BRAZILIAN PRIVATE EQUITY AND VENTURE CAPITAL FUNDS PERFORMANCE

Insper-Spectra Analysis November 2013

This report presents an overview of Brazilian Private Equity and Venture Capital (PE and VC) funds performance. It was prepared by the Strategy Center of Insper and Spectra Investments. It is based on the Spectra-Insper database, a comprehensive set of information about private equity organizations, funds, deals and people in Latin America.

Main highlights are:

- Despite the Brazilian PE and VC industry being very young, its players are slowly maturing:
    - 72% of the firms have been operating for 5 years or more;
    - 22% of the organizations have raised 4 or more funds and have been operating for 10 years or more;
    - The average number of funds raised by organizations is 3.

- PE and VC have provided healthy returns in Brazil over the period:
    - The average gross IRR is 22% (median is 23% - 46 funds);
    - PE Funds have returned on average 3.6x its invested capital (median is 2.5x);
    - The average holding period is 6.2 years (median is 4.6 years).
    - The difference in IRR between the top and bottom fund quartiles is around 60%;
    - Funds that operate exclusively in Brazil slightly outperform funds that were diversified regionally (but not significantly);
    - Buyout funds outperformed growth funds (but not significantly);
    - Buyout and Growth funds outperformed VC (but there are very few VC funds in the sample with sufficient exits to access performance).

- Brazilian PE and VC funds raised between 1990 and 2008 outperformed US funds raised in equivalent period:
    - Vintage 1990-1998: US PE and VC funds outperform Brazilian funds;
    - Vintage 1999-2008: Brazilian PE and VC funds outperform US funds (except vintage 2002).

Spectra-Insper database contains information of 172 funds with vintage year from 78 organizations. Figures 1, 2 and 3 draw a picture of the Brazilian PE and VC industry maturity.

22% of the organizations have raised only one fund, but almost half of them are from new organizations and the rest is from organizations that have operated in the industry for more than 5 years. This shows that some organizations have already or will probably disappear (Figures 1 and 3).

78% of the organizations have raised 2 or more funds (Figure 1), and 72% of the firms have been operating 5 or more years in the industry (first fund raised in 2008 or before) (Figure 2). There are 21 firms with 4 or more funds, of which 17 have raised the first fund 10 or more years ago, and 4 between 5 and 10 years (Figure 3).

Figure 1. Number of funds raised by organization

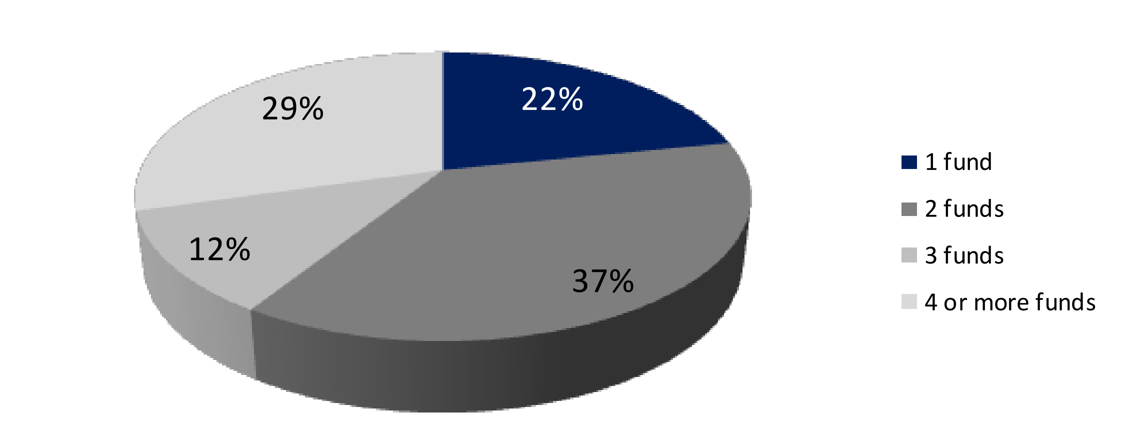


Figure 2. Vintage of first fund raised by the organization

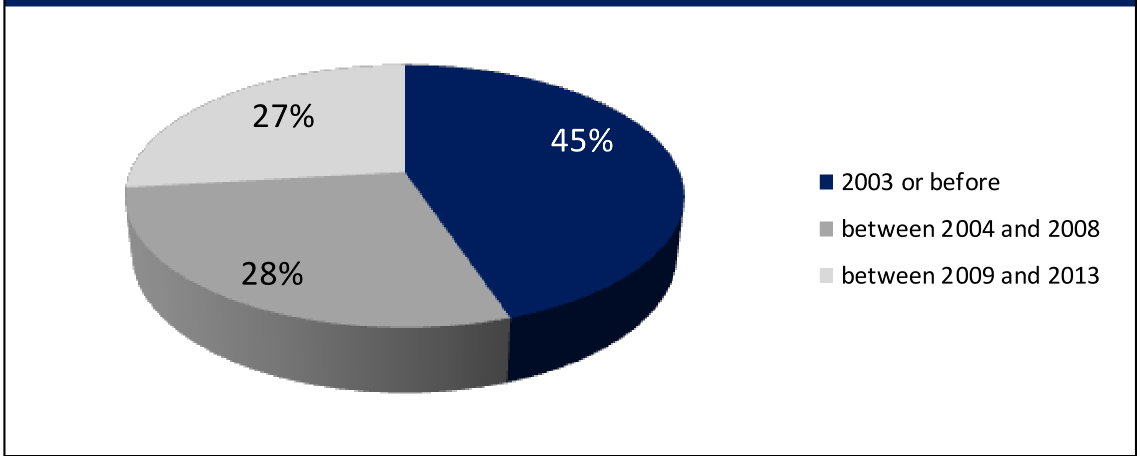
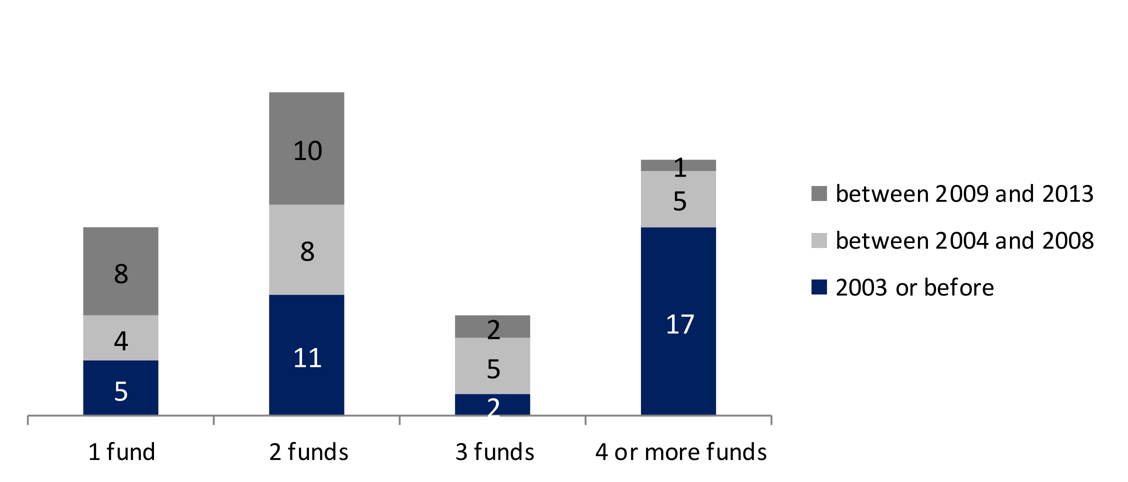


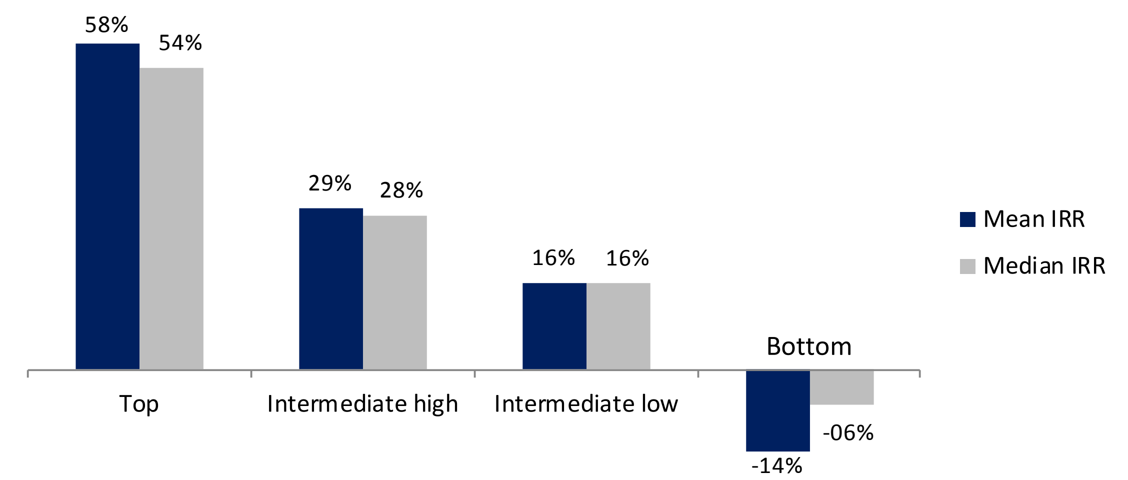
Figure 3. Number of funds raised by organizations versus Vintage of first fund raised by the organization



Return Difference from Top and Bottom Quartiles

The difference between top and bottom quartiles in terms of mean IRR is around 72% and in median IRR is around 60%. Figure 4 illustrates the difference in performance.

Figure 4. Comparison Between Top and Bottom Quartiles

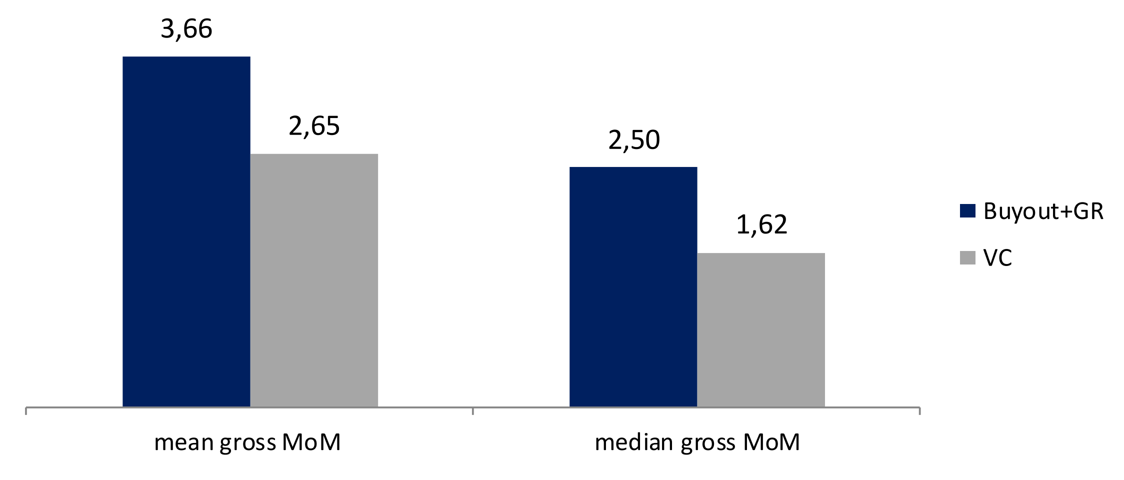


Holding Period

The average gross IRR is 22% and the median gross IRR is 23%. On a Multiple basis, Private Equity Funds have returned on average 3.6x its invested capital, with a median of 2.5x. This translates to a median holding period of 4.6 years, and an average holding period of 6.2 years.

PE multiples are higher than VC multiples for funds raised between 1990 – 2008 (Figure 5).

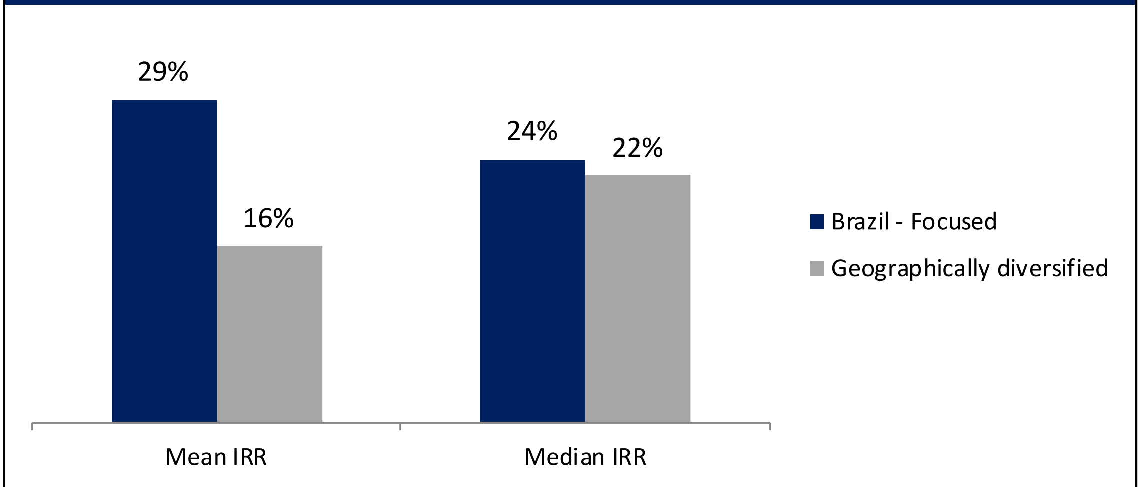
Figure 5. Comparison between PE and VC fundo MoM



Difference in Gross IRR between Geographically Diversified Funds and Funds focused only in Brazil

Funds that operate exclusively in Brazil have a slightly higher IRR (Figure 6), though the difference between groups is not significant. The sample is comprised approximately 50%-50% of each group.

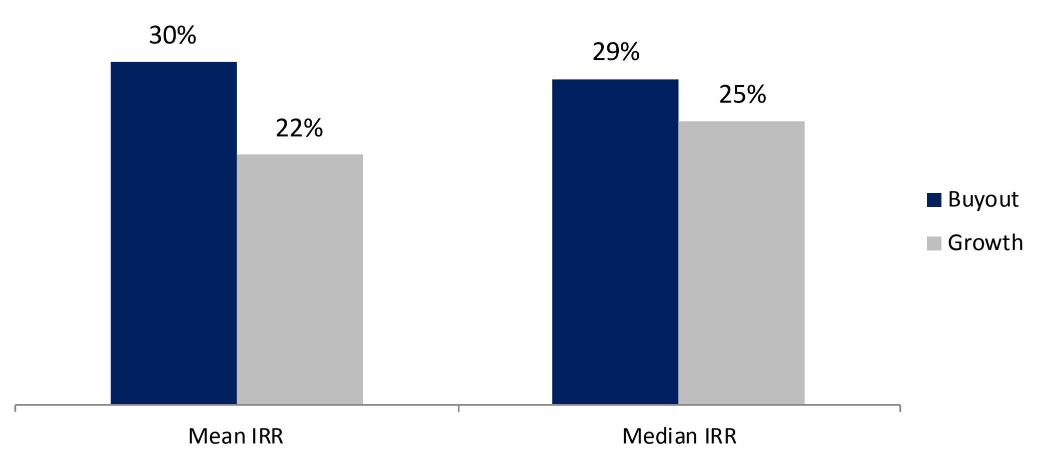
Figure 6. Difference in performance between geographically diversified funds and Brazil-Focused funds



Difference in IRR between Buyout Funds and Growth Funds

Buyout funds outperformed growth funds in the period analyzed (Figure 7), but the difference in performance is not statistically significant.

Figure 7. Difference in performance between buyout and growth PE funds

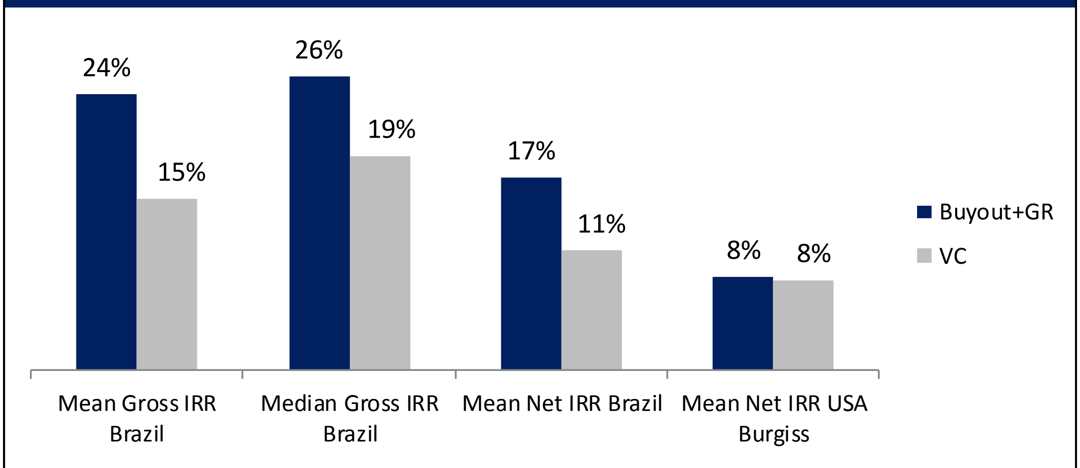


Difference between Brazilian PE (Buyout + Growth) , Brazilian VC, US VC and US PE (Burgiss)

Brazilian PE and VC have outperformed US returns for the period by 8% p.a. on average (Figure 8).

Also, as we only have gross IRR for the Brazilian funds, we multiplied them by a factor of 0.7 in order to estimate net IRR. We considered that carried interests, management fees and other expenses paid by the Limited Partners accounts on average for 30% of gross returns. We compute the mean net IRR of US VC and PE using the Burgiss data disclosed by vintage in Harries at al. (2012) [1].

Figure 8. Comparison between PE and VC funds - IRR - Brazil vs USA



[1] Robert S. Harris, Tim Jenkinson, and Steven N. Kaplan. "Private Equity Performance: What Do We Know?". NBER Working Paper No. 17874 February 2012

It is important to note though that we could analyze only 8 Brazilian VC funds, since most of the VC observations in the sample do not have enough exits to estimate a reasonable performance.

Difference between Brazilian and US funds by vintage

Brazilian funds raised between 1990 and 1998 underperformed US funds for the same period, though Brazilian funds raised between 1999 and 2008 outperformed US funds.

Table 1 contains IRR by vintage for Brazilian and US funds, and Table 2 contains the MoM.

Table 1. Descriptive Statistics of IRR of Brazilian and US PE and VC funds by vintage

	Brazil						USA Burgiss			
	Whole Sample			Sample Without outliers			VC		PE	
Vintage	Gross IRR	Net IRR	# of Funds	Gross IRR	Net IRR	# of Funds	Net IRR	# of Funds	Net IRR	# of Funds
1990	21,7%	15,2%	2	21,7%	15,2%	2	25,3%	13	31,9%	2
1993	26,0%	18,2%	2	26,0%	18,2%	2	47,1%	13	31,0%	11
1994	15,7%	11,0%	2	15,7%	11,0%	2	41,7%	20	29,6%	13
1996	7,8%	5,5%	6	7,8%	5,5%	6	64,5%	20	6,0%	9
1997	9,8%	6,9%	4	9,8%	6,9%	4	65,9%	33	8,6%	30
1998	-6,7%	-4,7%	5	16,6%	11,6%	4	16,3%	46	6,4%	38
1999	20,2%	14,2%	4	20,2%	14,2%	4	-7,4%	65	3,3%	28
2000	23,3%	16,3%	4	23,3%	16,3%	4	-2,7%	80	12,7%	39
2001	60,3%	42,2%	4	60,3%	42,2%	4	-1,7%	48	13,7%	26
2002	13,1%	9,1%	3	13,1%	9,1%	3	-1,1%	18	16,1%	21
2003	47,7%	33,4%	1	47,7%	33,4%	1	-2,1%	25	19,5%	13
2004	20,0%	14,0%	1	20,0%	14,0%	1	-1,5%	32	12,8%	46
2005	77,2%	54,0%	2	43,4%	30,4%	1	2,2%	48	6,8%	57
2006	60,0%	42,0%	1	60,0%	42,0%	1	-1,3%	62	2,6%	67
2007	23,8%	16,7%	2	23,8%	16,7%	2	1,7%	65	3,7%	74
2008	11,9%	8,3%	2	11,9%	8,3%	2	-2,8%	45	3,2%	68

obs. We estimated net IRR by multiplying the gross IRR by 0.7 and we used Burgiss data for the US funds

Table 2. Descriptive Statistics of MoM of Brazilian and US PE and VC funds by vintage

	Brazil				USA Burgiss			
	Whole Sample		Sample Without outliers		VC		PE	
Vintage	Gross MoM	# of Funds	Gross Mom	# of Funds	Net MoM	# of Funds	Net MoM	# of Funds
1990	2.10	2	2.10	2	2.96	13	3.03	2
1993	2.06	2	2.06	2	6.65	13	2.62	11
1994	2.48	2	2.48	2	3.32	20	2.73	13
1996	1.65	4	1.65	4	5.92	20	1.46	9
1997	5.22	3	1.80	2	3.03	33	1.42	30
1998	3.13	3	3.13	3	1.55	46	1.42	38
1999	3.15	4	3.15	4	0.81	65	1.31	28
2000	2.15	4	2.15	4	0.91	80	2.66	39
2001	4.92	4	4.92	4	0.97	48	1.58	26
2002	3.27	3	3.27	3	1.01	18	1.72	21
2003	2.90	1	2.90	1	0.99	25	1.98	13
2004	1.14	1	1.14	1	1.01	32	1.53	46
2005	13.16	2	2.20	1	1.37	48	1.26	57
2006	3.30	1	3.30	1	1.01	62	1.08	67
2007	1.63	3	1.63	3	1.06	65	1.11	74
2008	1.29	2	1.29	2	0.99	45	1.07	68

Figure 9. Comparison between IRR of Brazilian and US funds by Vintage

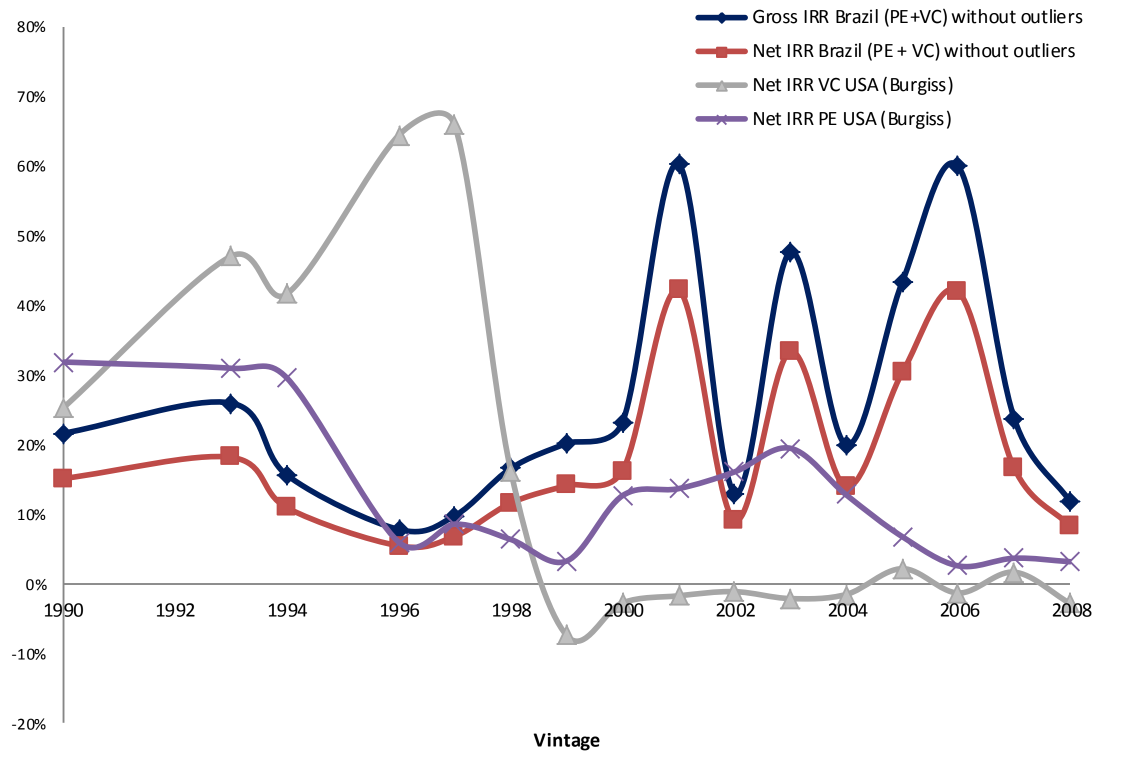
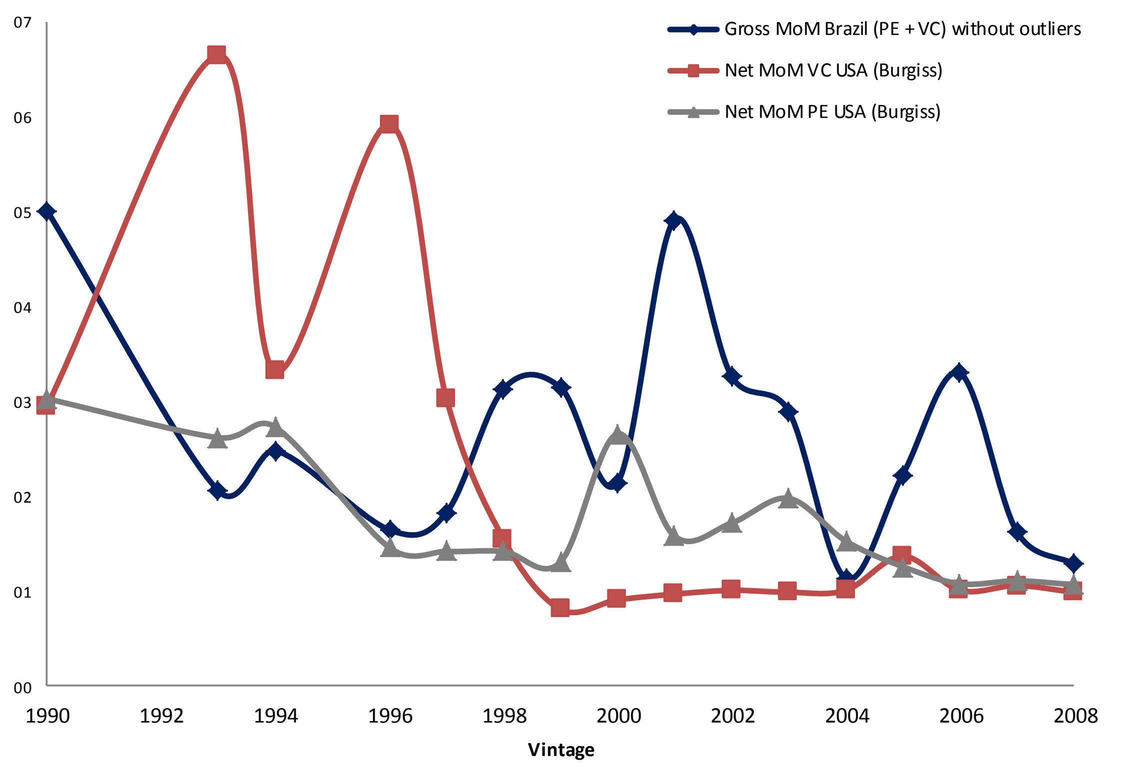


Figure 10. Comparison between MoM of Brazil and US funds by Vintage



CONCLUDING REMARKS

Brazilian PE and VC funds raised between 1990 and 2008 outperform on average US funds, especially if they were raised between 1998 and 2008. There are three main reasons for this phenomenon: (1) the Brazilian economic boom between 2004 and 2012 (2) still limited competition for deals in Brazil and (3) the fact that Brazilian PE and VC managers are becoming more experienced, thus allowing for better performance.

Healthy returns and good prospects have propelled a growing number of PE and VC organizations in Brazil. At the same time, the industry shall pass through a natural selection process driven by the huge difference between top and bottom performers. 11% of the organizations haven't raised a new fund in 5 years and, most probably, will cease to exist soon.

The growing number of PE and VC organizations looking for investment opportunities should lead to a higher number of Brazilian companies improving their corporate governance practices, reducing their labor/legal contingent liabilities and strengthening their professionalization process so that they can become investment targets. More investment targets shall lead to new managers to emerge. A greater number of experienced managers should lead to more LPs looking to invest. It's a virtuous circle that we believe will drive the growth of the industry during the next coming years.

Spectra-Insper Database

Spectra-Insper database contains information about PE and VC organization, funds, deals and people. The information used in this report is based mainly on data from Spectra Investments. This data is collected through PPMs and in interviews with organizations and is updated up to November 2013. Confidential information from Spectra is sanitized before being uploaded into the database.

The partnership between the Strategy Center of Insper and Spectra Investments, has the objective of continually maintaining and upgrading this database.

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