

**CAPITAL INVESTMENT IN THE
VENTURE CAPITAL FUND FOR AGRIBUSINESS (AGROSEED)**

(TC-98-03-47-1-ME)

EXECUTIVE SUMMARY

EXECUTING AGENCY: Fondo Agroseed, Mexican SINCA established under Mexican laws

SPONSOR: Operadora Agros is a Mexican company that has been engaged for five years in venture capital investment in the agribusiness sector, and is a leading player in capital management in that sector.

FINANCING:	<u>Investors</u>	<u>in US\$ thousands</u>
	MIF:	US\$3,000
	NAFIN:	US\$1,500
	AGROS:	US\$1,500
	Total:	US\$6,000

SOCIAL AND ENVIRONMENTAL IMPACT: The Fund administrator will adhere to operating criteria that include environmental and social standards approved by IDB. As a prior condition to the disbursement of MIF's contribution, the administrator will be required to prepare an environmental management plan containing criteria for environmental and social eligibility. The development of this environmental management plan will draw on the Bank's experience in establishing the Competitive Food and Agriculture Technological Development Fund in Mexico (ME-0192). This follow-up and environmental management plan will include activities for environmental management and increasing people's awareness as part of the technical assistance and activities to be offered by the administrator to the companies that are part of the portfolio. In essence, the structure of the management plan will consist of establishing environmental eligibility criteria, forming an environmental review advisory committee, and providing the plan for follow-up and technical assistance to the companies on environmental matters.

DESCRIPTION OF THE PROJECT: The project consists of establishing a venture capital fund for the formation of small agroindustrial companies in Mexico. Approximately 15 investments will be carried out in various segments of agroindustry. The size of the companies will not exceed US\$3,000,000 in sales/assets, with

the average size of portfolio investments being US\$ 350,000.

OBJECTIVES:

The purpose of this operation is to attract private and public investment for using venture capital as an instrument for financing small agroindustrial companies in Mexico.

The general objective is to expand the existing activity of Operadora Agros (the Fund administrator) in the Mexican agroindustrial sector, and develop the use of venture capital for the niche occupied by small agroindustrial companies.

The financial objective of the Fund will be to achieve long term capital appreciation. The Fund's development objective will be the creation of employment, generation of income and contributing to improvement in the living conditions of Mexico's rural population.

**ELIGIBILITY
FOR THE PROJECT:**

Mexico has been declared eligible to receive MIF funding. Agroseed is compatible with MIF's general objectives, as it promotes raising the level of private investment in small companies. In particular, this fund promotes initiatives related to products with a high value-added component aimed at the export market, helping to develop opportunities in which Mexico has comparative advantages.

**RISKS AND ISSUES
TO CONSIDER:**

Exchange risk. Although the Fund will invest in local currency, in companies located and operating in Mexico, there is a low risk linked to the country's macroeconomic stability. In the event of devaluation, the value of the Fund's investments could decrease. However, this risk is mitigated by: (i) the Fund's approach of investing in companies strongly geared toward exports, and (ii) the fact that the Fund will hold the investments in its portfolio for more than four years, making it possible to recover such losses in value caused by devaluation. Because of the high cost that would be involved, the Fund does not seek to guarantee any of its investments in companies by means of a hedge fund, however it will try to protect cash assets with hedge contracts approved by the National Securities Commission (CNV).

Disinvestment. The investments will be made in small, newly-formed companies in the agribusiness sector. This type of investment significantly increases the possibility of a short term exit in the stock market. In some cases, it is anticipated that

the company will be placed on the intermediate stock market, but it is expected that the majority will be private exits to strategic investors or to the company's management group itself. During the trading of each of the investments, put option contracts will be established to minimize the exit risk and assure the expected profitability of the Fund.

Agribusiness Sector. Despite regulation favorable to agribusiness in Mexico, this sector characteristically carries a high risk and could affect the viability and profitability of the Fund. This risk is mitigated by the Fund's policy of diversification within the sector and by the fact that the investments are held in the portfolio for between 4 and 6 years, thus lessening the impact of the cyclic effect and of the sector's volatility on the portfolio's return rate.

Concentration. Given that the Fund will concentrate its investments in a single sector, it will not be able to take advantage of sectoral diversification of its portfolio. In order to mitigate this negative effect, the Fund will seek diversification in the subsectors, thus minimizing any positive correlation between the companies in the portfolio.

Management. Operadora Agros is a small fund management company, whose strengths derive from the experience of its two partners. Accordingly, it relies to some extent on the management quality of the administrator and the active involvement of its two managers. This risk will be minimized by: (i) structuring the management contract in such a way as to ensure that the managers devote a substantial proportion of their time to the project; and (ii) reinforcing the professional team through the recruitment of two senior analysts to strengthen the institutional capacity of the administrator.

Newly-formed company. That the Fund invests in newly formed companies may adversely affect the percentage of failed companies in the portfolio. Offsetting this risk is the administrator's track record over the last five years managing a similar type of fund with a relatively low rate of failed firms (around 10%).