including Trade Finance and Capital Markets activities
- Corporate Strategic Partner

Organization and Influence

- Centralization of treasury and finance activities
- Visibility and accountability for global accounts and bank relationships
- Major stakeholder in all key corporate strategic decisions: 'a seat at the table'

Treasury Trends in 2011 and Application in Latin America

Risk Management and Mitigation

- Managing more risk than before (including trade, FX, etc.)
- Developing and executing plans to mitigate identified risks
- Using technology and standardized processes to strengthen controls around risk and exposure management
- Monitor the health of banks and partners

Optimized Liquidity and Treasury Structures

- Pooling (physical and notional) to leverage cash and optimize returns
- Regional treasury centers, payment factories, and shared service centers
- Outsourcing of investment management, reporting and other treasury functions

Treasury Trends in 2011 and Application in Latin America

Global Liquidity Trends

- Continued concerns around counter-party risk
- Overall banking relationships are growing to mitigate counter party risk, while at the same time being rationalized for overlap of day to day treasury management
- Treasurers and cash managers are becoming more strategic, since operating cash has become more strategic – liquidity at adequate levels is as important as yield in this environment
- Expensive credit markets are placing greater focus on internal liquidity and cash flow forecasting has become most critical

Treasury Trends in 2011 and Application in Latin America

Conclusions

- Latin American subsidiaries are currently unable to duplicate the centralized treasury approach utilized in other parts of the World.
- Improved efficiency in Latin American treasury operations will not be achieved by designating a sole regional bank or adopting standardized banking services.
- Success will be gained from an internal corporate emphasis on effective local cash and working capital management and
- A focus on managing debt/equity ratios through tactical capital injections and realistic short-term financing strategies

Questions

