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U.S. Companies See Profits In Latin America Go South

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At a time when many U.S. companies are struggling to meet sales targets at home, a once-reliable market abroad suddenly looks much less hospitable: Latin America.

American multinational corporations in the 1990s earned billions of dollars from their subsidiaries based in South America and Mexico, as countries there enjoyed periods of high growth and attracted investment from hundreds of U.S. companies. But after recording a meager profit in the region during 2001, U.S. companies reported a loss of $500 million in South America through the first nine months of 2002, their first loss in the region in more than a decade.

Although Latin American economists suggest that 2002 may have marked the worst of the region's downturn, few are predicting much of a recovery this year -- or any meaningful profit rebound for most of the U.S. subsidiaries based there.

"Latin America will continue to be a drag on U.S. earnings in 2003," says Joseph Quinlan, global economist at Johns Hopkins' Center for Trans-Atlantic Relations in Washington. "That's something analysts may not have fully factored in."

A number of U.S. companies already have indicated that Latin America's economic turmoil and currency depreciations weighed on last year's earnings. In the telecommunications industry, **BellSouth** Corp. said that 2002 earnings from 11 Latin American countries fell 24% to $2.2 billion from a year earlier, while **AT&T** Corp. said last month it was taking a $1.1 billion charge related to its Latin American unit, which AT&T is in the process of selling. Energy company **AES** Corp. cited Brazil's energy rationing and currency devaluation in announcing a $1.3 billion write-down.

Some U.S. firms, sensing that profitable opportunities in Latin America are diminishing, have been reducing their exposure after years of beefing up investment. **J.P. Morgan Chase** & Co. last week said it plans to sell its Brazilian money management operations to **Banco Bradesco**, a Brazilian bank; **Bank of America** Corp. also said a few days ago that it is exiting capital-markets operations in Argentina and Brazil.

Other multinationals have warned that Latin America's economic weakness will continue to hurt earnings throughout this year. **Kraft Foods** Inc., for instance, recently said that 2003 profits will be hurt in part by depreciating currencies in Brazil, Argentina and Venezuela.

These sort of warnings represent a sharp break from the mostly prosperous years of the 1990s, when Latin America was a reassuringly bankable destination for U.S. multinationals. U.S. affiliate income from the region totaled $5.7 billion in 1990, and climbed steadily to a peak of $14.6 billion in 1997, before falling in

1998 because of the emerging-markets crisis.

During most of that decade, Latin America produced more annual profits for U.S. firms than did U.S. investments in the developing Asian markets. Indeed, the two biggest countries in the region, Brazil and Mexico, generated more earnings for U.S. firms than many European countries.

The recent evaporation of profits reflects a series of recent economic crises in the region, starting in 2001 with Argentina's default on debt and subsequent devaluation of its currency. Concern about Brazil's ability to meet international debt obligations, meanwhile, helped to push its currency down 50% against the dollar last year and led to the first loss for U.S. subsidiaries in that country since the 1980s.

Multinationals thought they could at least count on Venezuela, where U.S. companies earned $500 million in the first nine months of 2002. But more recently, a crippling oil workers' strike and political chaos threatens U.S. earnings in Venezuela, too. What's more, the rapidly falling Mexican peso has started cutting into affiliate company profits when translated back into dollars.

Just how much pain U.S. affiliate companies will feel is hard to say. Latin America's gross domestic product fell by 1.1% last year, with the economies in Argentina and Uruguay both contracting by 10% and Venezuela's by 8%, according to Merrill Lynch & Co. At the same time, GDP per capita in the region shrank last year to just $3,200, down from $4,200 in 1998.

"Effectively that means less buying power for U.S. products," notes Pablo Goldberg, Latin America economist for Merrill Lynch.

Mr. Goldberg predicts that economic growth in the region will perk up a bit in 2003, expanding at the rate of 1.7%. But he adds that Mexico is expected to count for much of that growth, and if the U.S. economy stagnates this year, U.S. companies shouldn't look for much earnings growth from Mexico or South America.

In fact, Mexico accounted for about one-third of U.S. earnings from Latin America over the past decade as the North American Free Trade Agreement increased economic ties between the two countries. Nafta also has helped transform Mexico from primarily a low-cost production base for multinational companies to an important consumer market for U.S. goods. U.S. foreign-affiliate sales to Mexico in 2000 totaled nearly $63 billion, making Mexico the seventh-biggest market globally for U.S. affiliate sales.

But the recent collapse of the peso threatens to undermine Mexico as a profit center. The peso has tumbled more than 20% against the dollar from its high in March 2002, largely on concern that the U.S. economic slowdown will batter the Mexican economy. Already, however, the peso weakness means less revenue for U.S. affiliate companies when translated back into dollars.

In Argentina, the financial crisis turned around what had been $600 million in U.S. profits in 1999 into $2 billion in losses accumulated since the fourth quarter of 2001. While the economic collapse appears to have bottomed, any recovery looks slow and tentative. U.S. subsidiaries, meanwhile, lost a combined $564 million in the second and third quarters last year in Brazil. A surprisingly market-friendly reform agenda put forth by newly elected President Luiz Inacio Lula da Silva helped to boost the stock market and currency in the final weeks of the year. But Mr. Quinlan, the economist, thinks that U.S. firms in Brazil probably still lost money in the fourth quarter.

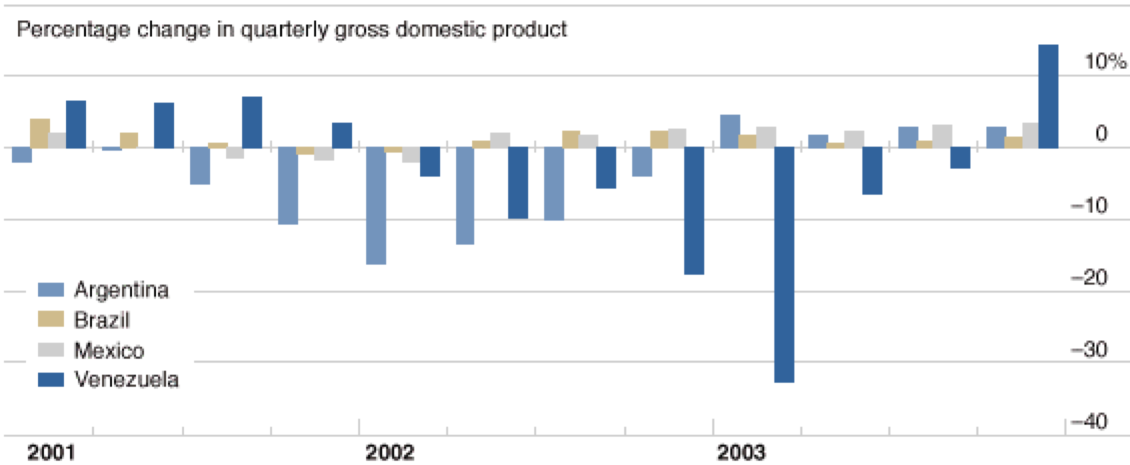
The profit backdrop looks even worse in Venezuela. Three years ago, as the South American nation pulled out of recession and President Hugo Chavez embraced a series of market-friendly initiatives to attract foreign capital, U.S. investment has been on the rise. The average annual investment in 1999 through 2001 was $2.1

billion, more than triple the amount averaged over the previous four years.

"Lost on investors is the fact that for the past two years, Venezuela has been an earnings backstop for U.S. companies bruised by events in Argentina and Brazil," says Mr. Quinlan. But given the devastating economic effect of the oil workers' strike and widespread street protests, he adds, "that's over."

SLOWER GROWTH, WEAKENED CURRENCIES

Political and financial turmoil in Argentina, Brazil and now Venezuela, have shaken Latin America. Economic growth (top) has slowed or turned negative; currencies (below), are losing ground, even against a weakened dollar.



Sources: Merrill Lynch; WSJ Market Data Group

A supporter of Venezuela's President Hugo Chavez *(top)* holds a picture of him with Cuban President Fidel Castro during a protest in Caracas, Venezuela. Fears that **President Luiz Inacio Lula da Silva**, *bottom left*, wouldn't meet the country's debt obligations help rattle Brazil's markets in 2002.

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