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BRAZIL

INVESTMENT FUND FOR EMERGING TECHNOLOGY-BASED COMPANIES RIO BRAVO INVESTECH II

(TC- 0205012-BR)
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DONORS COMMITTEE MEMORANDUM

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CONFIDENTIAL

This document was prepared by the project team composed of: Susana García-Robles (MIF) Project Team Leader, Sandra Darville (MIF), Alberto Galhardo Simoes (LEG), and Monica Ribaudo (MIF).

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Project Resolution

BRAZIL
Investment Fund for Emerging Technology-Based Companies Rio Bravo Investech II

Currency:
Dollars of the United States (USD)

ACRONYMS

ABCR	Associação Brasileira de Capital de Risco
BN	Billions
BNDESPAR	Banco Nacional de Desenvolvimiento Económico e Social Participações S.A.
BOVESPA	Bolsa de Valores de Sao Paulo
CMN	Conselho Monetario Nacional
CVM	Comissão de Valores Mobiliarios (Securities Exchange Commission)
ELETROS	Fundação Eletrobras de Seguridade Social
FAPES	Fundação de Assistencia e Previdencia Social do BNDES
FINEP	Financiadora de Estudos e Projetos
FMIEE	Fundo Mutuo de Investimento em Empresas Emergentes
FUNCEF	Fundação dos Economiarios Federais
IDB	Inter-American Development Bank
IT	Information Technology
MIF	Multilateral Investment Fund
MM	Millions
PE	Private Equity
PETROS	Fundação Petrobras de Seguridade Social
R$	Brazilian Reais
SEBRAE	Serviço Brasileiro de Apoio as Micro e Pequenas Empresas
SEs	Small Enterprises
TIF	Technology Investment Facility
USD	United States Dollars
VC	Venture Capital

Project Team

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EXECUTIVE SUMMARY

EXECUTING AGENCY: Rio Bravo Investech II for Emerging Technology-based Companies established in Brazil and regulated by the CVM. The Fund's projected capital will be R$ 30 mm (approximately USD 12 mm)[1], over a ten year maximum lifetime. (Eight years with one possible extension for two more years, to be determined by the General Assembly with a supermajority vote by the shareholders). The minimum size of the fund will be R$ 10 mm (USD 4 mm).

OBJECTIVES: Financial Objective: The Fund could be expected to provide a gross return in R$ of between 23% and 38% p.a. This return is calculated in a fund financial model (see Annex III) which assumes returns of 70% for 20% of the portfolio, 25% for 50% of the portfolio, 0% (just return on initial investment) on 20% of the portfolio, and losses on 10% of the portfolio, plus a 10% reserve. The project team has analyzed the Fund Manager's return projections and considers them reasonable.
Developmental Impact: The establishment of this Fund is expected to further four key MIF objectives:

(i) To consolidate the structure created by the INOVAR Program, designed to stimulate the establishment of new venture capital funds with a focus on emerging and start-up technology based-companies;
(ii) To play a catalytic role in the creation of a critical mass of world class local fund managers under the INOVAR partnership;
(iii) To further the development of the venture capital industry in Brazil, as well as the dialogue among all actors in this industry to improve the regulatory environment; and
(iv) To fund a vehicle, which will provide equity capital, financial and technical advisory, and value-added governance to approximately 12-15 Brazilian SEs that have sound business plans and strong growth prospects.

PROJECT COST AND FINANCING: The MIF is planning to invest up to USD 3 mm but no more than 40% of total capital in the Fund. Additionally, MIF's commitment will depend on a 1:1 matching of private capital. The MIF will also allocate up to USD 60 thousand in resources from the grant facility to cover the costs of three independent evaluations throughout the Fund's life. The Fund will receive the grant money to pay for these services, but MIF will select and contract the firm or individual to perform the evaluations, using the IDB/MIF's own procedure policies. The

[1] The exchange rate used throughout the document is of USD 1/R$ 2.50

evaluations will consider the financial performance of the Fund, the types of deals in the pipeline, the overall operational functioning of the Fund Manager, as well as the social and environmental impact of the Fund's investments.

The projected capital is as follows:

Investors	Current Amount (USD)	Projected Amount
FAPES (pension Fund)	1,000,000	1,000,000
Rio Bravo Partners	600,000	600,000
Other individual and Institutional investors	2,400,000	5,400,000
Facility 3-b	3,000,000	3,000,000
INOVAR Partners	2,000,000	2,000,000
Total	9,000,000	12,000,000
MIF Facility 3-a Up to	60,000	

SPECIAL CONDITIONS: The Rio Bravo Investech II Fund will be established as a *"Fundo Mutuo de Investimento em Empresas Emergentes"* (FMIEE) in accordance with Brazilian regulation CVM n. 209 and CVM n. 363, and expects to include among its investors the MIF, FINEP and several Brazilian and foreign private investors (such as FAPES, PETROS, and Swiss Re). Disbursement of the MIF funding and that of the other investors will be contingent on the establishment of the Fund.

PROJECT DESCRIPTION: Rio Bravo Investech II Fund is expected to make equity investments in 12-15 companies throughout the life of the fund. The Fund will invest in small companies, preferably located in the South and South East of Brazil, in sectors related to biotechnology and bio-informatics (this will represent a maximum of 30% of the portfolio), solution providers in software and hardware for telecommunications, and information technology including software and logistics (this will represent a maximum of 70-80% of the portfolio). Companies in early stages of development are expected to comprise between 25-35% of the portfolio, while the rest will be invested in established companies.

MANAGEMENT: Rio Bravo Investech II Fund will be managed by Rio Bravo Investimentos S.A. (former Rio Bravo Asset Management S.A.), headquartered in Sao Paulo. The company was legally formed in 1997, but commercial operations effectively began in 2000. Rio Bravo is an independent Brazilian firm dedicated to providing financial services in the areas of venture capital and private equity, asset management and corporate finance. Activities related to asset management are carried out by Fiducia Asset Management S.A., and

activities related to real estate assets are conducted by Mercurio DTVM, both subsidiaries of Rio Bravo Investimentos S.A. Corporate finance is conducted by Rio Bravo Consultoria Financeira LTDA. Rio Bravo Investimentos manages R$ 1,040 mm (USD 416 mm) through its different activities. The Rio Bravo team has already managed VC/PE Latin American funds through its funds Investech I (a R$ 4 mm "demonstration" fund), Rio Bravo Investment Partnership I, LP (a PE off-shore fund with USD 25 mm from foreign investors), and Rio Bravo Nordeste I Fund. (Commitments of R$ 20 mm have already been approved by the investors in this fund, and the fund is now in the process of obtaining CVM approval).

ENVIRONMENT: The Fund Manager will follow operational criteria that are in agreement with the IDB/MIF's environmental review guidelines, and with Brazilian environmental and labor laws and regulations. Given the technological nature of the sectors in which the Fund will be investing, the project team does not foresee significant environmental issues. The Committee on Environment and Social Impact approved this project with no restrictions at its May 17th, 2002 meeting.

RISKS AND ISSUES: Risk: Rio Bravo is a rather new VC fund manager, with limited track record, having previously managed PE funds, and a very small fund started in 2001 with R$ 4 mm (USD 1.7mm) and which is totally invested as of today. Consideration: Rio Bravo Investech II was unanimously chosen by the INOVAR's partners at the second Call for Proposals. The project team and the INOVAR partners are favorably impressed with the qualifications, experience and reputation of the Rio Bravo Principals and believe that they will provide strong value-added to the Fund's investees. The Principals have relevant experience as: (i) advisor of a US based USD 500 mm private equity fund; (ii) board member of several Brazilian companies; and (iii) member of the board of São Paulo Stock Exchange (BOVESPA) representing institutional investors of the private sector. The key executives have been together since 1997 and represent a very strong and well-balanced mix of complementary skills in corporate management, investment banking and strategic consulting, and in managing funds. In addition, Rio Bravo VC/PE division is a joint-venture between Rio Bravo Investimentos S.A. and Securitas Capital LLC, a US private equity firm sponsored by Swiss Re with USD 600 mm in commitments from a PE fund (USD 500 mm) and a VC fund (USD 100 mm). Since Rio Bravo's funds have only recently begun to be invested, neither the PE fund nor the VC fund has sold any position in an investee company.

Issue: Rio Bravo Investech II may be unable to raise sufficient private sector capital to establish the Fund. There would be no loss to the MIF in this instance since there will be contractual clauses preventing MIF

from disbursing unless there is sufficient private sector investment matching the MIF's.

Risk: The investment strategy of the Fund is focused on the technology sector, implying a high underlying business risk. Consideration: The project team believes that Rio Bravo has the background and skills, both internally and externally via its consultants, to manage this risk prudently. Nevertheless, the sector is extremely volatile.

Risk: Currency depreciation of the Brazilian real could result in foreign exchange losses**.** Consideration: Long-term hedging of currency risk is not available. Rio Bravo expects to invest in high-growth companies that are capable of generating enough capital appreciation to compensate investors for possible currency depreciation.

Risk: Exiting the Fund's investments may be troublesome in light of the illiquid and early stage nature of the portfolio and macroeconomic factors. Consideration: The Fund Manager's contact network and reputation will be key to exit. The exits will most likely be through sale to third parties, be it strategic investors or financial investors through the stock market, or managers of the businesses. In most of the cases, Rio Bravo will require the invested companies to comply with all requirements to be listed in the BOVESPA's Novo Mercado to facilitate the possibilities of exiting through the stock market.

Risk: In light of the global downturn in the technology sector and its effects on the international VC environment, as well as the capital flight from emerging markets in general, subsequent rounds of financing for the growth of Rio Bravo Investech II's investees may not be available when necessary. Mitigant: Shortage of investment capital is unfortunately the norm in most markets in which MIF invests, and it is impossible to mitigate this risk entirely. Rio Bravo will keep an additional 10% reserve for refinancing rounds. While the current negative environment is projected to continue through most of Rio Bravo Investech II's investment period, investment trends could be expected to improve thereafter, if historical cycles are any indication. In addition, Rio Bravo intends to co-invest in some deals with other VC funds in order to reduce the refinancing risk and the exposure to a single investment.

I. MIF ELIGIBILITY

1.01 At its meeting of February 9, 1995, the MIF Donors Committee declared Brazil eligible for all forms of financing.

1.02 The MIF's participation in this project is consistent with its mission of increasing private investment and encouraging private enterprise to boost the country's economic growth and social development. This project meets the criteria for equity investments in financial intermediaries that are establishing or expanding services to small enterprises, as set forth in Article III, Section (4) of the Agreement Establishing the Multilateral Investment Fund.

II. BACKGROUND

A. Current State of the Venture Capital Industry in Brazil

2.01 The year 2000 was generally positive for Brazilian venture capital/private equity (VC/PE). A stabilized macroeconomic environment brought with it low inflation, declining interest rates and a record USD 30.6 bn in foreign direct investment. Entrepreneurial activity and innovation emanating from Brazil's technology centers were still relatively vibrant, despite the first rumblings of the global technology slowdown. Brazilian institutional investors (particularly pension funds) who had historically shied away from VC/PE as an asset class, began to show interest as lower returns on their traditional fixed income investments drove them in search of higher returning alternatives. Several important and related institutions such as the *Novo Mercado* and the *Asociacao Brasileira de Capital de Risco (ABCR)* (Brazilian Venture Capital Association) were also created.

2.02 Furthermore, the *Conselho Monetario Nacional (CMN)*, an entity which regulates the insurance, banking and pension fund industries, issued Resolution 2720, which, *inter alia*, loosened restrictions on the maximum percentage of assets under management which institutional investors could dedicate to "alternative" asset classes such as VC/PE. The Brazilian Government and prominent VC/PE industry players joined forces in the "*Brasil Empreendedor*" Program to review/amend the existing regulatory framework for investment funds, to propose changes in the tax law and to lobby for other legislation to provide a more favorable VC/PE environment. Within this context, domestic and offshore VC/PE funds raised a total of USD 440 mm and USD 1.1 bn, respectively, for investments in Brazil. Eighty-seven transactions were consummated and the number of VC/PE fund managers active in Brazil grew to 82.[1] It should be noted that the overwhelming majority of the latter statistics relates to PE deals, since the line between venture capital and private equity in Brazil is blurred due to the incipient nature of the industry.

2.03 In the year 2001, the Brazilian venture capital and private equity (VC/PE) industry faced an unfavorable environment for both fund raising and investments. The 2001 scenario to date looks rather more challenging. An increasingly difficult macroeconomic environment, higher prevailing interest rates and problems in the global technology sector

[1] Brasil venture News, March/April 2001.

caused Brazilian investors to initiate a "flight to (relative) safety/quality" and VC/PE fund managers to focus on their existing portfolios rather than on new fundraising. As a consequence, VC/PE investments in 2001 were reduced to USD 0.7 bn with 71 transactions, from its 2000 peak of USD 1.4 bn (with 87 transactions) during the 1999-2000 Internet bubble.

2.04 The first half of 2002 has seen no significant changes in the venture capital environment since last year, which highlight the need for continued MIF involvement as a catalytic agent for regulatory reform, greater awareness of international fund industry best practices, and investment fund creation.

2.05 The Latin American VC/PE markets have remained cautious and extremely conservative in terms of new investments, as is the case in the US market. The slower pace of investing over the past 18 months has allowed relatively small pockets of available funds to last longer than planned and valuations have fallen dramatically; however this has been offset by extremely difficult fundraising environments for new capital sources, low liquidity for existing investments, and increasing political and economic instability throughout the region.

2.06 There are, nonetheless, some improvements in different areas: (i) a positive medium-term outlook for the domestic stock market development reflected in the fact that high-profile Brazilian public companies, such as Banco Itaú, Gerdau, Globocabo and Sabesp, have gotten into, --and several others are signalizing their interest in-- the "Novo Mercado", a special market in the national stock exchange, which aims to create a secondary capital market to Bovespa, fulfilling international standards of governance, transparency and accounting, which will increase liquidity of the capital markets and reduce capital costs to private companies; (ii) the absence of alternative supply of capital in the form of low cost of debt or public offerings leaves companies with fewer options, making VC/PE one of the most interesting sources of capital available; and (iii) the "Lei da Informática", a new regulation that provides to the technology manufacturers, which invests at least 5% of their tax revenues in R&D, with partial exemption of IPI (Tax over Industrialized Products) until 2009. In addition, there is an administrative rule, being discussed in the Brazilian Congress, which envisages that the technology manufacturers can also invest the 5% of their tax revenues in VC domestic Funds (FMIEE) in order to obtain the fiscal benefits.

2.07 The IDB and the MIF, in partnership with the Brazilian government, BNDESPAR, SEBRAE, INOVAR, Banco do Nordeste, and ABCR, has several projects in execution and under preparation whose aim is to improve the enabling environment of VC/PE in Brazil and to encourage private institutional investors' interest in this asset class.

2.08 As of today, MIF has a portfolio of seven VC funds in Brazil for a total of USD 29.8 mm in MIF's commitments. Four of these are fully operational and have made investments (RSTec, SCTec, Fundotec, and Dekassegui); and three have recently been approved by the CVM and will become operational in the next few months (Stratus, Nordeste, and MVPTech). The MIF portfolio of funds in Brazil is still very young; therefore it is too early to see results in any of them. The MIF's strategy in continuing to create more technology funds is based on its long-term goal to enable the venture capital environment

in Brazil through the INOVAR Program (see section B), and on the developmental impacts that will be achieved through it (see n. 3.35).

B. The INOVAR Partnership

2.09 Rio Bravo Investech II, if approved, will be the third investment fund to be generated from the Technology Investment Facility (TIF) of the INOVAR project (ref. TC-00-11-04-1BR).[2] The TIF is a joint collaboration between MIF and local Brazilian institutions (SEBRAE, FINEP, and PETROS) to stimulate the creation of technology VC funds in Brazil. Each partner has agreed to direct up to USD 15 mm in investment through the TIF over a three-year period. The TIF partners committed to perform joint due diligence on VC funds that presented proposals to the TIF, focusing on those which best matched the INOVAR partners' different mandates and investment criteria. Each institution, after completing the due diligence, is free to make its individual investment decision –there is no a priori investment commitment.

2.10 This project is consistent with the goals set for the INOVAR program and with the MIF's overall strategy to promote the entrance of the private sector in the region, as well as to promote the emergence of an entrepreneurial, local, world class of fund managers.

2.11 The first meeting of the TIF partners occurred in February 2001. The project team met with the partners to exchange investment criteria and analytical methodologies. Eighteen prospects for investment funds were presented, and several were considered for investment. Stratus I fund, approved by the Donors Committee at the beginning of October 2001, was the result of this first call. The second call for funds was at the end of October 2001, and three out of the thirteen proposals presented were unanimously chosen by all the TIF partners to be pursued for due diligence. Rio Bravo Investech II was among these.

2.12 All proposals are jointly analyzed and prioritized according to the quality and degree to which each Fund's proposed investment strategy fit with those of the individual INOVAR partners. On the MIF's part, the rationale for the selection of funds is based mainly on the strength of the Management Company, its investment strategy, and its capacity to tap private sector investors, despite the current difficult environment.

2.13 Since its establishment, the INOVAR Partnership has created a strong momentum among potential investors, fund managers and entrepreneurs. The INOVAR partners are also pleased that several institutional investors are considering joining the TIF, most notably the corporate venture arm of a Brazilian financial institution.

2.14 The INOVAR program for matchmaking between investors and entrepreneurs has hosted six Venture Forums to date: two in Rio de Janeiro, one in Porto Alegre, one in Sao Paulo, one in Belo Horizonte, and one in Fortaleza (April 2002). These events have been very successful, with a total of 1,300 participants, 69 companies presented and 210 investors in attendance.

[2] See TC-0011041-BR, n. 2.8, 2.9, 3.19, and 3.20

III. THE PROJECT: FUND OBJECTIVES AND DESCRIPTION

A. Objectives and Fund Strategy

Fund Objective

3.01 The objective of this project is to establish Rio Bravo Investech II, a VC fund for SEs in Brazil. The proposed Fund Manager and Sponsor of the Fund is Rio Bravo Investimentos S.A. Rio Bravo Investech II will be established as a FMIEE in accordance with Brazilian regulation CVM n. 209 and CVM n. 363. The Fund expects to include among its investors the MIF, FINEP, and several Brazilian and foreign private investors, such as FAPES, PETROS, and Swiss Re.

Fund Investment Strategy

3.02. The objective of the fund is to make equity investments in 12-15 companies throughout its life, preferably located in the South and South East of Brazil, in sectors related to biotechnology and bio-informatics (this will represent a maximum of 30% of the portfolio), solution providers in software and hardware for telecommunications, and information technology including software and logistics (maximum of 70-80% of the portfolio).

3.03. The Brazilian biotech market is a very attractive industry for VC investments. The industry experienced a significant growth starting in 1997, when new patent legislation was introduced to provide the necessary incentives for research. Since then, a coalition of researchers succeeded in mapping the entire genome of a bacterium that attacks citrus fruits, making Brazil belong to the group of few countries who have already mapped any type of genome. The importance of the agricultural industry in the Brazilian economy, the extended biodiversity of the country, and the quality and worldwide recognition of scientific expertise in molecular biology, genetics, cell biology and bioinformatics make the Brazilian biotech industry an attractive one.

3.04. The sector presents significant upside potential and considerable risks. Some of the difficulties the country faces in this industry are : i) there are not many pharma and research-based industries in the country, although several pharmaceutical companies have operations in Brazil, and given the current biotech industry development, is likely that they will increase their R&D in the country; ii) the patent legislation is rather new, and researchers are not accustomed to filling out the required forms. Some organizations, like FAPESP (Sao Paulo’s research agency) and Biominas (biotech incubator based in Minas Gerais) are providing advisory services on the topic; and iii) the biotech industry in Brazil is very young, so there are few role models for entrepreneurial scientists. Rio Bravo intends to work with executives from the pharmaceutical industry with corporate experience.

3.05. The interest this sector has received among investors in Brazil can be verified by these recent developments: i) the sale of the controlling stake (39%) of Biobras, a biotech company focused on human insulin production, to Novo Nordisk for approx. USD 31 mm; ii) investments in Extracta (discoverer of novel natural molecules), Allelyx (a start-

up company focused on applied genomics), and Scylla (a bioinformatics company), totaling more than USD 15 mm investment in this field.

3.06. Rio Bravo will use a consultant based in England, Prof. Humphrey Rang, who is an expert in the analysis and follow-up of biotech companies, to ensure that the scientific and commercial aspects of all deals in biotech are properly covered.

3.07. Companies in early stages of development are expected to comprise between 25-35% of the portfolio, while the rest will be invested in established companies.

3.08. The exits will most likely be through sale to third parties, be it strategic investors or financial investors through the stock market, or managers of the businesses. Rio Bravo will try to obtain specific rights in the structuring of the transaction to guarantee the exit of the investment after a determined amount of time and to protect possible negative returns. In most of the cases, Rio Bravo will require the invested companies to comply with all requirements to be listed in the BOVESPA’s Novo Mercado to facilitate the possibilities of exiting through the stock market. Rio Bravo also believes that it will be able to maximize the divestments of the portfolio companies due to its Principals’ network of contacts and the presence in the international markets through Securitas Capital.

Market Opportunity/Pipeline

3.09. Based on due diligence, Rio Bravo’s deal-sourcing ability seems to be strong, in terms of active origination of prospects as well as referrals from business channels. The Principals have an extensive network of contacts among incubators and universities in the targeted region, other VC/PE domestic and international players, Brazilian financial institutions, and within many segments of the Brazilian corporate universe. This network has allowed Rio Bravo to generate an indicative pipeline for the Fund (see Annex I) and provides a positive indication that the Fund Manager will be able to source additional prospects on a timely basis.

3.10. The project team has reviewed the indicative pipeline and met with several of the entrepreneurs during due diligence. They all fit within the sectors identified in the Fund's investment strategy and the MIF's investment criteria.

B. Composition of the Investor Group

3.11. Rio Bravo has been developing strong partnerships in Brazil among the Brazilian pension funds community. Rio Bravo’s strongest potential candidates for funding this initiative are FAPES, Petros, Eletros and Funcef. Rio Bravo and its sponsor are committing to invest an amount equivalent to 10% of the investments made by INOVAR partners, up to R$ 1.5 mm.

3.12. At the same time that MIF is submitting this proposal for consideration, FINEP is also beginning its internal approval process. PETROS is participating in the INOVAR due diligence process but may be slower in committing. SEBRAE has recently invested in the Rio Bravo fund for the North East of Brazil. (See section C. Fund Manager, n. 3.12).

3.13. As shown in the chart below, Rio Bravo has indications of interest of approximately USD 9 mm in capital, USD 4 mm of which is expected to be derived from non-INOVAR institutional investors.

INVESTOR	DESCRIPTION	AMOUNT USD =	GOVERNANCE ROLE/VALUE-ADDED	% TOTAL CAPITAL
MIF	Multilateral	3,000,000	Investment Committee observer	33.3%
FINEP	Agency of Brazilian Government	2,000,000	Investment Committee observer	22.2%
SUBTOTAL INOVAR		**5,000,000**		**55.5%**
FAPES (Fundação de Assistência e Previdência Social do BNDES)	BNDES/BNDESPAR pension fund w/ assets under management of RS 1.6 bn; ranks 12th; considered an industry opinion maker; previous VC/PE investing experience.	1,000,000	May require to have a seat in the Investment Committee	11.1%
PETROS	Petrobrás pension fund w/ assets under management R$ 8.16 bn (2nd largest in Brazil); holds direct strategic stakes in several Brazilian companies having active role on the Board.	1,600,000	Investment Committee observer	17.8%
FUNCEF	A closed entity and private pension fund sponsored by the Federal Savings Bank (Caixa Economica Federal) with assets under management of R$ 8.7 bn.	400,000		4.4%
ELETROS	Pension Fund of some utilities companies (Eletrobras, Cepel, ONS and Eletros) with assets under management of R$ 1 bn.	400,000		4.4%
SUBTOTAL INSTITUTIONAL INVESTORS		**3,400,000**		**37.8%**
Rio Bravo and sponsor	Fund Manager. Includes Swiss Re's investment.	600,000	Manager of Rio Bravo Investech II	6.7%
SUBTOTAL PRIVATE SECTOR INCLUDING FUND MANAGER		**4,000,000**		**44.4%**
TOTAL CAPITAL		**9,000,000**		**100.0%**

3.14. In addition, Rio Bravo is actively marketing the Fund to other group of investors that may represent the capital needed to reach their maximum goal.

C. Fund Manager

3.15. The fund will be managed by Rio Bravo Investimentos S.A. (former Rio Bravo Asset Management S.A.), headquartered in Sao Paulo. The company was formed in 1997, but commercial operations began effectively in 2000. Rio Bravo is an independent Brazilian firm dedicated in providing financial services in the areas of venture capital and private equity, asset management and corporate finance. Activities related to asset management are carried out by Fiducia Asset Management S.A., and activities related to real estate assets are conducted by Mercurio DTVM, both subsidiaries of Rio Bravo Investimentos S.A. Corporate finance is conducted by Rio Bravo Consultoria Financiera LTDA. Rio Bravo Investimentos manages R$ 1,040 mm (USD 416 mm) through all its different activities.

3.16. Rio Bravo formed a joint venture for its VC/PE activities with Securitas Capital, LLC, a global private equity investment firm sponsored by Swiss Reinsurance Company, the second largest reinsurance company with total assets under management of USD 40 bn. Securitas manages two VC/PE funds with total commitments of USD 600 mm. Among the nascent venture capital industry in Latin America, Rio Bravo seems to have the potential to become, in time, a management company comparable to the world's leading venture capitalists. The Rio Bravo team has already managed VC/PE Latin American funds through its funds Investech I (a R$ 4 mm "demonstration" fund), Rio Bravo Investment Partnership I, LP (a PE off- shore fund that counts already with USD 25 mm from foreign investors), and Rio Bravo Nordeste I Fund (Commitments of R$ 20 mm have already been approved by the investors and the fund is now in the process of obtaining CVM approval).

3.17. The project team and the INOVAR partners have analyzed the qualifications, experience and reputations of the Rio Bravo Principals and believe that they will provide strong value-added to the Fund's investees (see chart below for assessment of strengths and weaknesses). The key executives have been working together since 1997 and represent a strong and well-balanced mix of complementary skills corporate management, investment banking and strategic consulting, and in managing funds.

3.18. The key executives in the team have relevant experience, as indicated below:

- *Paulo Bilyk*, Senior Executive Director, is a founding member of Rio Bravo and responsible for the PE area. He has previously worked at Banco Pactual, being a member of the bank's Executive Committee and doing M&A, corporate finance and financial restructuring, and being in charge of some of the most important and complex transactions in Brazil during the last ten years. Before Pactual, Mr. Bilyk worked at Itautec, reaching technological agreements with multinationals;
- *Antonio Athayde*, Senior Executive Director, is responsible for the venture capital area. Prior to working at Rio Bravo, Mr. Athayde worked as an strategic planning consultant for some of the most important media companies in Brazil, including Grupo Abril and Rede de Televisao Bandeirantes, and previously he worked as Director of Rede Globo for twenty years;
- *Alexandre Rhinow*, Executive Director, acts as Director for the PE and venture capital areas. Prior to joining Rio Bravo, Mr. Rhinow worked on several M&A, corporate finance and restructuring transactions at local and foreign investment banks, as Senior Associate at Morgan Stanley Dean Witter (1999-2000) and Banco Pactual (1993-99);
- *Luiz Eugenio Figueredo*, Executive Director, has been working since Rio Bravo's beginnings as its Director for the PE and venture capital areas. His experience is in M&A, corporate finance, and investment analyses; having previously worked at Banco Pactual (1997-2000), Unibanco (1995-97), and Price Waterhouse (1993-95);
- *Luiz Carlos Rudge*, Senior consultant and advisor, is responsible for the commercial area, having a relevant role in the prospecting of projects and fundraising for the different areas of Rio Bravo. Prior to joining the company in March 2001, Mr. Rudge acted as Globopar Business Director in charge of

real state investments, and was Senior Partner and Vice President of Banco Primus until 1994; and

- *Dr. Humphrey Rang*, Biotechnology Advisor, is responsible for the technical analysis of the Biotech projects. He retired from Novartis in 1999, to focus on research, writing and consultancy work for the pharmaceutical and biotechnology industries. From 1985 to 1999, Mr. Rang was Director of the Sandoz (later Novartis) Institute for Medical Research, involved in drug discovery research, with overall responsibility for pharmacological research across all research centers. In 1979, he became Professor and Chairman of Pharmacology at University College London.

3.19. Paulo Bilyk, Alexandre Rhinow, and Luiz Eugenio Figuereido will be mainly involved in Investech II's management. Rio Bravo Investech II will be supported by Rio Bravo Investimentos S.A. as its general partner and management company; Rio Bravo Investimentos Ltda. as the consulting vehicle for the fund; and Prof. Humphrey Rang as the bio-technology consultant for the fund.

3.20. The project team views positively the transparency of Rio Bravo's back-office administration, which enhances the firm's independent reputation and inspires investor confidence. Portfolio compliance and reporting, custody and accounting functions will be outsourced to well-respected institutions such as Bradesco and Price Waterhouse Coopers. In addition to having an in-house lawyer, they have proposed Machado, Meyer & Sendacz as the external legal counsel for the Fund.

Strengths	Weaknesses
Good information and monitoring system of investees, available to management company and investors via online	Fund's strategy may be higher risk (bio-tech deals)
Value-added governance of investees	
Transparent decision-making process	
Good network for origination and development of business	
Team has VC/PE experience and has already managed a domestic fund, Investech I	
Good analytical and sectorial skills	
Long-term investment horizon	
Focused investment strategy	

D. Fund Legal and Decision-Making Structure

3.21. <u>*Legal Structure*</u>*:* The Fund will be set up in Brazil as a *FMIEE* regulated by the CVM n. 209 "*Regulamento*" that abides by the standard CVM regulatory format. The Fund will have a term of eight years, with one possible extension for two more years, subject to approval by a supermajority of the shareholders. The standard Term Sheet, Shareholders Agreement, Management Contract, and other legal documents usually drafted for the constitution of a Fund are not written in the case of Brazilian investment funds, since most of the terms for these funds are standardized in the *Regulamento* and the *Contrato de Investimento*.

3.22. *Investment Committee:* It will evaluate the investments and decide whether to approve or reject them, based on the Fund's investment policy and the merits of the proposal. The investment committee will also monitor the performance of the portfolio companies, as well as the right timing to exit them. The committee will be composed of up to seven members: two from Rio Bravo, a minimum of two members from the investors' group, and a minimum of two other members. The investment committee composition will be ratified by the General Assembly. FINEP and the MIF will participate in an observer capacity, reserving their right to become active members in the future. They will have full access to all the investment committee's information provided to the other members, and will participate in the meetings either in person or via videoconference. The independent members will be chosen by Rio Bravo and the INOVAR partners, among several candidates.

3.23. *Shareholders Assembly:* It is the highest deliberative body; it selects the members of the Investment Committee and oversees the performance of the Fund Manager. The Shareholders Assembly will approve the Fund's general strategy and will be composed of the shareholders' representatives, whose voting power will be proportional to their share of the capital. The quorum necessary for decisions will be a simple majority of the shares present at the meeting, with each share representing one vote. Specifically, a quorum of two thirds of the shares issued will be required to decide: (i) changes to the Fund's rules; (ii) replacement of the Fund Manager, (iii) transformation, merger, liquidation of the Fund not provided for in the *Regulamento*; (iv) changes in the remuneration of the Fund Manager; and (v) issuance and distribution of shares.

E. Investment Policy

3.24. *Size and Type of Enterprises*: CVM n.209 has been recently modified by CVM n. 363, altering the definition of a small emerging enterprise as one with net annual sales (year prior to the point at which the investment is made) of less than R$ 100 mm (USD 44.4 mm), as opposed to what it was before, up to R$ 60 mm (USD 26.6 mm). The project team has reviewed the indicative pipeline and has confirmed that most of the potential investees cited are within the MIF's size limit. On an exception basis, the fund manager may present to the investment committee one or two investment opportunities in companies slightly outside the MIF's size.

3.25. *Diversification*: In keeping with the objective of the TIF to invest in technology-related funds in Brazil, Rio Bravo Investech II will focus broadly on that sector; although the Fund is likely to be diversified in terms of sub-sectors. Therefore, the Fund will not be diversified in terms of industry or country; however, the concentration limit for investment in any single company will be 15% of total committed capital of the Fund.

3.26. *Controlling Stakes*: The Fund Manager will generally take influential minority stakes in investee companies. In most cases, the fund will take stakes in the investee companies ranging from 15 to 35%.

3.27. *Supervision*: The Fund Manager will take a seat on the Board of Directors of any of the investee companies and will be careful to monitor the financial performance of the business, and its compliance with environmental, labor and safety standards. The Fund Manager will also actively supervise its portfolio and will help further the goals of

growing the businesses by providing advisory support in the various areas of technology, markets, financial management, marketing, etc.

3.28. *Exit Strategy:* A clear exit strategy will be identified prior to investment. This will be included as a clause in the *Regulamento*. The exits will most likely be through sale to third parties, be it strategic investors through the stock market, or managers of the businesses. Rio Bravo will try to obtain specific rights in the structuring of the transaction to guarantee the exit of the investment after a determined amount of time and to protect possible negative returns. In most of the cases, Rio Bravo will require the invested companies to comply with all requirements to be listed in the BOVESPA’s Novo Mercado to facilitate the possibilities of exiting through the stock market. Rio Bravo also believes that it will be able to maximize the divestments of the portfolio companies due to its Principals’ network of contacts and the presence in the international markets through Securitas Capital.

3.29. *Valuation of the Portfolio:* The valuation of the portfolio by the Fund Manager will be held at cost.

3.30. *Social and Environmental Impact*: The Fund Manager will follow operational criteria that are in agreement with the IDB/MIF’s environmental review guidelines, and with Brazilian environmental and labor laws and regulations. Given the technological nature of the sectors in which the Fund will be investing, the project team does not foresee significant environmental issues. It should be noted that the Committee on Environment and Social Impact approved this project with no restrictions at its May 17th, 2002 meeting.

3.31. *Evaluation*: The Fund will be submitted to an independent bi-annual evaluation to be financed by MIF. The MIF is allocating up to USD 60 thousand in resources from the grant facility to cover the costs of these evaluations. The Fund will receive the grant money to pay for these services, but MIF will select and contract the firm or individual to perform the evaluations, using the IDB/MIF 's own procedure policies. The evaluations will consider the financial performance of the Fund, the types of deals in the portfolio, the overall operational functioning of the Manager, as well as the social and environmental impact of the Fund's investments.

F. Fee Structure and Operating Expenses

3.32. The management fee to be paid to the Fund Manager will be 2% per annum based on committed capital, during the investment period, and afterwards, same 2% but based on invested capital (net assets of the fund). If the fund stays at the minimum size (R$ 10 mm), the management company will have an estimated operational deficit during the fund’s investment period of approx. USD 60,000 per annum. This deficit will be absorbed by the operational profits obtained by Rio Bravo in its other VC/PE activities. The partners are confident that the performance fee will compensate for any deficit incurred during the life of the fund.

3.33. The project team is comfortable that Rio Bravo’s long-term interests remain aligned with those of the investors, since the management company is willing to invest in the fund,

and the Manager’s 20% carried interest will only be earned through successful and profitable portfolio management over the life of the Fund.

3.34. The carried interest will be 20% of the Fund’s capital gain, being capital gain the distributed amount over preferred return exceeding inflation index (IGPM) plus 8% per annum.

G. Projected Return and Developmental Impact

3.35. The distribution cascade for the return of capital and capital gains to be realized by the Fund is as follows:

- 100% of capital to the investors
- Preferred return of IGP-M (Fundacão Getulio Vargas inflation adjusted index) + 8% p.a. to the investors
- 80% of capital gains to the investors and 20% of capital gains to the Fund Manager

3.36. Projected Return: The Fund could be expected to provide a gross return in R$ of between 23% and 38% p.a. This return is calculated in a fund financial model (see Annex III) which assumes returns of 70% for 20% of the portfolio, 25% for 50% of the portfolio, 0% (just return on initial investment) on 20% of the portfolio, and losses on 10% of the portfolio, plus a 10% reserve. The project team has analyzed the Fund Manager's return projections and considers them reasonable.

3.37. Developmental Impact: The establishment of this Fund is expected to further four key MIF objectives:

(i) To consolidate the structure created by the INOVAR Program, designed to stimulate the establishment of new venture capital funds with a focus on emerging and start-up technology based-companies;
(ii) To play a catalytic role in the creation of a critical mass of world class local fund managers under the INOVAR partnership;
(iii) To further the development of the venture capital industry in Brazil, as well as the dialogue among all actors in this industry to improve the regulatory environment; and
(iv) To fund a vehicle, which will provide equity capital, financial and technical advisory, and value-added governance to approximately 12-15 Brazilian SEs that have sound business plans and strong growth prospects.

IV. TERMS OF THE MIF INVESTMENT

4.01 *MIF Investment:* Up to USD 3 mm (R$ 7.5 mm); disbursement of the MIF funding and that of the other investors will be contingent upon the establishment of the Fund. The MIF investment will be conditioned to matching private sector investment.

4.02 *Minimum Size of the Fund*: currently estimated at R$ 10 mm (approx. USD 4 mm);

4.03 *Investment Period*: Three years.

4.04 *Fund Investment Size*: Initial investments in the range of R$ 500,000 to R$ 2.5 mm (USD 200,000 up to USD 1 mm). In most of the cases, the fund will take stakes in the investee companies ranging from 15-35%.

4.05 *Maximum Life of the Fund*: Eight years with one possible two-year extension, to be determined by the General Assembly with a supermajority vote.

4.06 *Termination Clause*: The investors, by a supermajority representing two thirds of total commitments, may vote to terminate the Fund. Upon the effective date of such termination, the Fund Manager shall either cease to manage the Fund or shall wind up its activities.

4.07 *Reporting to Investors*: The Fund Manager will provide quarterly unaudited financial statements, annual audited financial statements, valuation reports, and any other report or information that investors may request, without placing an undue burden on the Fund's operations.

4.08 *Key Person Provisions and Dedication of Personnel*: The *Regulamento* will specify that the Fund Manager may not begin fundraising for a similar new fund until at least 80% of Rio Bravo Investech II Fund's resources are invested. The team has committed their time as follows for the life of the Fund and will be subject to Key-Person Provisions.

Key Executives Personal Time Allocation Over Fund Life (%)				
Name	**Fundraising**	**Investment**	**Monitoring**	**Divestment**
Paulo Bilyk	50%	40%	50%	30%
Alexandre Rhinow	30%	55%	40%	30%
Luiz Eugenio Figuereido	10%	50%	40%	30%
Luis Carlos Rudge	60%	15%-	-	15%

V. RISKS AND ISSUES

5.01 Risk: Rio Bravo is a rather new VC fund manager, with limited track record, having previously managed PE funds, and a very small fund started in 2001 with R$ 4 mm (USD 1.7 mm) and which is totally invested as of today. Consideration: Rio Bravo Investech II was unanimously chosen by the INOVAR's partners at the second Call for Proposals. The project team and the INOVAR partners are favorably impressed with the qualifications, experience and reputation of the Rio Bravo Principals and believe that they will provide strong value-added to the Fund's investees. The Principals have relevant experience as: (i) advisor director of a US based USD 500 mm private equity fund; (ii) board member of several Brazilian companies; and (iii) member of the board of São Paulo Stock Exchange (BOVESPA) representing institutional investors of the private sector. The key executives have been together since 1997 and represent a very strong and well-balanced mix of complementary skills in corporate management, investment banking and strategic consulting, and in managing funds. In addition, Rio Bravo VC/PE division is a joint-venture between Rio Bravo Investimentos S.A. and Securitas Capital LLC, a US private equity firm sponsored by Swiss Re with USD 600 mm in commitments from a PE fund (USD 500 mm) and a VC fund (USD 100 mm). Since Rio

Bravo's funds have only recently begun to be invested, neither the PE fund nor the VC fund has sold any position in an investee company.

5.02 Issue: Rio Bravo Investech II may be unable to raise sufficient private sector capital to establish the Fund. There will be contractual clauses which will prevent the fund from starting operations without the minimum amount of private sector investment or the minimum size needed for the fund to cover all operational costs.

5.03 Risk: The investment strategy of the Fund is focused on the technology sector, implying a high underlying business risk. Consideration: The project team is comfortable that Rio Bravo has the background and skills, both internally and externally via its consultants, to manage this risk prudently. Nevertheless, the sector is extremely volatile.

5.04 Risk: Currency depreciation of the Brazilian real could result in foreign exchange losses**.** Consideration: Long-term hedging of currency risk is not available. Rio Bravo expects to invest in high-growth companies that are capable of generating enough capital appreciation to compensate investors for possible currency depreciation.

5.05 Risk: Exiting the Fund's investments may be troublesome in light of the illiquid and early stage nature of the portfolio and macroeconomic factors. Consideration: The Fund Manager's contact network and reputation will be key to exit. The exits will most likely be through sale to third parties, be it strategic investors or financial investors through the stock market, or managers of the businesses. In most of the cases, Rio Bravo will require the invested companies to comply with all requirements to be listed in the BOVESPA's Novo Mercado to facilitate the possibilities of exiting through the stock market.

5.06 Risk: In light of the global downturn in the technology sector and its effects on the international VC environment, as well as the capital flight from emerging markets in general, subsequent rounds of financing for the growth of Rio Bravo Investech II's investees may not be available when necessary. Mitigant: Shortage of investment capital is unfortunately the norm in most markets in which MIF invests, and it is impossible to mitigate this risk entirely. Rio Bravo will keep an additional 10% reserve for refinancing rounds. While the current negative environment is projected to continue through most of Rio Bravo Investech II's investment period, investment trends could be expected to improve thereafter, if historical cycles are any indication. In addition, Rio Bravo intends to co-invest in some deals with other VC funds in order to reduce the refinancing risk and the exposure to a single investment.