abvcap
Brazilian Private Equity &
Venture Capital Association

About the Sector

A crucial tool for the development of capital markets and emerging economies, Venture Capital and Private Equity is particularly noteworthy in Brazil. This is a type of investment focused on stakes in companies with high potential for growth and profits, through purchasing shares or other securities (stock-convertible debentures, subscription bonds and others), in order to earn significant capital gains over the medium and long terms. Through VC/PE, small and medium enterprises that are eager to expand into major corporations are offered suitable opportunities for underwriting their growth, with support for establishing sturdy corporate governance structures, focusing on growth and profits, in addition to underpinning the future sustainability of the business.

In contrast to conventional variable income funds (shares), venture capital and private equity funds are normally structured through closed groups, meaning that investors subscribe to units when the fund is launched, with no possibility of redemption along the way, as unit-holders receive their capital back only when the fund divests or sells off the companies in the portfolio, typically five to ten years after the launch of the fund.

While venture capital is channeled to start-up enterprises, private equity is linked to more mature corporations that are restructuring consolidating and/or expanding their businesses. The essence of these investments consists of sharing the business risks while firming up the joint efforts of managers and investors in order to add value to the target company. Investments may be channeled to any sector with prospects of dynamic growth and profitability over the long term, depending on the investment focus defined by the investors or funds.

Investors

Venture capital investments may be allocated by holding companies or managers, through investment funds structured for this purpose, or by individual investors with capital available for investing in this field. The main investors are institutional, especially pension funds and insurance companies. Some funds must adapt to the Qualified Investor definition stipulated by the Brazilian Securities Commission (CVM).

Venture capital and private equity investment funds may be regulated or not, depending on how and where they are established. In Brazil, the Securities Commission (CVM) is in charge of regulating and overseeing the activities of these funds, in addition to the activities of their managers and officers. The applicable regulations are: CVM Instruction Nº 209/94 (Emerging Company Mutual Funds – normally for venture capital), CVM Instruction Nº 391/03 (Investment Funds for Stakes – applicable to venture capital and private equity financing). Regardless of the fund format, its management is assigned to specialized firms.

Depending on the target company profile (size, sector, stage, etc.), VC/PE investors will be involved in the management of the business to a greater of lesser extent. This involvement is grounded on the need for support generally required by business executives. It is also related to the establishment of corporate governance structures that underpin corporate growth and project the allocated investments.

VC/PE Track Record in Brazil

The initial steps taken by the Brazilian Government to encourage the development of venture capital activities date back to 1974, through programs run by the National Social and Economic Development Bank (BNDES), and 1976, through the Studies and Projects Financing Agency (FINEP). With the opportunities opened up by the real Economic Stabilization Plan in the early 1990s, VC/PE activities became more institutionalized in Brazil, with the issue of the initial regulations for this sector (ICVM Nº 209/94). This economic context grew into a business environment that attracted private equity investors that selected this channel as appropriate for investing in privatization. According to data taken from the Brazilian Private Equity and Venture Capital Census, conducted by the Getúlio Vargas Foundation (FGV/SP) in São Paulo, there were eight fund managers in 1994. By 2000, this figure had risen to 45, reaching 132 in 2008. By mid-2008, 24 funds had been launched, bringing in US$ 2.6 billion.

According to information from this Census, by December 2009 the VC/PE industry encompassed 180 management entities, with 1,747 professionals involved in this field, 236 investment channels and 554 companies in portfolios.

In 2003, Brazil's VC/PE investments options expanded through the promulgation of ICVM Nº 391/03, regulating Private Equity Funds, which until then lacked their own control system established by law or regulation. Added to this was corporate law reform, together with confirmation by the judiciary branch of arbitration as a lawful way of settling corporate disputes, while underlying macro-economic conditions remained stable.

The private equity and venture capital segment set a new record when bringing in US$ 34 billion capital in 2009, earmarked for investments in Brazil. In 2008, this figure reached US$ 27.1 billion, up from US$ 5.6 billion in 2004. In just half a decade, this amount expanded more than fivefold, according to data taken from the census of this sector conducted by the FGV. It is also important to stress that the inflow of VC/PE foreign capital to Brazil reached a record level of around US$ 4 billion in 2007.

Out of the total amount of capital allocated to VC/PE investments, some 58% comes from foreign investors. By mid-2008, they channeled some US$ 1.11 billion to Brazil, equivalent to 43% of the funds brought in last year.

As the 1997-2004 investment cycle tapered off, it became quite clear that the VC/PE sector is endowed with ample growth potential, reaffirming its importance for the development of the capitals market in Brazil, which is clearly apparent through countless case studies of successful enterprises in this sector. Untiring efforts by the market, the government and the regulators, striving to fine-tune the channels through which funding is brokered, are focused on offering entrepreneurs easier access to capital, while helping generate more jobs and higher incomes, in parallel to fostering sustainable economic growth for Brazil.

Current VC/PE Context in Brazil

The private equity sector has been progressing rapidly in Brazil. With economic stability firmly established, dropping interest rates and low country risk, the Brazilian market is already an attractive option for enterprise capital investors.

With the award of Investment Grade status by Standard & Poor's in 2008, Brazil started to offer a major cluster of opportunities for long term investments, compared to other emerging economies. To an increasing extent, pension funds are wagering on funds allocated to this sector, which is of the utmost importance, as international financing has played a key role in the expansion of industry in the USA and other developed countries. At the moment, Brazilian government pension funds such as Previ, Petros, Funcef and Fapes are already allocating some of their assets to VC/PE opportunities.

In 2008, the share held by pension funds in new funding uptakes reached 50%. In terms of committed capital, these Brazilian funds accounted for 24% of the total amount, equivalent to US$ 6.4 billion.

In addition, Brazil also offers easy cash-out options, through either going public or strategic sales, with attractive and widely diversified investment options, in addition to fragmented sectors that present opportunities for consolidation. According to the Global Entrepreneurship Monitor (GEM), the infrastructure, real estate, IT, biotechnology and agribusiness sectors are attracting much interest among investors.

It is important to stress Brazil's powerful entrepreneurial culture. According to the GEM Report, Brazil ranks among the top seven entrepreneurial countries, with more than 200 incubators, 3,000 companies, more than 15 million entrepreneurs and over 450,000 new companies established each year in Brazil. It is important to mention the Instituto Gênesis, established in 1997 by the Pontifical Catholic University (PUC) in Rio de Janeiro, which offers entrepreneurship courses and structures a research center for venture capital development. Additionally, the Graduate Engineering Program Coordination Unit (COPPE) at the Rio de Janeiro Federal University (UFRJ) has established a huge technology park.

The institutional context has also been improving steadily, with greater transparency and more partnerships with investors, in addition to greater expertise among managers and rising specialization among funds, which are becoming smaller, more tightly focused and theme-specific.

The conversion by the Brazilian Congress of Provisional Measure Nº 281 into Law Nº 11,312/06 brought major benefits for this sector, by reducing income tax to zero on earnings posted by investors not residing in Brazil, charged on amounts allocated to local regulated VC/PE funds. This also introduced a specific taxation structure for these funds, with a 15% rate for investors resident in Brazil.

The VC/PE sector is helping develop governance standards for companies not listed on stock exchanges, helping firm up the idea that good corporate governance increases the value of a company, in addition to ensuring greater transparency and better protection for minority shareholders, with easier access to capital, thus ensuring longer corporate lives.

Venture capital and private equity have been paving the way for many companies to go public. According to the BMF&Bovespa, seven IPOs were conducted by companies targeted by these funds in 2004, rising to nine in 2005; twelve in 2006 and thirteen in 2007. Many companies went public very successfully, ensuring smooth withdrawals and excellent paybacks for VC/PE investors, while also buttressing Brazil's capitals markets.

Some examples of successful companies in this sector are presented below.

Successful Case Studies

Diagnósticos da América S.A. – DASA

Extremely active in São Paulo, Rio de Janeiro and Curitiba, DASA has 148 units and three hub laboratories servicing more than 15,000 customers, in addition to handling 80,000 examinations each day. The units operate under eight brands names, with good reputations in their markets, including Delboni Auriermo, Lavoisier, Lâmina, Bronstein and Curitiba Santa Casa.

In 1999, the Pátria Banco de Negocios acquired a stake in DASA through a private equity fund, underpinning its expansion to the extent that it become the largest diagnostic medicine enterprise in Latin America. The success of this investment culminated in the company being accepted for the *Novo Mercado* segment of the São Paulo Stock Exchange (BOVESPA) on November 19, 2004, raising R$ 377 million.

América Latina Logística – ALL

The largest rail-based logistics operator in Latin America, ALL ships goods for customers in many different segments, including agricultural produce, inputs and fertilizers, fuels, civil construction, forestry, steel, toiletries and clearing, electro-electronics, automobiles, parts and spares, packaging, chemicals, petrochemicals and beverages. It offers a full range of logistics services, blending the economic advantages of rail transportation with the flexibility of trucks, throughout an area that accounts for more than 62% of the GDP of the Southern Cone Common Market (MERCOSUR).

After absorbing investments from private equity funds allocated by firms such as GP Investimentos, CSFB, Electra, and GEF, ALL was able to expand. Today, it runs more than seventy service units located in major cities all over Brazil, Argentina, Chile and Uruguay, in addition to distribution centers and 185,000 square meters of warehousing facilities. The rail network administered by ALL covers 20,495 kilometers, encompassing Southern São Paulo, Paraná, Santa Catarina and Rio Grande do Sul States, in addition to central Argentina. It crosses the borders with Paraguay and Uruguay, while also servicing Chile by road through its intermodal logistics base at Mendoza in Argentina. Six of the most important ports in Brazil and Argentina are also serviced by ALL. It conducted its first public offering of shares on June 25, 2004, bringing in R$ 588 million.

Submarino E-Commerce

A leader among companies working exclusively with retail electronics in Brazil, the Submarino website offers more than 700,000 items in twenty product categories, sourced from more than 950 suppliers, in addition to outsourced e-commerce services rendered to leading companies in the consumption goods fields, such as Natura cosmetics and Nokia and Motorola mobile telephones.

This company has expanded significantly since its operations began in 1999, absorbing investments allocated through private equity funds from the following companies: GP Investimentos, Warburg Dillion, THLee, Santander, JPMorgan and Flatiron. For the financial year ending on December 31, 2004, it posted gross revenues of around R$ 361 million, reflecting an annual growth rate of some 68% during the last three financial years ending on December 31, 2004.

Natura Cosmetics

On the market for more than 35 years, Natura is reaffirming its leadership on the cosmetics, toiletries and perfumeries sector. During the late 1980s, it undertook a broad-ranging restructuring process, with new companies joining the group between 1979 and 1981, merging in 1989. During the early 1990s, Natura began to showcase its corporate beliefs and mission, formally establishing its social commitments and gearing up for the deregulation of the Brazilian markets, as imports began to appear.

Expanding rapidly, Natura launched its internationalization drive in 1994, moving into Argentina, Chile and Peru, where it set up distribution centers and trained its consultants. In 2005, its income topped R$ 3.2 billion, with net revenues of R$ 1.5 billion.

Natura has absorbed private equity financing allocated by Janos Participações and BNDESPar as the investors. Renowned for corporate accountability and transparency, it went public on the São Paulo Stock Exchange (BOVESPA) in May 2004, with a volume of R$ 768 million.

GOL Airlines

Ranked as one of the world's fastest-growing companies, Gol Airlines took off for the first time in 2001. Today, it flies to 49 towns and cities all over Brazil, in addition to neighboring countries such as Argentina, Uruguay, Bolivia and Paraguay. It holds a 29% stake of Brazil's air travel market, with ample potential for further growth. In 2005, Gol posted net revenues of R$ 2,669 billion, with net profits of R$ 513 million.

In April 2002, Gol entered into discussions with AIG Capital in order to absorb investments underwriting its initial growth spurts. With an inflow of US$ 26 million, Gol expanded its services on the international market and introduced good corporate governance practices. Continuing to grow, it went public in June 2004, bringing in more than US$ 280 million on the São Paulo Stock Exchange (BOVESPA). This is a great example of a Brazilian company that is geared for aggressive growth, ready to absorb private equity funds.

Localiza Car Hire

The largest car hire chain in Brazil by number of agencies, the Localiza service network includes 283 car-hire facilities, 96 run by the company and 187 franchised out, operating in six countries in 203 towns and cities in Latin America. It works with car hire, fleet management and leasing, as well as franchises, which are complementary and synergetic.

In 1997, Donaldson, Lufkin & Jenrette purchased a third of Localiza for US$ 50 million, with this investment allowing it to grow and establish its credibility on the market. In 2005, Credit Suisse successfully sold off its stake in the company through an IPO on the São Paulo Stock Exchange (BOVESPA), bringing in around US$ 130 million, with Credit Suisse receiving more than US$ 20 million in dividends. Private equity investments allow successful cash-outs with healthy profits.

Universo Online - UOL Internet Services

The main online mainline media portal, UOL is the largest internet company in Brazil, based on page visits and time spent online each month, and number of subscribers. A pioneer paving the way for internet development in Brazil, UOL has successfully held on to its high audience ratings and leadership since it was established in 1996.

Offering local internet access at more than 3,000 locations in Brazil and 14,000 elsewhere, by November 2005, UOL had signed up more than 1.4 million paying content subscribers. Since September 1999, it has also served as a portal and access provider in Argentina. According to IBOPE / NetRatings, UOL posted an average of 7.1 million single household visitors a month in Brazil during 2004, ranking it top among Brazil's leading content portals, and accounting for around 63% of the scope of this market. In 1999, Morgan Stanley purchased a minority (12.5%) stake in UOL for US$ 100 million. Through this financing, UOL was able to conduct a successful IPO in December 2005, bringing in R$ 555 million.

Lupatech Valves

Established in 1980, Lupatech may be rated as a classic case study for this sector, as this was the first target company to be financed by the first fund structured under the aegis of CVM Instruction Nº 209/94 (Emerging Company Mutual Funds), having gone through all the capitalization stages of the private equity system.

A Brazilian enterprise, Lupatech is a leading industrial valve production and sale company, used mainly by the oil and gas industry. It also holds a leading position on the international market, specializing in the development and production of complex parts and sub-sets made from metal alloys, particularly for the world automotive industry, through steel injection and precisions casting processes.

Backed by an impressive track-record of relationships with VC/PE investors, it stands out from other companies in this sector. Its ongoing relationships with these investors – which include Bozano Simonsen Advent, CRP Caderi, GP Investimentos and the Axxon Group, in addition to BNDESPAR – have firmed up a culture of transparency, creating value for its shareholders and adopting stringent corporate governance practices, including the presence of an active Board since 1987.

Outlook for the Sector

With positive macro-economic aspects, a market welcoming IPOs, an excellent cash-out history and a considerable number of international investors, Brazil's

VC/PE industry has matured in a sustainable manner. With prospects of a dropping basic interest rate in Brazil, alternative investments (VC/PE) are becoming more attractive to long term investors, due to the high profitability rates that they offer, in addition to the need to diversify their portfolios. Consequently, some of Brazil's largest pension funds are returning to or entering the private equity /venture capital universe. Higher funding volumes are expected for this sector from this investor category.

Another noteworthy aspect is the increased interest in Brazilian VC/PE at Brazil's National Social and Economic Development Bank (BNDES) and the Studies and Projects Financing Agency (FINEP), eager to encourage the entrepreneurial spirit, spurring the development of innovative enterprises and building up an enterprise capital culture in Brazil.

Actions taken by the Brazilian Private Equity & Venture Capital Association (ABVCAP) in partnership with the Brazilian Industrial Development Agency (ABDI), has also played a key role in showcasing the Brazilian market. Another noteworthy aspect is the Technical and Financial cooperation agreement signed with APEX-Brazil, whose main purpose is to attract foreign capital to Brazil's enterprise capital industry, in addition to showcasing and burnishing the image of Brazil all over the world.

Among international investors, Brazil is rated as a great opportunity. Over the last few years, it has extended its investment possibilities immensely, offering a feasible alternative for attractive paybacks over the long term, with diversified investments.

Through the introduction of the *Bovespa Mais* entry-level over-the-counter market, an upsurge in going public is expected among target companies financed by Brazilian VC/PE, particularly as this has proven an excellent cash-out option over the past few years.

All these factors prove that Brazilian industry has grown and is now ready for a quantum leap, moving towards dimensions similar to those of the VC/PE sectors in the more developed countries.