

PRIVATE EQUITY UPDATE

Rising star: The Brazilian private equity after the crisis

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This report presents an overview of private equity investments made in Brazil since the 09/2008 crisis. It was prepared by Ocroma Alternative Investments based on its comprehensive database of private equity deals made in Latin America.

An analysis of the industry's deal activity is very rich because it reveals how the industry is evolving in terms of managers, funds, industry sectors, deal size, etc. Also, the 2008 economic crisis marks a new cycle for the private equity industry, making those transactions a good predictor of the profile of investments to be seen over the next few years.

METHOD

In the course of its fund investment practice, Ocroma keeps track of the deal activity of more than 130 managers with operations in Brazil, as well as relevant investments and exits made in Brazil from foreign managers without offices in the country.

Given the extent of Ocroma's relationships in the local market and the depth of its research effort, the firm believes that its database is fairly representative of the population of deals made in Brazil from 09/2008 to 05/19/2010, especially in the segments of growth capital, buyout, mezzanine, distress and infrastructure.

Given confidentiality agreements signed with managers, Ocroma is unable to publish details of individual deals.

RESULTS

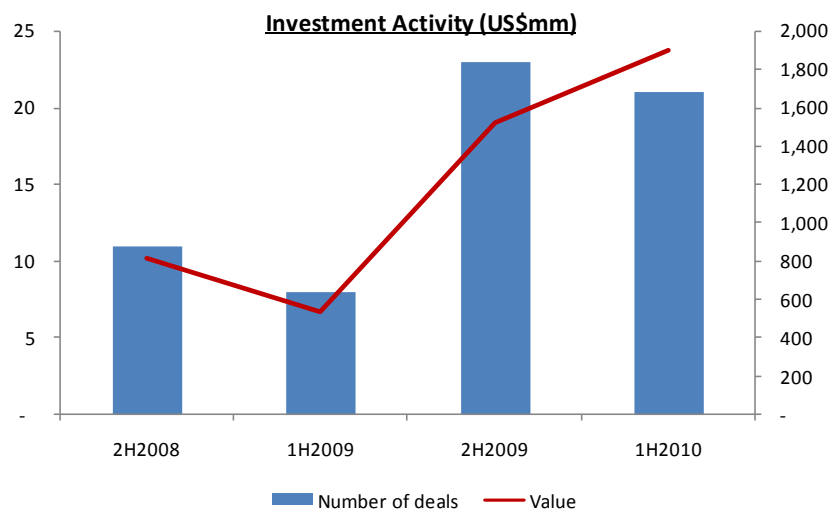
Deal activity

The Brazilian private equity industry has been very active since the crisis, with 34 managers investing around US\$4.8 billion in 63 deals.

The number of managers active in this period represents 22% of the 130 managers with offices in Brazil. Other 5 managers made investment in the country without having a local presence.

As depicted below, the deal activity was quite strong in 2H2008 with US\$813 million invested in 11 deals. A disproportionate 36% of this volume was directed to PIPE transactions, given the attractive valuations of listed assets.

The overall activity suddenly dropped in 1H2009 when the crisis finally began to impact growth rates of Brazilian firms. While the number of deals was quite similar, totaling nine, the volume actually fell to US\$547 million. We highlight that 75% of that was made in the 2nd quarter, when recovery was already taking place and the resilience of the Brazilian economy became more evident.



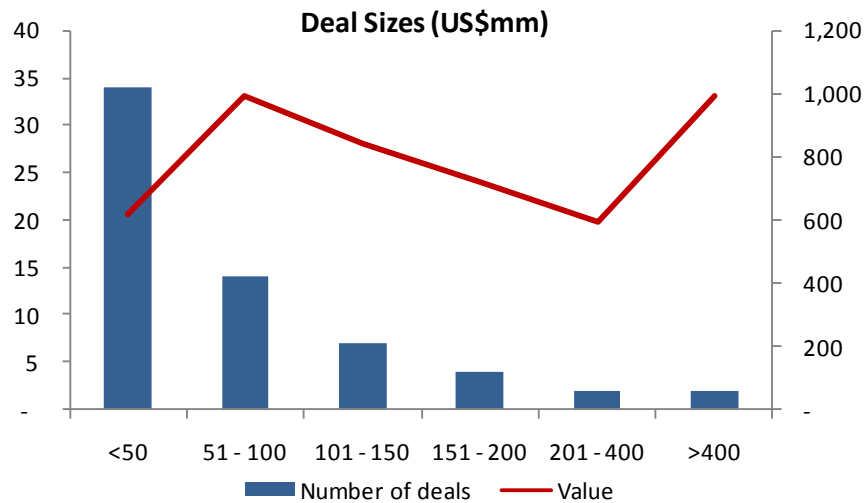
From 2H2009 onward, the activity increased quarter by quarter, reaching US\$3.4 billion since then. We expect 2H2010 to surpass the level of activity of the last four quarters. From 2H2008 to 2H2009, the raising of new funds with foreign investors was practically impossible. As those funds start to close their fundraising process now, more capital will be available and the average size of deals will also increase. The closing of Advent's LAPEF V at US\$1.65 billion in April 2010 is a noteworthy example as it was the biggest fund ever raised for the region.

Deal sizes

The average deal size in Brazil since the crisis was US\$75 million, but the distribution of transactions according to size shows a range going from less than US\$2 million and up to US\$500 million (reportedly made by FirstReserve in Barra Energia, an oil & gas company).

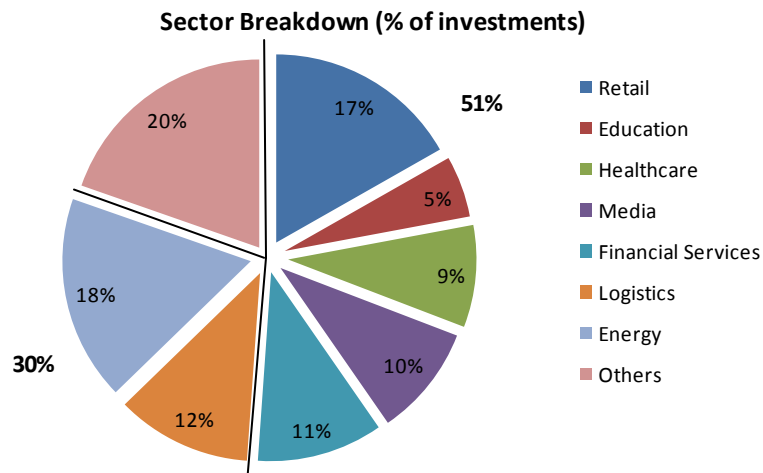
Interestingly, deals in the range of US\$50 million to US\$200 million were the most common, representing more than half the aggregate capital invested and almost 40% the number of deals.

These findings reinforce the fact that Brazilian private equity tends to be more reliant on growth capital and mid-market buyout, the types of deals that require managers to be more active in operational value creation rather than financial engineering or arbitration of multiples.



Industry sectors

Most investments made since the crisis were directed to sectors with a strong link to domestic consumption and the growing and unleveraged Brazilian middle class. Sectors such as retail, education, healthcare, media and financial services represented half of the invested capital. Also, infrastructure investments, mainly energy and logistics amounted to 30% of aggregated capital invested.



While agribusiness and real estate were among the most popular industry sectors just before the crisis, they now account for only 5% of the capital invested.

Funds and managers

Out of the 34 managers active in this period, ten most active represented 75% of the capital invested, while the top five represented 55%. But in terms of numbers, 75% was made by other 29 managers.

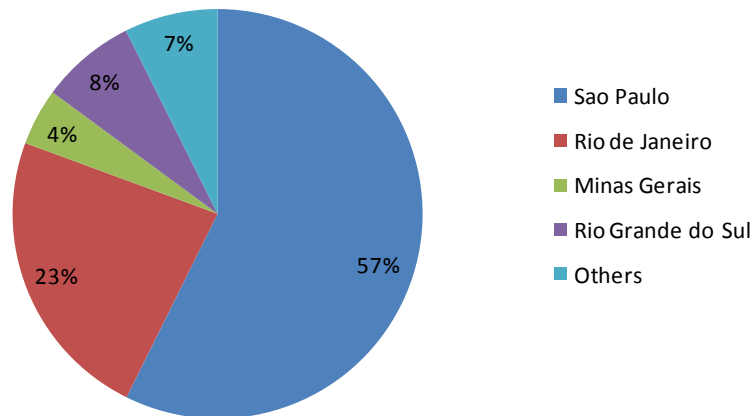
Another tendency usually seen in the late 1990s and early 2000s is the investment made by firms without offices in Brazil. Since the crisis this represented 25% of volume invested.

Most private equity funds established in Brazil cater only to local investors and happen to be established as Brazilian investment vehicles. Consequently, more than half the deals are made by those funds. However, offshore funds usually make the largest and more visible deals and thus add up to 78% of the capital invested.

Regions

The States of Rio de Janeiro and São Paulo still attract most of the capital (80%). Adding the States of Minas Gerais and Rio Grande do Sul to the analysis increases the figure to 93%. Note that those four States account for only 61% of Brazilian GDP.

Regional Breakdown (% of investments)



CONCLUDING REMARKS

Brazil has had a burgeoning private equity market since 2004 in general and the last two years in particular. While the financial crisis has made the raising of funds abroad practically impossible until the end of 2009, the crisis did not slow investment activity nor stopped local fundraising (mainly with Brazilian pension funds).

Actually the crisis increased deal making as funds and managers saw attractive entry points for long-term investments, firstly in PIPE transactions and then in more mainstream strategies of private equity.

Another important aspect to note is the high number of managers actively investing in this period, mostly looking to profit from the growing domestic market and companies located mainly in Southeast Brazil or Rio Grande do Sul.

The back-to-basics nature of the Brazilian private equity industry has attracted a lot of international attention. In Brazil, most deals happen to be in growth and mid-market buyout segments and require a strong emphasis on improving management.

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Alternative Investments

While the level of activity is high and expected to increase as the 35 funds currently in the market reach their closings (sometimes at record levels) and more investments are made from funds coming from abroad (something unseen in the last decade), one can hardly feel the same level of competition for deals usually seen in Asia and specially China.

Another aspect of private equity in Brazil is the concentration of managers and deals in a region that produces only 63% of the GDP. There is clearly room for private equity to foster in other regions. For example, Northeast Brazil is quite unexplored and offers 2-digit growth rates. Also, many funds that operate in Brazil have the flexibility to invest in other Latin American countries. So a portion of funds raised to the region will end up in Mexico, Colombia, Peru, Chile and Argentina.

As the industry continues its rapid growth, one should expect increased competition, but the reputation of some managers as outstanding business accelerators and their capacity to originate deals on more exclusive terms and structure them creatively will become important differentiation factors and will impact fund performance.

Ocroma Alternative Investments

Ocroma Alternative Investments is the first private equity fund-of-funds manager focused in Brazil and Latin America. The firm is formed by professionals with deep private equity investment and research experience, unique local market knowledge, established relationship with private equity groups and expertise in a broad array of alternative assets.

Ocroma invests with best-of-breed country-specific funds and regional funds, with a core position in Brazil. The firm invests US\$5 million to US\$15 million per transaction and seeks to diversify its investments in a broad array of stages, including growth capital and buyout. It can also undertake co-investment opportunities with selected funds.