

Multilateral Investment Fund-TC Profile

I. Basic Project Data

Country/Region:	Brazil
Program Name/Number:	Investment Fund for Technology-based companies in Brazil, CRP Venture Fund. BR-M1013.
Team Leader/Members:	Susana García-Robles (MIF/INV), Team Leader Tatiana Soufen (MIF), and Rosemary Jeronimides (LEG)
Date of Request:	July 2004
Beneficiary:	Brazilian technology-based SMEs
Executing Agency:	CRP Companhia de Participacoes
Financing Plan:	
	MIF (IIIB) up to US\$ 3,700,000
	FINEP US\$ 1,600,000
	Pension Funds US\$ 2,900,000
	<u>Private Investors</u> US\$ 2,900,000
	Total US\$11,100,000
Technical and	
Basic Responsibility:	MIF Investment Unit
Tentative Dates:	POC July 2004 Donors September 2004

II. Background and Problem Statement

- 2.1 Brazil has seen a significant growth on the private equity activity in the last 10 years. There have been more than 50 different groups of investors looking for opportunities in all segments of the Brazilian economy, which has caused a deeper understanding of the implications and contributions of private equity investment.
- 2.2 The boom in technology and Internet investments favored investing in venture capital for a very short period of time. The collapse of the market in 2001/2002 diminished considerably this level of VC activity in Brazil as well as the investors' interest on it. Furthermore, it did not allow enough time to create a culture in the market with a critical mass of entrepreneurs and VC investors prepared for an efficient and productive investment process.
- 2.3 In 2003, the venture capital activity in Brazil began to show some signs of recovery, aligned with the positive performance of global markets. After two consecutive years of decline, venture capital investments reverted the trend and increased 7% in R\$ (32% in USD), reaching a level of about half the 2001 figures. However, there is still a significant amount of capital allocated to larger companies, along with a small but growing presence of early-stage venture capital funds. Often, these lack specialized investors interested in the "start-up" phase. That situation creates a gap, where companies that may have the opportunity to achieve critical mass to tap the capital markets, or to receive capital from the larger funds, are not able to accelerate their growth and compete against other incumbent players.
- 2.4 The CRP Venture Fund intends to work in this niche by drawing on the extensive experience and network of CRP in identifying, supporting and developing companies with high-growth potential. The problem of lack of available long-term financing for SMEs continues, as they have limited access to credit in the banking system. Moreover, as interest rates decline and GDP growth resumes in Brazil, a significant demand for risk capital from these target companies is to be expected.

- 2.5 In 2003, the government completed some important changes in regulation, paving the way for a more active participation from pension funds in the VC market. CRP has been taking advantage of this opportunity to market the fund to several pension funds, which are anticipated to account for a portion of the investor base. Adding to CRP's longtime relationships with institutional investors, the partnership CRP is entering into with GP Investimentos (see n. 5.6) is expected to facilitate access to both new institutions and private investors.
- 2.6 A recent external independent evaluation conducted by OVE¹ on the MIF investments found that VC results in the region were below expectations, but that Brazil presented a sound scenario for VC activity, with some incipient signs of interest from private parties in VC investing and a number of significant non-commercial sources of capital with long-term programs to support the industry.
- 2.7 MIF is also contributing to building institutional mechanisms for the promotion of the VC industry in the country. As highlighted by OVE, the diffusion and institutionalization of SME investing has been strengthened due to the presence of more public support and the success of initiatives as INOVAR. Throughout the last 4 years, MIF has been involved in the program, participating in Calls for Proposals and selecting along other INOVAR Technology Investment Facility (TIF) members, a few funds for due diligence. Among these few selected funds, the majority approved CRP Venture as a potential investment.
- 2.8 To date, the MIF has approved three investment funds through the TIF process. The first one, Stratus I, was approved in October 2001, and it is performing very well. It expects to be fully invested by the end of this year. The second one, LatinTech Ventures, approved in August 2002, suffered a major change in the management company's shareholders and team's composition shortly after MIF's approval, which affected the fundraising process. Since almost two years elapsed with no further investment commitments from either pension funds or private investors in order to match ours, this fund has been officially taken out from the SEIF portfolio as of the end of June. The third fund, Rio Bravo Investech II, also approved by the Donors Committee in August 2002, suffered delays in closing. As of now, the fund has closed and is starting due diligence on its first investment.
- 2.9 The MIF's USD 3.7 million proposed investment in CRP Venture results from its previous commitment to two other funds managed by CRP: RSTec (approved in 1999) and SCTec (approved in 2000), which were not fully capitalized, due to several factors: i) changes in policies and strategies by some of the public institutions that were investors, ii) the currency depreciation in relation to the dollar, and iii) a lack of pipeline in the state of Santa Catarina. MIF is therefore proposing to invest the committed but non-allocated amount, approximately USD 3.7 mm, in this new fund, CRP Venture.
- 2.10 The following table shows MIF's current exposure in Brazil, as well as the amounts not used in RSTec and SCTec, which can be directed to CRP Venture:

¹ Evaluation of MIF Projects: development of venture capital. Office of Evaluation and Oversight. MIF/GN-78-11.

	Investment Unit	MIF	MIF		Amount
	Projects in Brazil	Commitment	Disbursed	Cancelled	Available for CRP
1998	Fundotec	5,000,000	2,895,013	0	
1999	RSTEC	3,000,000	2,097,964	0	902,036
2000	SCTec	3,300,000	419,404	0	2,880,596
2000	MVP Tech	4,500,000	200,835	0	
2001	REIF Dekasegui	5,000,000	1,170, 260	0	
2001	Nordeste	6,000,000	625,500	0	
2001	Stratus	3,000,000	1,504,718	0	
2002	Latin Tech	4,000,000	0	4,000,000	
2002	Rio Bravo	3,000,000	0	0	
2003	Serra Gaucha	1,800,000	0	0	
	Total	38,600,000	8,913,694	4,000,000	3,782,632

III. Program Objective and Description

- 3.1 The project consists of the creation of CRP Venture – Fundo de Investimento em Empresas Tecnologicamente Competitivas, a VC fund for early-stage technology-based companies in Brazil, with a preference for the South and Southeast of the country, reflecting CRP's accumulated expertise and network of prospective investments in these regions. Since CRP co-manages with Eccelera the SPTec fund in Sao Paulo, SPTec will have the right of first refusal on pre-screened investments.
- 3.2 The objectives of the project are:
- To fund a vehicle which will provide equity and cuasi-equity financing, financial and technical advisory, and value-added governance to approximately 20 to 25 Brazilian technology-based SMEs;
 - To increase competitiveness and innovation among technology-based SMEs and generate employment; and
 - To further the development of the venture capital industry in Brazil, providing examples of how the financing of early-stage Brazilian companies through VC produces an impact on the growth and organization of these companies.
- 3.3 This project is in line with the MIF OVE Evaluation recommendation to prioritize technology-focused funds, especially in an environment like Brazil, where funds, clusters of technology companies, and functioning institutions come together.
- 3.4 Expected results. CRP Venture plans to invest in 20-25 companies that, based on their track record, may account for approximately 1,000 direct jobs. The Fund intends to fill a financing gap for the small and mid-size growing company in Brazil that currently has no access to long term financing, and to collaborate in increasing SMEs' governance and operating standards.
- 3.5 The Fund will focus on companies with annual sales up to R\$ 30 mm (approx. USD 9.6 mm); mainly in the segments of information technology, biotechnology, fine chemistry, precision mechanics, plastics technology and agroindustry. Investments will be staggered in three different rounds, each following a selective assessment of the best opportunities in the portfolio. The average investment will increase progressively from around R\$ 0.8 mm (USD 0.3 mm) in each of the 20-25 companies selected in the first round to R\$ 1.5 mm (USD 0.5 mm) in 10 companies in the second round, and finally to R\$ 3 mm (USD 1 mm) in 4 companies in the third round. The Fund will provide financing for MIF eligible

companies (i.e., companies with turnover below US\$5 million per year, less than 100 employees, etc.) for at least twice the amount of MIF resources in the Fund (i.e., US\$ 7.2 mm with US\$ 3.6 mm in MIF capital).

- 3.6 The Fund will typically be a minority investor with a 10% to 40% share of total capital. The most likely exits will be through trade sales or company buy-back operations. Although priority for investments in the second and third rounds will be given to companies selected in the first round, the fund may decide to invest in other attractive companies, provided that it is able to secure funds from other funds interested in co-investing in these new assets.
- 3.7 The Fund plans to invest up to 15% of its capital in each portfolio company. The Fund may seek to co-invest with other local or strategic investors when the investment needed by the company surpasses the financing that the Fund can provide. In addition to that, the Fund plans to create value by taking a very active “hands-on” role in the strategic and financial direction of its portfolio companies, as indicated by its track record in other funds. The strategy of the Fund and the skills and experience of the management team will contribute to the development of early-stage Brazilian companies that may serve as an example of how venture capital produces an impact on the growth and organization of this type of enterprise.

IV. Cost and Financing

- 4.1 The Fund is planning a first closing of at least R\$ 35 mm, with a maximum goal of R\$ 50 mm (approx. USD 11-16 mm). This size is necessary to attain the critical mass necessary for the Fund to make investments according to the investment strategy devised. Moreover, it represents a significant increase in size compared to other funds previously managed by CRP, falling in line with the OVE evaluation’s recommendations, that recommended that the size of funds in the region should be increased in order to cover management fees and operational expenses, and still allow the fund to yield a normal market rate of return.
- 4.2 A significant part of the Fund will be raised from local private investors, mainly pension funds. This is also a change in CRP’s strategy, supported by the partnership with GP, and the lessons learned in its other funds, in which the majority of investors were public institutions more susceptible to suffering internal changes in their policies and strategies. This time around, CRP intends to target more aggressively private sector investors, and therefore, is aiming at raising more than 50% of total capital from them.
- 4.3 To date, the Fund has secured FINEP’s investment of at least R\$ 5 mm (approx. USD 1.6 mm) and has indications of interest from pension funds for at least another R\$ 18 mm (approx. USD 5.8 mm).
- 4.4 Compensation. The management fee was structured to comprise two different phases: in phase I, the annual fee to the administrator will consist of 2% of the aggregate capital commitment during the first three years of the fund – which corresponds to the investment period for the first round. Thereafter, in phase II, the annual fee will consist of 0.5% of the aggregate capital commitment plus a variable fee per invested company of R\$ 25,000 (USD 8,000) corrected monthly by the INPC price index.
- 4.5 Compensation will also include a success fee, only payable to the manager after the investors have received the initial capital plus a preferred return. Its exact structure is still being negotiated.
- 4.6 The Fund will have an Investment Period of five years (covering the three investment rounds) and a life of nine years, with a two-year extension possible. The Fund will be regulated by the CVM n. 391/03, a recently approved instruction that instituted the FIP – Fundos de Investimento em Participacoes and allowed for more flexible rules for PE and VC funds. The governance structure includes a General Assembly of Shareholders and an Investment Committee of up to 5 members. MIF will have a role in

both bodies. In the investment committee, MIF will participate in an observer capacity, reserving its right to become an active member in the future.

V. Executing Agency and Execution Structure

- 5.1 The administrator of the Fund is CRP Companhia de Participacoes, founded in 1981 by a pool of companies and development banks established in the state of Rio Grande do Sul. Since then, CRP has been targeting the management of risk-capital investments in the South and Southeast regions in Brazil. Having accumulated experience in dealing with small and medium enterprises, CRP focused its activities on technology-based companies in the 1990s.
- 5.2 CRP is one of the oldest, most professional management companies, with 22 years working in the VC industry in Brazil. CRP's efforts to create better conditions for the venture capital market also include a vigorous role in ABCR – Associacao Brasileira de Capital de Risco, and in the development of new regulation and public policies affecting the industry. On its own initiative, CRP started bi-annual meetings in which fund managers, investors, and regulators from all over the country gather for two days to take a look at the industry and what needs to be improved. With respect to its portfolio companies, CRP holds six meetings per year in which all the entrepreneurs meet for a day, to network and learn from each other's experiences managing SMEs.
- 5.3 Track record. Overall, CRP has invested in 48 companies through 60 transactions. The company has already divested from 26 companies, and is currently managing 22 investments. Its pioneering fund, CRP fund, started in 1981, is fully divested, and has generated a gross return of 8.8% p.a. in USD. The CRP Caderi fund is still in the process of divesting one remaining company (scheduled for the beginning of 2005).
- 5.4 As pointed by OVE, one factor that drives the performance of a venture capital fund is management quality, reflected by a successful track record in the business and experience operating companies. As highlighted in the OVE report², CRP fulfills these requirements, and has become a trusted and sought-after investor. Their capability of adding value beyond the financial contribution has created a management style based on partnership, being viewed by the entrepreneurs as an ally and rather than a threat to their authority. As the report concludes, throughout their 22 years of experience of the management team, they developed a clear talent in identifying good partners.
- 5.5 Current activity. Three CRP funds are active at the moment: RSTec, started in 1999, has recently finished its investment period, having invested in 15 companies; and two other funds are still in their investment period: SCTec (2000), and SPTec (2002, co-managed with Eccelera and Proinvest). MIF participated in both RSTec and SPTec, but chose not to invest in SPTec.
- 5.6 CRP established a partnership with GP Investimentos for managing CRP Venture. GP Investimentos will work as a consultant on strategic decisions regarding investments, monitoring, and divestments. GP is one of the major and most successful asset management firms in Brazil, specialized in private equity, financial investment funds, and real estate funds. Given its track record of investment in different segments, and their vast network of contacts among the investors community, GP Investimentos will mostly contribute to broaden the base of prospect investors and to structure profitable exits in the future.

VI. Major issues

- 6.1 Some of the issues that the team will keep looking into are:

² Evaluation of MIF Projects: development of venture capital. Office of Evaluation and Oversight. MIF/GN-78-11. Annex III, page 23, box 7.

- Fundraising. MIF will keep abreast of ongoing fundraising efforts in order to synchronize the timing of its approval with that of other investors in the group, so that the fund's commencement of operations will come in a relatively short time after the MIF approval.
- Partnership with GP Inestimentos. MIF will seek to further understand and assess potential benefits and risks of having GP Inestimentos as a partner in CRP Venture.
- The team will further study the issue of the success fee cascade (see paragraph 4.5).

VII. Environment & Social Issues

- 7.1 Given the investment focus of the fund, the team does not foresee any negative environmental impact. However, CRP will ensure that the investee companies practice sound labor and hiring practices. CRP will manage the fund in accordance with the IDB/MIF environmental and social guidelines for MIF-supported financial intermediaries³. As part of fulfilling the requirements of these guidelines, CRP Venture managers have participated in a MIF/IDB-approved training course on environmental and social review for financial intermediaries. In addition, MIF recently commissioned the development of a specific manual for social and environmental monitoring and due diligence for financial intermediaries that will be soon distributed for use by our fund managers.

VIII. Action Plan

- 8.1 The following is a preliminary schedule for the project's approval process:

Abstract	July 2004
CESI	July 2004
Update on due diligence	July/August 2004
Donors	September 22 nd 2004

³ MIF/IDB Environmental and Social Guidelines for MIF Financial Intermediary Operations. <http://www.iadb.org/mif/>