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Spotlight on Brazil

Inside Brazilian private equity and venture capital

With expert insights from leaders at:

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It's Not About the Macro

Thanks to a dramatic and consequential national election, Brazil's economy has been getting a lot of attention recently. Weaker GDP and the reelection of president Dilma Rousseff, who is viewed unfavorably by the business community, have many analysts predicting tough times for the country for the foreseeable future. And much of that commentary might lead one to believe that the opportunities for private equity investors are slim.

But as you'll learn from the in-depth interviews featured in this briefing, macro conditions are not the sole determinant of investment success. Private equity in Brazil should be a viable opportunity in spite of the economy.

Private equity is a people business. In committing capital to a private equity fund, you are emphatically not buying an index but backing a group of people who are seeking to invest in and guide a company through various conditions to a successful outcome.

Brazil's vast middle market is teeming with companies that need to step up their games to better serve a growing domestic market as well as take advantage of global opportunities. A slower economy has increased the need for private capital, combined with top-notch strategic and tactical guidance, to achieve that goal.

In this briefing we also present expert views on the state of Brazil's venture capital market. A startup culture is beginning to gel, marked principally by a shift in mindset among ambitious young professionals who are breaking free of the fear of business failure that held back earlier generations of entrepreneurs.

Brazil's advanced agricultural industry is just one example of a differentiated advantage that VCs in the country are hoping to exploit. Agritech startups in Brazil, for example, stand the chance of competing in a booming global market. Look for a case study of one firm's investment in a company that breeds and ships stingless bees—that's right, bees—for use as pollinators in agriculture. It's just one example of how VC-backed Brazilian agritech could change the future of global food production.

Enjoy the briefing.

David Snow
CEO & Co-founder
Privcap
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In This Report

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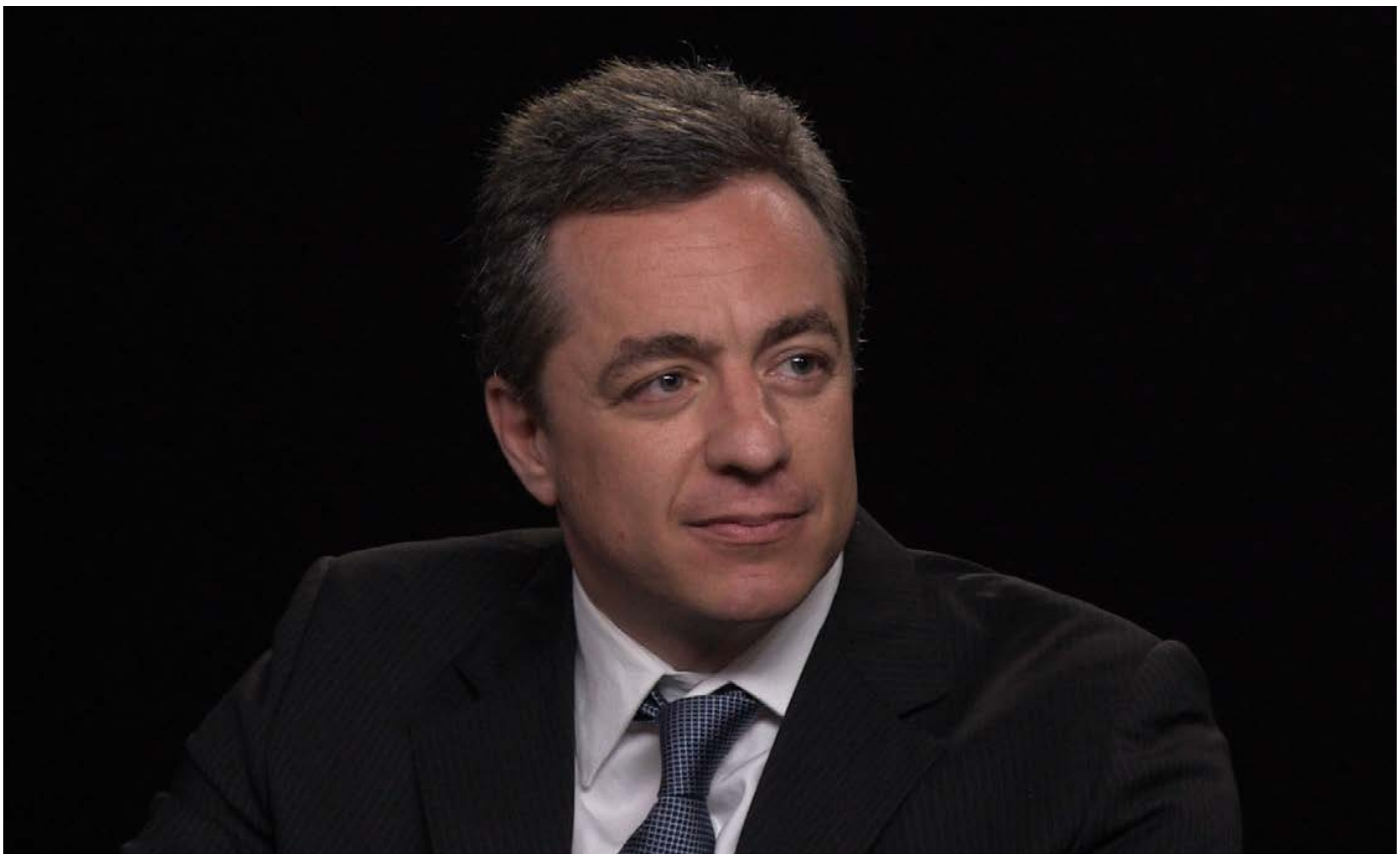
The Challenges of Investing in Brazil's CBDs

Demand for office space in Brazil's has decreased in 2014, says **Wise Capital's Flavio Mantesso.** But he expects that to change in the next couple of years as the economy improves. He also discusses how his firm has boosted returns on its real estate investments in central business districts.



Flavio Mantesso, Wise Capital

Bio

Mantesso is a managing partner at Wise Capital. Previously he worked as the director of portfolio management of the Select Fund from Standard Life Investments in Brazil at Eccelera. He was also previously responsible for real estate development in Construtora Tenda S/A and has worked at Colliers International. Mantesso received degrees from FAAP and Rollins College and a postgraduate degree from FAAP.

"If you talk to any developer in Brazil, they will say that it's craziness to start developing new buildings now."

–Flavio Mantesso, Wise Capital

Privcap: You invest in the Brazilian office real estate market. The economy's growing, and whenever economies grow, people need offices to build their businesses in. What are the most important dynamics driving Brazil's office market?

Mantesso: The most important dynamics are the demand and supply. In every business, demand has been decreasing this year, but we expect it to grow in the next years. On the other hand, new construction starts, where we measure the initiation of supply, decreased during this year. So expected deliveries for '15 and '16 has decreased substantially to 40 percent of what it was in 2014. So all the stock that was delivered during this period will be absorbed, and we expect vacancy rates to start to decrease in 2016, with rents coming up until then.

Talk about how the debt markets work in Brazil's real estate market. How do you finance your deals? How much debt is available, and what kinds of groups are supplying it?

Mantesso: Financing in Brazil for the commercial properties, for office buildings, is too expensive. Interest rates in Brazil are some of the highest in the world. Financing will cost around 14 percent, so in the strategies that are aimed to add value in properties, it's not possible to leverage.

Would you be open to having investment partners for some of these properties?

Mantesso: We could have partners investing along with us. We may maintain the control of the investment; as we designed the strategy, we execute the strategy. We [would] keep all of the returns to the investors, since we buy the land and we hire the construction company. We don't enter into third-party projects, but we can [find] other investors to invest alongside us in bigger deals.

What are some of the most important things that international investors need to understand about doing business and investing in property in Brazil?

Mantesso: Investing in property anywhere in the world, you have to have local expertise. International investors normally look for a partner or the platform where they can operate, because it's very local [in Brazil]. Location is very important. It can change the vacancy rates you have in your investment, the rents, the returns. And every market is different.

How does the relationship between the public market and private markets affect your returns? How does it affect the decisions that you make?

Mantesso: Public and private markets are co-related. Normally the public markets anticipate what happens in the private market. As an example, this year in Brazil, public markets were priced down very fast because of our increase in interest rates, and this was faster than the effect it has in the private [markets]. Sometimes it's possible to leverage from one side to another. In the last fund, we exited two properties in a public market because we saw that they were already pricing the properties in the upper values, and the private market hadn't reached that [level]. On the other hand, it's possible also to buy from the public market and exit in the private market.

Can you talk about receiving higher-than-market risk-adjusted returns in the Brazilian RE market? What approaches does your firm take to accomplish this?

Mantesso: We have three basic things. One is the access to the pipeline. We have a big network of brokers, architects, lawyers—people we think have information about deals for office buildings. We can choose the better ones and not just focus on what we receive from brokers. As we are focused in CBDs and very constrained regions, this is important to have. The second strength we use to maximize returns is research. We have developed research through the years and have been working with these econometric models where the end results are what [level] rents are going to reach. On the other side, you have demand. Mixing those, you can forecast rents and have a more accurate figure of returns to deliver to the investor, and he can know the risk of these returns, too.

Based on your models, were you surprised that construction of new office buildings slowed down with the most recent economic downturn? Was that a predictable result?

Mantesso: It was a predictable result, because rents are coming down. If you talk to any developer in Brazil, they will say that it's craziness to start developing new buildings now. Our new fund targets development in businesses exactly because of this. We are contrarian, as we have more information. We have information and specialization in the office market. With these rents decreasing and vacancy increasing, it doesn't make sense for the developers to construct. ■

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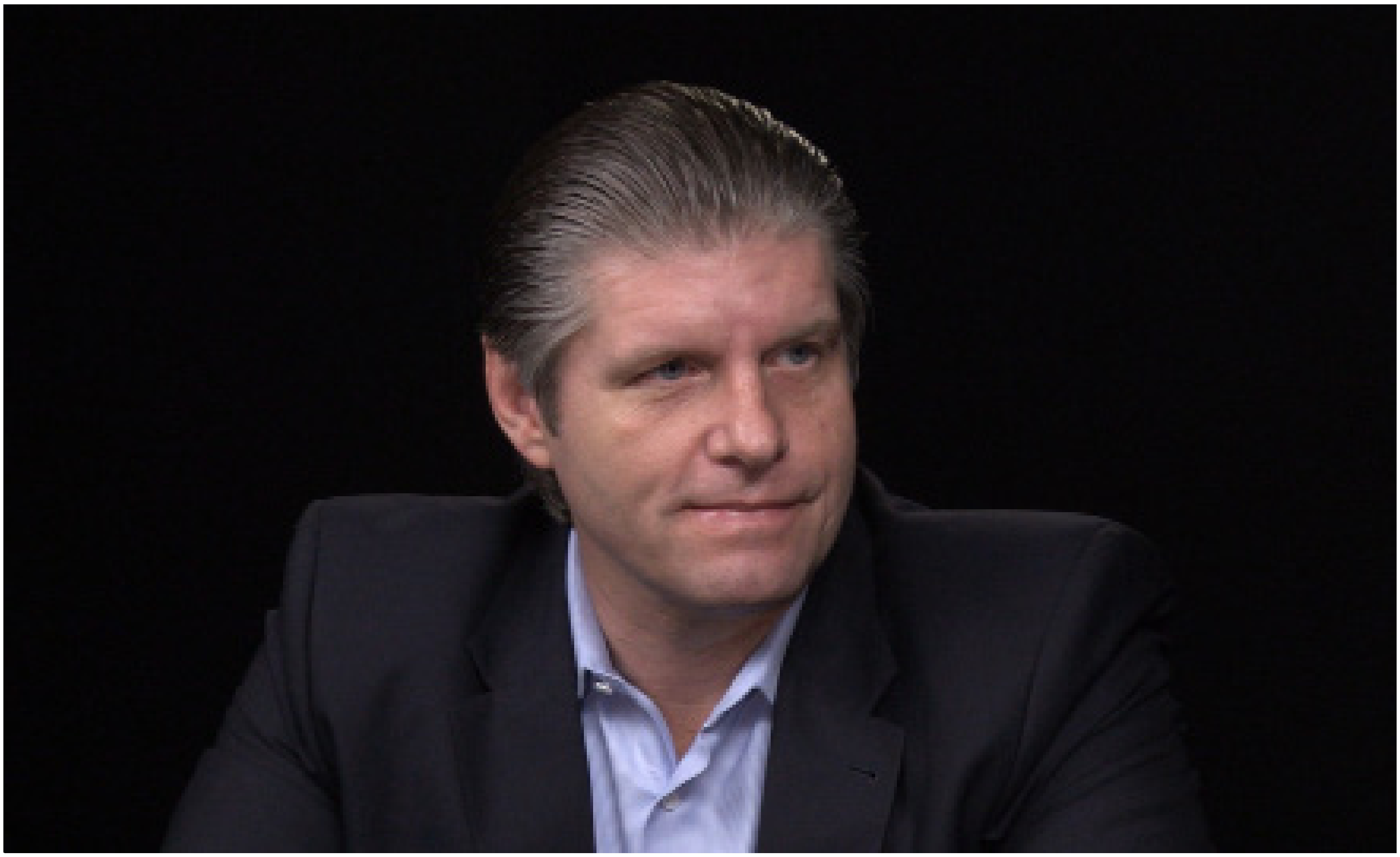
The Macro View

Brazil's weak economy means sectors like healthcare and education are prime targets for private equity investment, says **Gávea Investimentos' Chris Meyn**



Chris Meyn, Gávea Investimentos

Bio

Meyn is a partner at Gávea Investimentos and is responsible for the management of illiquid strategies. He previously worked as a consultant to alternative investment managers and was a managing director and an investment committee member for Latinvest Asset Management and parent company Globalvest Management Company, where he was responsible for the firms' private equity and venture capital initiatives in Latin America. He has also worked at Dick Clark International Cable Ventures, The Markets Group, and Dean Witter Reynolds. Meyn received a degree from Stanford University.

"Deal activity right now is fairly slow. I expect that to improve and start to be more active next year."

–Chris Meyn, Gávea Investimentos

Privcap: You are the head of private equity at one of the largest investment institutions in Brazil. With a softer economy, what is the environment like for people who do deals?

Meyn: It is definitely a more challenged macroeconomic environment. Deal activity right now is fairly slow. I expect that to improve next year. That also dovetails with several of our peers and ourselves having raised or raising new funds. With the slower economy, you're going to look for more defensive businesses like healthcare and education and services. Access to capital is a key theme. Capital markets are very soft. You've seen few public offerings. We don't expect a large pipeline of IPOs.

We're not seeing the risk of a crisis, but what we are seeing is not a lot of visibility on when Brazil moves from the zero-to-1-percent growth back to 3, 4, 5 [percent], and with that comes additional money for consumption. Unemployment's rising continually, so there aren't a lot of signals that there's extra dry powder for the consumer right now.

In addition to making the right play in a softening consumer environment, what are some other investment theses that your group is interested in?

Meyn: We like healthcare. It's an inefficient, fragmented market, whether you're looking at health plans or lab businesses and some unregulated hospital services. You could pull that all the way down to the retail side. You'd rather be in pharmacies, for instance, than a clothing retailer right now. Food, staples, healthcare, education, services, and businesses that circle the steady staples of life really are the least likely to slow down significantly.

Internationally, what factors will impact the Brazilian economy?

Meyn: The [U.S.] dollar is [a factor] for most of the private equity industry in Brazil. Most of the managers, including ourselves, raise the bulk of their capital in dollar-denominated funds. It's not cost-efficient to hedge; it's very expensive, so you are running significant currency risk.

China is an 80 percent trade partner [with Brazil] in oil and iron ore. It's a 20 percent trade partner in other products, so in a way it's not weighing on Brazil significantly.

Your private equity team recently raised a fund that included international investors. What questions were investors asking you that differed from a previous investment cycle?

Meyn: Every LP that's looking at Brazil is looking at a pretty deep dive. There's going to be the camp that's disappointed in how Brazil's performed relative to their expectations in 2010 and '11. It's not hot money, but it's people who are in firms that are really not happy with taking additional exposure risk in Brazil, and they're not looking seriously at the market. We're seeing more investors, and more large institutional investors, looking at Brazil with a dedicated long-term view. ■

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Bringing PE to Small Brazilian Companies

The evolving technology sector in Brazil has attracted international institutional investors. **Carlos Eduardo Guillaume** explains how his firm, **Confrapar,** is sourcing deals in technology and other sectors, through a network of trusted advisors.

Carlos Eduardo Guillaume, Confrapar

Bio

Guillaume is CEO and co-founder at Confrapar. He has worked for technology companies such as Microsoft and Hewlett-Packard in Latin America, Asia, and the U.S., as well as for the Ericsson Corporate Venture in São Paulo. He received a degree from the Federal University of Minas Gerais, and MBAs from the Getulio Vargas Foundation and from IBMEC.

The technology sector in Brazil has become very popular with international institutional investors. What do they need to understand about the ability to make money investing there?

Guillaume: Most investors got the idea that they have to go for the leaders of those industries, and their strategy is to invest in the leaders and then consolidate the sector. We also go to the leaders of the industries, but we [ask] different questions. We ask them who's providing smart solutions for their business, and they name eight, 10 midmarket companies. [Those are] our target.

Talk about how you would source an investment, or how you would start a platform for this style of investment that you pursue.

Guillaume: That's one strategy—going to the leaders and asking them direct questions of who's providing them the best solutions. So, most funds in Brazil are consolidating their sectors, even though they call themselves growth. We have a real growth approach. We came up with a strategy of creating a network of advisors in Brazil. These are senior people in the industry of technology and also in the industries we invest in, which are education, healthcare, and media. They're bringing us the deals. That strategy has been working for us for some time.

Talk about the importance of the domestic Brazilian market versus the importance of trying to build companies that can cross borders and win international business.

Guillaume: There has been an emergence of the middle class in Brazil for the past 10 years. But last year, everyone saw protests in Brazil, and those people were demanding high-quality services in education and healthcare. So those sectors are highly demanded, and the productivity in Brazil is historically low. When we invest in companies, they are mainly local. We invest outside of the main financial hub in São Paulo, but many of the providers are still around universities, are still in the countryside—and when we bring those companies to São Paulo, they get more visibility. And then we start to think of internationalizing those companies.

Can you talk about a recent investment your firm has made that is a good example of the kind of strategy you pursue?

Guillaume: We made an investment in a company that provides technology for logistics in the oil and gas sector, and it was sourced by our network—from one of our investors. We used to tend a lot of family offices investing, and they are also a source of deals in Brazil, because they are [used by] entrepreneurs. These entrepreneurs come to the family offices asking for money, for advice, and this family office just referred this company to us. And this company didn't think of having a board of advisers or a board of directors. So we named one IBM director to the board of this company and another director from a company from Houston, and now that they have a director here in the U.S., they are able to become a global company.

It sounds like they were interested in partnering with you not only because you had capital but because you could connect them.

Guillaume: We try to build that trust when we are analyzing the company, so they understand it's not only capital. Actually, there are only a few funds doing that in Brazil right now in the middle-market area. Brazil has a lot of funds and has become of interest for many international funds to invest and to deploy money into mature companies. When you take private equity as a whole, you see that most funds are investing in consolidating sectors. They write $100M checks, $50M checks, but we are writing smaller checks, for $5M to $10M, for companies that are under the radar for those funds. And we are investing in companies that provide solutions for the leaders, not the leaders [themselves]. This is so that, when we enter the companies [with an investment], there is no competition for the assets. And when you're about to exit the companies, there is a lot of interest.

We would love to have one or two in our portfolio, but the most likely exits will still be through M&A. We receive a lot of visits from big corporations that have Brazil on their agenda, so they are not necessarily doing something this year, but they will do something in the next four or five years, and that matches our exit time frame. And as a consequence of that, local incumbents will start to react as well, so the best exits will include competition between new entrants and/or incumbents trying to protect the market. ■

"We came up with a strategy of creating a network of advisors in Brazil. These are senior people in the industry of technology and also in the industries we invest in, which are education, healthcare, and media."

–Carlos Eduardo Guillaume, Confrapar

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Venturing Into Brazil

Anderson Thees of Silicon Valley–backed, São Paulo–based Redpoint e.ventures discusses why he is eyeing technology investments and how the Brazilian venture capital scene is evolving

Anderson Thees, Redpoint e.ventures

Bio

Thees is a founding partner at Redpoint e.ventures. He was formerly CEO of Apontador, a leading Brazilian search website and geolocation web services provider, and served as an investment principal at Naspers/MIH, responsible for Latin America. He also worked at venture capital firm Eccelera and as a software developer in Brazil and Switzerland. Apontador received degrees from the University of Campinas and the Yale School of Management.

Privcap: Tell us about the Brazilian venture capital scene. What are its main characteristics, and how does the startup scene differ from the U.S.?

Thees: The biggest factor is that it's very young. It is growing really fast compared to five or seven years ago; it's a new world. We have a completely new breed of providers, so lawyers and accountants are getting specialized on the Internet startup scene. The terms and the way we do investments is very new. We also have a new wave of support agents in the industry like accelerators, incubators. There is a new generation that is more aligned with what we see in Silicon Valley, and activity in general is much bigger.

What sectors are you most interested in right now?

Thees: The short answer is the Internet: web and mobile. Our key expertise is in consumer Internet, both in Brazil and from our sponsoring funds in the U.S. In terms of industries, we are seeing a lot happening in education. We really want to do something, but haven't identified the right company yet. There is a lot of innovation happening [in healthcare]. We've made two investments in the financial sector as well.

What are one or two recent deals that you've done, and how are you seeking to help build companies?

Thees: The last deal that we announced is called Nibo. It addresses a big inefficiency in Brazil. They are offering a financial monitoring solution for small businesses and the counterpart of that for the accounting firms in Brazil. The idea is to increase the efficiency and increase the value-add that accounting firms in Brazil can provide to small businesses. Traditionally, this has been a very hard relationship. It's mandatory by law to have an accountant, and they end up with a bureaucratic and compliance-focused relationship. The accountants could actually help businesses plan better and have a stronger financial health.

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>
> –Anderson Thees, Redpoint e.ventures

Do you anticipate that most of your investments will be strategic acquisitions, or do you see a possibility for doing IPOs either in Brazil or somewhere else?

Thees: If we do, it's most likely going to be somewhere else because of the nature of the industry, the volume of revenues and profitability that technology commands. The market in Brazil could change, but as of now it favors the more brick-and-mortar, old-style economy. Nasdaq and the New York Stock Exchange are more supportive of the kind of companies we back.

We would love to have one or two in our portfolio, but the most likely exits will still be through M&A. We receive a lot of visits from big corporations that have Brazil on their agenda, so they are not necessarily doing something this year, but they will do something in the next four or five years, and that matches our exit time frame. And as a consequence of that, local incumbents will start to react as well, so the best exits will include competition between new entrants and/or incumbents trying to protect the market. ■

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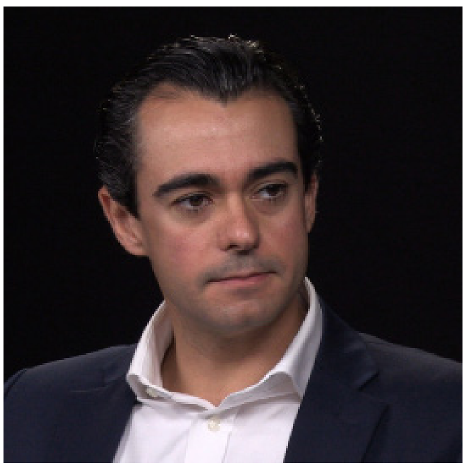
São Paulo's Buzzing Agricultural VC Market

Francisco Jardim, partner at São Paulo–based **SP Ventures,** tells Privcap how Brazil's VC sector differs from overseas markets and the opportunities he sees to invest in agriculture



Francisco Jardim, SP Ventures

Bio

Jardim helped found SP Ventures. He is responsible for the firm's Criatec Fund, the largest innovation-oriented seed capital fund in Brazilian history. Jardim sits on seven company boards. He previously held roles at FAMA Investimentos and Banco Santos. He received degrees from Saint Louis University and from Fundação Getúlio Vargas.

Privcap: What kinds of companies is your firm seeking to back?

Jardim: We take a different approach from the rest of the Brazilian venture capital community. You see a lot of firms that take the American VC, Silicon Valley model, and replicate it in Brazil. Truly disruptive innovation in Brazil is coming out of the agriculture sector. If we look at the major agricultural powerhouses on the planet, Brazil's the only tropical one, so we need to develop local technology. If we look at the 2050 human population projections of 9.4B, there's going to be a much larger [demand] for animal protein, and this is going to mean a lot more pressure on farming. And this farming output, this increase in yields, is going to have to come from Brazil or other tropical breadbaskets that are still not formed. The major platform for developing models and technologies to export to these places is going to come from Brazil.

What's a recent investment that your firm made that's a good example of the kinds of startups and innovations you're seeking to back?

Jardim: We backed a company in Piracicaba, Brazil, where probably the most renowned Latin American agriculture university is based, and it's a hub in bio-pest control—the use of biological agents for controlling pests. This company has been mass-producing and distributing mites since 2008, and recently they started groundbreaking research with stingless bees, how to mass produce and use them as artificial pollinizers. Bees have been disappearing from much of the planet over the past few years for a series of reasons, and that has seriously impacted agricultural yields.

How did you source that opportunity?

Jardim: We've been visiting the research centers for maybe six, seven years. We've known this company since it received its first grants for R&D in basic research. We understand our position in the financing chain in terms of entering a market-failure opportunity, which is post-R&D grant, post-basic-research funding, but before market adoption. And we've been talking to the entrepreneur and getting him comfortable with the idea of selling equity, selling political rights in the company, and also getting used to something that in Latin America is very hard, which is preparing a company to be sold within a 10-year range. Latin American entrepreneurs still have a culture of creating a company to be passed [from] generation to generation. ■

> **"Latin American entrepreneurs still have a culture of creating a company to be passed [from] generation to generation."**
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> –Francisco Jardim, SP Ventures

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