MIT Sloan Management

G-LAB Global Entrepreneurship Lab

Brazil VC Ecosystem Study | February 2013

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Overview

Background: This study was sponsored by Ideiasnet via the Global Entrepreneurship Lab at MIT Sloan

Objective: Analyze Brazil's current venture capital ecosystem and construct forward-looking scenarios to determine how it may evolve in the next 5 - 10 years

Approach:

1) Interview 21 VCs and ecosystem participants active in Brazil
2) Conduct extensive secondary research including industry publications, academic papers, and blogs
3) Develop a proprietary scenario framework
4) Synthesize findings and perspectives into a directional view of how Brazil's VC ecosystem could evolve

Outputs:

1) Scenario analysis of how the Brazilian VC ecosystem could evolve
2) Detailed findings regarding VC activity in Brazil:
   - *Investment landscape*
   - *Business environment*
   - *Investment thesis*
   - *Investment strategies*
   - *Exit opportunities*
   - *LP composition / perspectives*
3) Appendix: Additional detail regarding potential scenarios

Inputs

This study was informed by a combination of primary interviews with representatives of 21 VC firms and ecosystem participants, as well as extensive secondary research

US-based firms

- ACCEL PARTNERS
- BESSEMER VENTURE PARTNERS
- Felicis Ventures
- FLYBRIDGE CAPITAL PARTNERS
- HIGHLAND CAPITAL PARTNERS
- INSIGHT VENTURE PARTNERS
- SEQUOIA CAPITAL
- SPARK CAPITAL
- THRIVE CAPITAL
- VALOR CAPITAL GROUP, LLC

Brazil-based firms

- ARPEX CAPITAL – DREAM, PEOPLE, CULTURE
- astella investimentos
- DGF Investimentos
- ideiasnet
- KaszeK VENTURES
- MONASHEES CAPITAL+
- MOUNTAIN DO BRASIL
- Redpoint e.ventures

Other ecosystem participants

- GUNDERSON DETTMER
- RUMSON
- 21212

Extensive secondary sources including:

- Globalizing venture capital – Global venture capital insights and trends report 2011 – Ernst & Young
- The Global Venture Capital and Private Equity Country Attractiveness Index – 2012 Annual – IESE
- The Private Equity and Venture Capital Industry – Second Brazilian Census
- Global Limited Partners Survey – Investors' Views of Private Equity in Emerging Markets 2012
- LAVCA – Latin American Private Equity & Venture Capital Association
- Private Equity & Venture Capital in Brazil
- Startup Dealbook Brazil

Executive Summary (I of II)

Venture Capital in Brazil: the early days of an emerging ecosystem

The Brazilian venture capital ecosystem is nascent and rapidly evolving. While the Brazilian government and a handful of firms have been making technology investments for decades, the “Silicon Valley model” of private venture, particularly venture focused on Internet-enabled businesses, has only emerged in the past several years with a significant increase in activity in the last 18-24 months.

In 2012 at least 50 firms made approximately 80 investments in start-ups – a sharp increase over previous years – and at least two new Brazil-focused funds representing ~$260M in AUM were formed. Participants include foreign-based GPs selectively making investments from global funds, a handful of American/European GPs that have committed resources on the ground, and a small but growing number of Brazilian funds and super angels. Further demonstrating enthusiasm for the ecosystem is a budding network of accelerators and a marked uptick in angel investing.

The primary source of recent committed capital is foreign LPs, who tend to allow greater GP autonomy in investment decisions than their Brazilian counterparts. The Brazilian government remains an important LP for many domestic funds, especially those focusing on hard-technology innovation. However other Brazilian LPs are slowly warming to venture as awareness increases and returns from fixed income remain compressed.

Confluence of connectivity and consumption: a large addressable market to be claimed

These investors and the founders they are backing are attracted to Brazil by a remarkable confluence of demographic, economic, and secular technology trends forming a highly attractive addressable market for internet-enabled companies. With a consumption-oriented culture, rapidly growing middle class, critical mass of highly engaged digital users, and significant room for broadband and smartphone penetration growth, the vanguard believes the environment is ripe to grow a crop of internet giants. The stimulus and investment related to the 2014 World Cup and 2016 Olympics are not necessarily tied to investment theses, but certainly do not hurt investor awareness or ability to raise funds for Brazil.

More than just e-commerce and clones

The current wave of investment has focused on proven business models applied to the Brazilian context – particularly e-commerce, marketplaces, travel, and digital media. This focus is expected to shift towards unique business models serving Brazil and eventually the globe over time as investors become more comfortable taking business model risk and as the competitive dynamics and accompanying economics of sectors such as e-commerce dilute investor incentives.

Executive Summary (I of II)

The big question mark: exit opportunities

With limited precedence of successful exits and significant hurdles to domestic IPOs, the principle assumption underlying recent investment is the belief in a coming wave of strategic M&A activity, mostly driven by multi-national trade sales, that will establish liquidity. A string of successful exits over the next few years would fuel a virtuous cycle for the ecosystem. Defining companies and entrepreneurs would reinforce the gradual cultural embrace of entrepreneurship by top Brazilian talent, inspiring more founders. Demonstration of returns would drive more capital, both foreign and domestic, to enter the ecosystem.

If this wave of exits does not materialize in the medium-term, the current generation of portfolio companies will not be able to justify their present valuations. The ecosystem would then likely stagnate as foreign VCs redirect their capital until structural changes catalyze renewed investor interest and potentially reward those who are truly committed to the long-term view.

Local frictions: undermining ecosystem stability, enabling competitive advantage for some

In addition to uncertainty around exits, the current cohort of Brazilian tech companies and their investors face significant challenges due to their surrounding institutions and environmental factors. Start-ups in Brazil face a complex and prohibitive tax regime, a restrictive business regulatory system, extreme labor market rigidity, and pervasive bureaucracy.

These types of structural challenges undermine the stability of the ecosystem and according to LP surveys, represent a significant deterrent to new investment in emerging markets. Ironically, it is the ability to navigate and solve for these and other local frictions that give some Brazilian start-ups their competitive advantage over foreign entrants, and that make Brazilian GPs highly sought after as co-investors and river guides by foreign GPs. If these structural constraints, particularly lack of access to deep domestic capital markets, are not addressed, the likelihood of Brazil joining the ranks of global VC hotbeds is low.

Future outlook: is the hype justified?

Looking forward, the majority view, which we share, is that while the market is frothy, there will be a select group of strong businesses emerging from the current ecosystem that scale to capitalize on the secular technology and demographic trends in Brazil. These companies will realize exits, either by multi-national acquisition, domestic trade sales from category consolidation, or potentially international IPO.

When these exits occur, additional foreign venture capital will enter the market, primarily out of global funds. However the current institutional and structural constraints on the ecosystem will remain in place. These constraints, while strengthening the position of domestic GPs who can navigate the local context, will perpetuate the fragility of the venture model in Brazil.

Potential scenarios for the evolution of the Brazilian VC ecosystem

These scenarios can be thought of as directional indicators for the next 5-10 years to inform long-term strategic planning

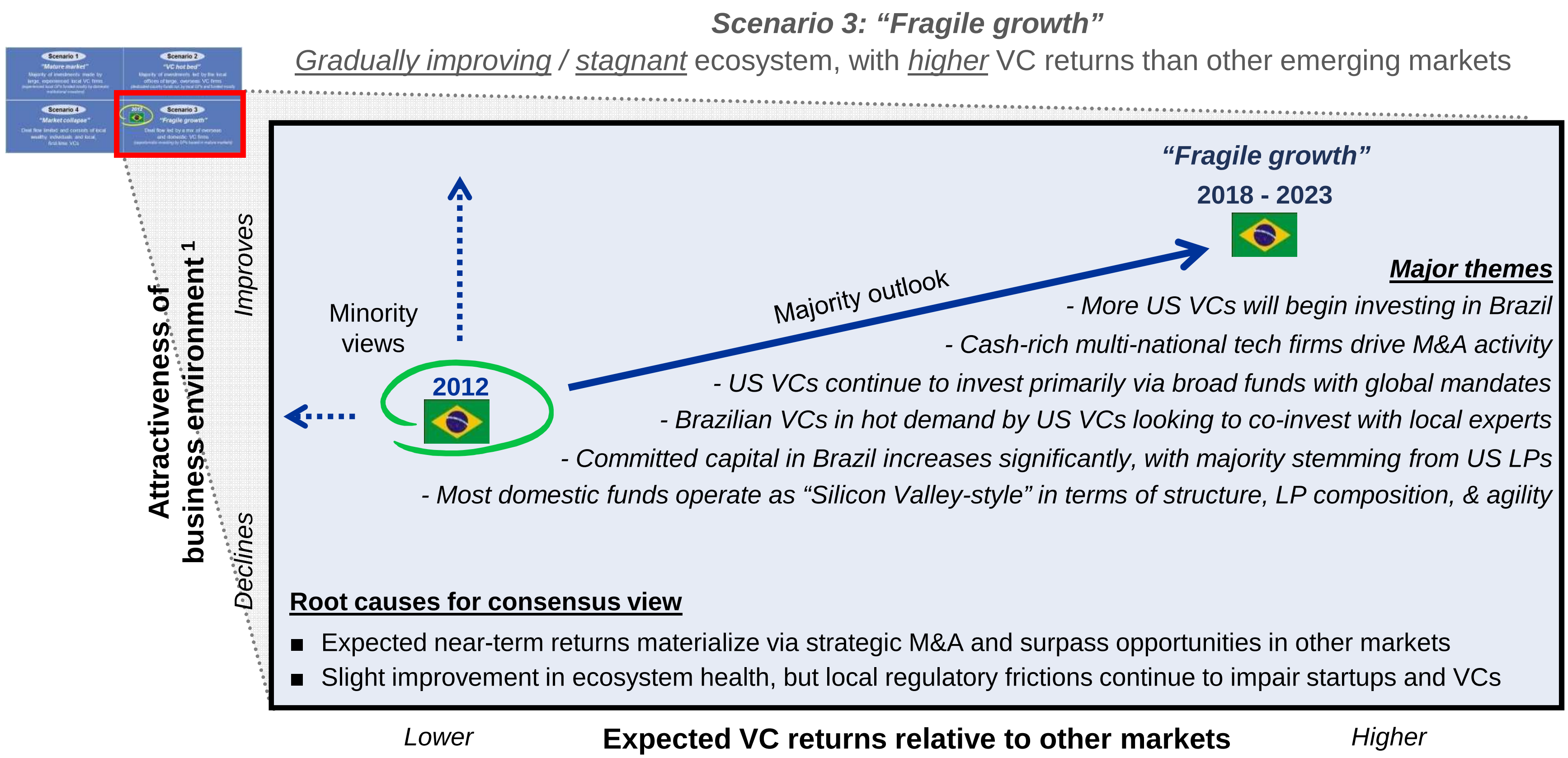
Expected VC returns relative to other markets

Attractiveness of business environment[1]	Lower	Higher
Improves	**Scenario 1** ***"Mature market"*** Majority of investments made by large, experienced local VC firms *(experienced local GPs funded mostly by domestic institutional investors)*	**Scenario 2** ***"VC hot bed"*** Majority of investments led by the local offices of large, overseas VC firms *(dedicated country funds run by local GPs and funded mostly by overseas investors)*
Declines	**Scenario 4** ***"Market collapse"*** Deal flow limited and consists of local wealthy individuals and local, first-time VCs	***2012*** **Scenario 3** ***"Fragile growth"*** Deal flow led by a mix of overseas and domestic VC firms *(opportunistic investing by GPs based in mature markets)*

Note 1: Attractiveness of business environment based on Global VC and PE Country Attractiveness Index, which accounts for economic activity, depth of capital markets, taxation, investor protection / corporate governance, human and social environment, and entrepreneurial culture & deal opportunities.

Perspectives from VCs active in Brazil: Outlook regarding the future of the ecosystem

We expect Brazil's VC ecosystem to grow significantly as returns materialize, but the ecosystem will remain fragile due to continued frictions in the business environment



Note 1: Attractiveness of business environment based on Global VC and PE Country Attractiveness Index, which accounts for economic activity, depth of capital markets, taxation, investor protection / corporate governance, human and social environment, and entrepreneurial culture & deal opportunities.

Potential ways to improve the attractiveness of the business environment in Brazil based on precedents in other markets

Research indicates the following reforms had a significantly positive effect on venture creation in other markets

Policy	Recommended Reforms
Domestic business	■ Decriminalize bankruptcy[1] ■ Allow entrepreneurs to quickly start over[1] ■ Allow entrepreneurs to avoid onerous tax prepayments[1]
International funding	■ Create and liberalize capital markets[1] ■ Lower administrative and legal barriers to venture formation[1] ■ Allow international funds to be invested with full domestic protection[2]
Labor	■ Reduce labor market rigidity[3] ■ Encourage international technical talent to join in ventures[3] ■ Shift unemployment protection from making termination difficult to supporting the unemployed[1]
Intellectual property	■ Strengthen copyright and patent protection[4] ■ Protect against unfair commercial use of proprietary data[4] ■ Develop effective legal structures for contractual enforcement, setup fast-track courts to manage IP and contract enforcement issues[5]

Sources: OECD BETTER POLICIES FOR BETTER LIVES; Massachusetts Institute of Technology; BABSON; HARVARD BUSINESS SCHOOL; Planning Commission Government of India

[1] *"How to Start an Entrepreneurial Revolution" by Daniel Isenberg, Harvard Business School Publishing*
[2] *"Pakistan: A Story of Technology, Entrepreneurs and Global Networks" by Sabir, Adris & Bird, MIT Sloan School of Management*
[3] *"The Supply Side of Innovation: H-1B Visa Reforms and U.S. Ethnic Invention" by William Kerr, Harvard Business School & William Lincoln, University of Michigan*
[4] *"Enhancing Market Openness, Intellectual Property Rights, & Compliance Through Regulatory Reform in Israel" by OECD, 2011*
[5] *"Creating a Vibrant Entrepreneurial Ecosystem in India" by the Committee on Angel Investment & Early Stage VC, Government of India, Planning Commission, June 2012*

Team Background

Sean Bonawitz

MIT Sloan – MBA 2013
US Naval Academy – BS International Relations

Sean is a former member of US Navy SEAL Team 5. As an explosives expert and primary assaulter, he led over 360 combat missions in the Middle East and 5 US Secret Service missions supporting Presidential and Vice Presidential security teams. Sean is dedicated to building a new career in sustainability and recently completed supply chain and sustainability projects at Deloitte Consulting.

Rahul "Hoolie" Tejwani

MIT Sloan – MBA 2013
Pennsylvania State – BS Information Sciences

Hoolie is the former COO of Pencils of Promise, an international education organization that has built over 100 schools in developing countries. Prior to that he was a management consultant at Deloitte focused on technology strategy and M&A. He recently worked on a private equity buyout of a major internet company with Morgan Stanley's technology investment banking group.

Nick Holda

MIT Sloan – MBA 2013
University of Aberdeen – Post-graduate Diploma (Business)
University of Texas at Austin – BBA (Finance)

Nick is a former Vice President at AlixPartners LLP, a global turnaround firm. In this role, he worked with distressed large / mid-cap clients across a number of industries. Nick is passionate about helping companies grow, and recently completed a complex pricing engagement during a summer at the Boston Consulting Group.

R. Blaize Wallace

MIT Sloan - MBA 2013
UCLA – BS Cognitive Science

Blaize is an experienced entrepreneur with expertise in early-stage marketing, business development, customer engagement, and product management. Prior to that, he was a technology consultant at Deloitte focused on software design and development. He most recently worked for a post-Series A startup developing marketing strategy in preparation for a product launch.

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Ideiasnet (IDNT3:BZ) is a Brazilian venture capital firm that invests in fast growing technology companies in the areas of Digital Commerce, Digital Media, SaaS ,Mobile, Health and Education. Ideiasnet focuses on companies between Early Series A and Growth Capital and has a proven track record of identifying, growing and exiting business successfully in the Brazilian market. Its current portfolio includes AUTOMATOS, BOLSA DE MULHER, CIASHOP, IMUSICA, MOIP, OFFICER, PADTEC, PINI, SPRING WIRELESS, TECTOTAL,ZURA! and AMO MUITO.

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G-Lab is the flagship international internship course at MIT Sloan. The course links teams of MIT Sloan MBA students with entrepreneurs in emerging markets from Ghana to India, Uruguay to Vietnam. The students share their knowledge, experience, and research with these business owners, helping them deal with such immediate challenges as internationalization commercialization, financing, and marketing. Meanwhile, the students gain experience in global environments and put their management skills to use. Currently G-Lab focuses on developing markets in Latin America, China, India, & Southeast Asia, and on global health delivery in Africa.

Key Findings

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Note: The following information is based on primary interviews unless otherwise cited

Summary of Key Findings – Investment Landscape

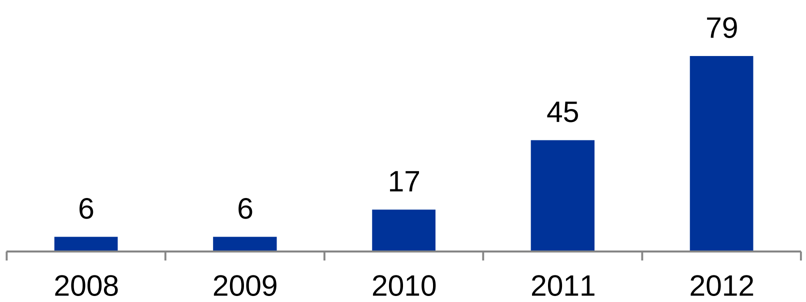
- The **Brazilian venture capital ecosystem is still nascent**; conventional VC has emerged over the past 5 years with accelerated activity in the last 24 months
  - The past two years have seen a significant increase of investor and LP interest in Brazil, with multiple high-profile international firms entering the market and the formation of several dedicated domestic funds
- Most international firms are evaluating the market or testing the water with infrequent opportunistic investments
- In addition to an influx of VC, there has been a **pronounced increase in seed activity** and **accelerator formation**

Capital Allocation Increasing

- There is limited up-to-date data on the amount of committed capital to Brazilian VC, due to many firms investing on global mandates and varying definitions of venture capital vs. private equity; **anecdotally, there are ~ 20 foreign-based firms and ~10 Brazilian firms that are reported to be active** participants in the market
  - In 2012, three new Brazil-focused funds were formed and at least 50 firms made over 80 investments through a variety of syndicated and non-syndicated deals (note that data re: quantity or amount of investments varies depending on the source)

Source: Startup Dealbook Brazil

Number of VC investments based on "Startup Dealbook Brazil"*



**Source: Startup Dealbook Brazil*

Note based on open source deal data; accuracy, especially pre-2011 is unknown

The Existence of a Series A/B Crunch is Debated

- The recent growth of accelerators and seed / early stage investing may be creating a funding gap in which many startups are unable to raise follow-on funds
  - While total VC deal flow increased 13% yr/yr from 2010 to 2011, dollars invested actually decreased by 40%
  - Seed / Early Stage investment has seen more pronounced growth, with deal flow increasing by 140% yr/yr from 2010 to 2011, and dollars invested increasing by 380%

Source: Analysis conducted using data from 2012 LAVCA Industry Data & Analysis

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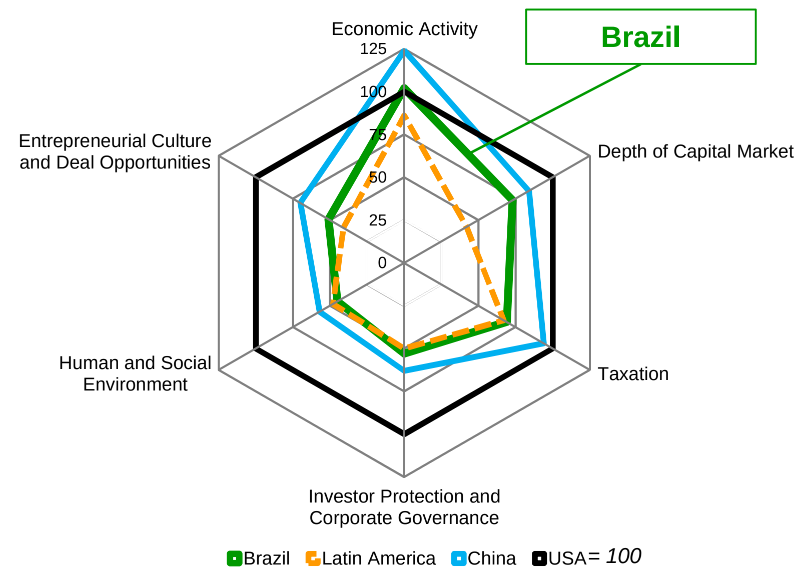
Summary of Key Findings – Attractiveness of Business Environment (I of II)

Attractiveness of business environment in Brazil

- We assessed Brazil's ecosystem using the **Global VCPE Country Attractiveness Index** generated by IESE
- **Brazil ranked 36th in 2012** (out of 161 countries), compared to 44th in 2010 and 51st in 2007
- Brazil's ecosystem has **gradually improved over the past five years, but continues to trail other BRICs** and developed countries

Brazil's business environment profile

(based on 2012 Global VCPE Attractiveness Index)



Source: Global Venture Capital and Private Equity Country Attractiveness Index (2012)

Methodology: Drivers & sub-categories used in the IESE Index

1. **Economic Activity**
   a) Size of the economy (GDP)
   b) Expected real GDP growth
   c) Unemployment
2. **Depth of Capital Market**
   a) Size of stock market
   b) Stock market liquidity
   c) IPOs and public issuing activity
   d) M&A market activity
   e) Debt and credit market
   f) Bank non-performing loans to total gross loans
   g) Financial market sophistication
3. **Taxation**
   a) Entrepreneurial tax incentives & admin. burdens
4. **Investor Protection / Corporate Governance**
   a) Quality of corporate governance
   b) Security of property rights
   c) Quality of legal enforcement
5. **Human and Social Environment**
   a) Education and human capital
   b) Labor market rigidities
   c) Bribing and corruption
6. **Entrepreneurial Culture & Deal Opportunities**
   a) Innovation
   b) Scientific and technical journal articles
   c) Ease of starting and running a business
   d) Simplicity of closing a business
   e) Corporate R&D

Sources: Global Venture Capital and Private Equity Country Attractiveness Index, 2012; interviews conducted by MIT G-Lab team during November 2012 –February 2013

Summary of Key Findings – Attractiveness of Business Environment (II of II)

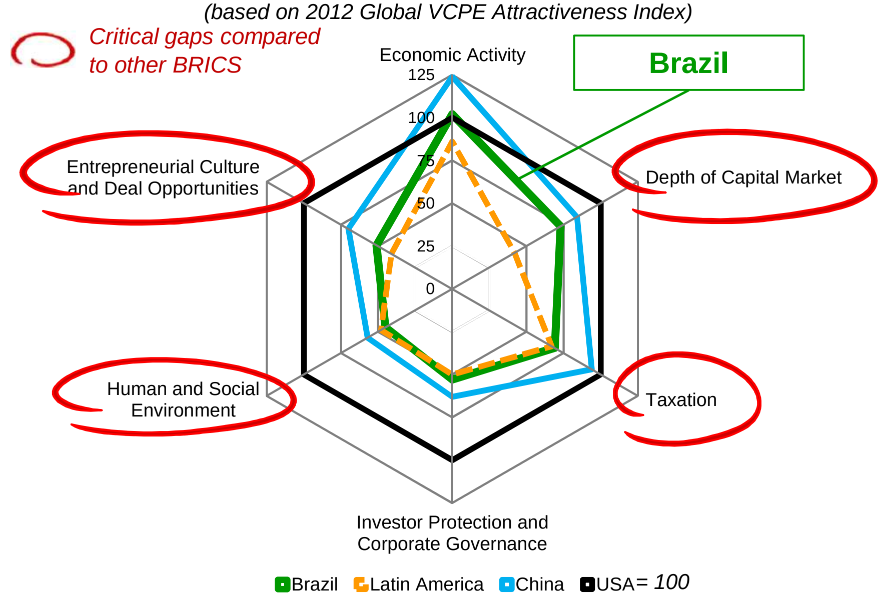
Major challenges must be overcome

(based on 2012 Global VCPE Attractiveness Index and interviews with VCs / ecosystem players)

- **Complex, multi-layered tax regime** burdens SMEs and investors with major compliance costs and high tax rates
- **Convoluted business regulatory system** makes it extremely time consuming and expensive to start (and close) businesses
- **Restrictive labor laws** make it challenging to scale businesses up and down quickly, and create long-term liabilities
- Lagging educational system and **cultural aversion to entrepreneurship** driving shortage of human capital in early stage tech
  - "Brazil currently grapples with an 11% illiteracy rate and low levels of post-secondary education"
  - Mixed opinions regarding shortage of engineering talent needed to grow early stage technology companies
  - Consistent view that technical talent continues to gravitate towards large oil, banking, and consulting firms

Brazil's business environment profile

(based on 2012 Global VCPE Attractiveness Index)



Source: Global Venture Capital and Private Equity Country Attractiveness Index (2012)

Sources: Global Venture Capital and Private Equity Country Attractiveness Index, 2012; interviews conducted by MIT G-Lab team during November 2012 –February 2013

Summary of Key Findings – Investment Thesis

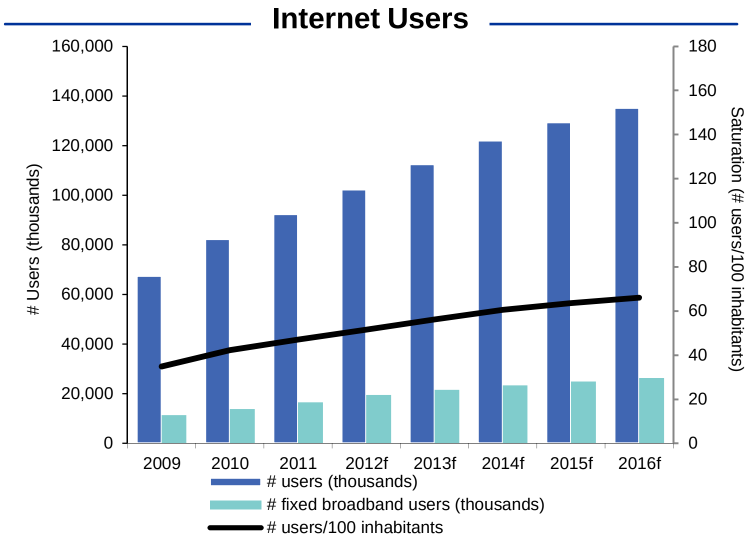
- The most common thesis driving interest in Brazil based on **secular technology and socioeconomic trends** (regardless of short-term macroeconomic factors)

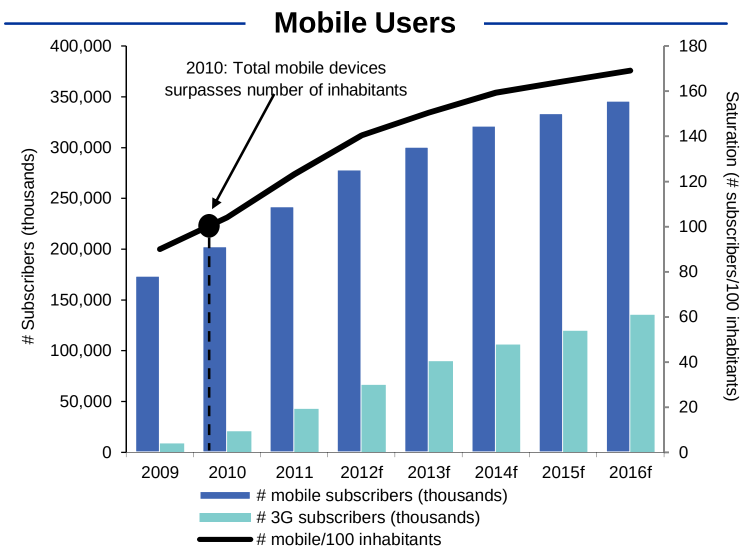
  1) **Growing middle class** with increased access to credit and high consumption rates
     - Over the past 20 years 28M Brazilians have been lifted out of extreme poverty; 36M entered the middle class[1]
     - Brazil's middle class is the largest of the 'official' classes, comprising more than 50% of the population[2]
     - In 2011 alone 2.7M Brazilians moved up into the middle or 'C' class[2]

  2) **Internet / broadband / mobile Penetration** has substantial base and significant room for growth
     - Number of broadband users to increase 32% by 2016[3]
     - Number of 3G mobile to increase 103% by 2016[3]

  3) **High digital engagement levels**
     - 2nd highest number of Facebook[4] and Twitter[6] users globally
     - 2nd highest globally in avg. social networking hours / visitor[5]

  4) **E-commerce** activity expected to continue to grow due to inefficiencies in brick-and-mortar retail, ubiquity of payments infrastructure, and high level of consumer comfort with online transactions





Sources: 1) http://riotimesonline.com/brazil-news/rio-business/brazil-strives-for-economic-equality/
2) http://riotimesonline.com/brazil-news/rio-daily/middle-class-growth-in-brazil/#
3)Chart data from Business Monitor International Brazil Forecasts Q4 2012
4) http://www.quintly.com/blog/2013/01/facebook-country-stats-january-2013-brazil-and-india-are-adding-millions/
5) http://thenextweb.com/la/2012/12/24/comscore-latin-americans-spend-56-more-time-on-social-networks-linkedin-passes-twitter/
6) http://www.mediabistro.com/alltwitter/twitter-stats_b32050

Detailed Findings – Investment Strategies (I of II)

Sectors

- The majority of current private venture investment is on **consumer facing sectors** given secular demographic and technology adoption trends in Brazil
- Some VCs are evaluating **B2B / Enterprise companies,** but the general perception is that this sector is underdeveloped presently due to tech-talent learning curve
- Private capital is generally avoiding technology innovation investment presently, with mainly government funding supporting hard tech innovation centered on Brazil's industrial strengths (e.g. agra-business / biotech, oil and gas enabling technology)
- Some common sectors of investment interest include:
  - **E-commerce / Marketplaces** – driven by decreasing friction for online transactions and Brazilian consumption culture
  - **Digital Media / Mobile Applications** – driven by large, growing population of connected users and extremely digital media consumption and engagement behavior
  - **Education / Healthcare** – based on the belief that these will be top spending priorities for growing, digitally connected middle class
  - **Financial Technology / Payments** – growing market of first-time financial services consumers and opportunity to digitize informal transaction culture (e.g., payments, lending, insurance)
  - **B2B2C** – increasing demand for infrastructure supporting technology companies serving consumers

Investment stages

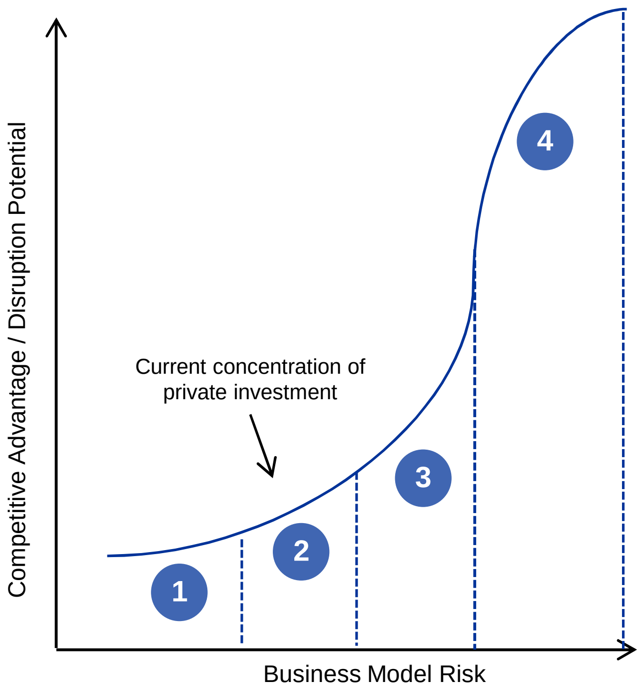
- Both early stage and growth players active in the market; perception that growth is crowded while there is opportunity for entrants in early stage (Series A/B)
- Marked observation in increase seed / angel funding in past 18-24 months (see Investment Landscape)

Geographic focus

- Many U.S. based firms investing in Brazil on **coattails of broader global sector strategies** (vs. Brazil-specific thesis), especially true of Internet and digital media centric investors
  - *Few U.S. firms have committed to establishing local offices and teams*
- Majority of portfolio companies are focused on serving the Brazilian market, some with goals of pan-regional expansion, few with strategy of global expansion

Summary of Key Findings – Investment Strategies (II of II)

Business model focus



- Investors are moving up a maturity curve in terms of business model focus:
  1. **Fast follow –** directly applying a proven business model / technology platform from another geography to the Brazilian market
  2. **Localized business model arbitrage** – applying proven business models customized to address local frictions and cultural norms that serve as barriers to entry
  3. **Uniquely Brazilian models –** solving problems unique to the Brazil / LATAM context, often in categories overlooked in the U.S market (e.g., education, financial services)
  4. **Innovation for global export** – IP-driven innovation associated with Brazilian industrial strengths, e.g. agra-business and energy; presently primarily funded by government (e.g. Criatec program) [1]
- **Current concentration of investment in Type 2**, but general belief that as investors become more comfortable with Brazil, they will be willing to take more business model risk, shifting investment focus up the curve

Syndication / Follow-On investment

- **Co-investment is highly desired** by both US and Brazilian Early Stage investors
  - *Early stage U.S. VCs* are generally looking for local co-investors as "river guides" and hands-on portfolio management
  - *Early stage Brazilian VCs* are seeking local co-investors to de-risk deals and distribute workload, and foreign partners for sector expertise and to foster international exits
  - Unclear at what point the collaborative / competitive dynamic might shift
- **Growth investors** primarily investing in late stage rounds without syndicate partners
- Firms are typically making smaller upfront investments in Brazilian companies but reserving similar amounts of follow-on capital as US comps

Source: http://dealbook.nytimes.com/2012/12/05/brazil-steps-up-investments-in-overlooked-tech-start-ups/

Summary of Key Findings – Exit Opportunities (I of II)

- **The major uncertainty** for investors is the **limited track record of major exits** to date, especially in current cycle of investments
  - Attributed to lack of mature acquisition targets and deliberate approach by multi-nationals towards market entry
  - Differing opinions exist on the long-term viability of companies in current pipeline as strategic targets

- Underlying assumption for most investors is a **near-term wave of multi-national strategic acquisition** will demonstrate the liquidity of existing Brazilian investments
  - **Strategic M&A**, with global players consolidating categories, is widely seen as **primary potential vehicle for liquidity**
  - The realization or non-realization of this acquisition wave will have significant impacts on GP and LP outlook and investment behavior in Brazil
  - Brazilian technology firms are expected to reach scale and transactional sophistication within the next few years to drive M&A activity domestically (limited domestic demand currently)
  - Talent acquisitions, currently non-existent, may become more common and further fuel domestic trade sales
  - Exits to Private Equity seen as less favorable due to limited willingness of buyers to pay a strategic premium

- **Occurrence of major liquidity event** from current generation of start-ups will likely intensify foreign VC investment activity

- Expectations of individual investment **returns more tempered** than in U.S. given limited exit paths and market size, **suggesting a different model** than typical Silicon Valley “home run” strategy
  - Concern that capturing the Brazilian market alone may not be sufficient to generate outsized exits, especially given Brazil’s limited track record of startups expanding internationally
  - Founder tendency / expectation to sell earlier than precedent in U.S. and other more mature markets

- Exit timeline similar to the US: 5 – 7 years for early stage

Summary of Key Findings – Exit Opportunities (II of II)

Current BOVESPA liquidity limits feasibility of domestic IPO exit option; some cautiously hopeful that this situation may improve in the near team

Most GPs are bearish regarding IPO exits

- BOVESPA not seen as viable exit path given low appetite for small cap, high risk equities
  - Observed market cap of USD$1B+ difficult to achieve for vast majority of domestically-focused consumer internet startups
  - Mixed opinions regarding the future impact of BOVESPA MAIS (SME exchange), although general consensus trends toward it having little, if any, impact on the path to liquidity for startups
- NASDAQ more likely IPO exit path, but will still only be available to select few companies

Yet, there are those who remain optimistic

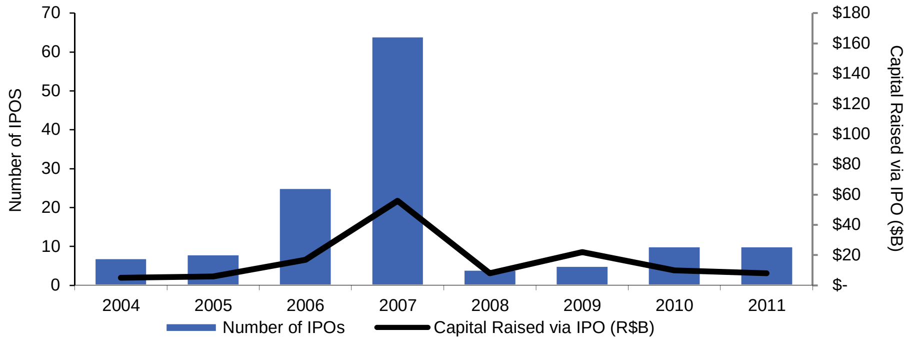
- "The government itself is taking measures to facilitate listings, although more for smaller offerings. The CVM, Brazil's main securities regulator, announced in November that it would consider, on a case-by-case basis, easing requirements for smaller IPOs."
- "Both government and private sector entities are also working together to present… a package of regulatory and tax measures to pave the way for smaller I.P.O.'s, though the measures probably would not be in place until 2014."

Source: NY Times "After I.P.O. Drought, Brazil Becomes More Hospitable to Investors" by Andrew Sorkin, January 8, 2013

Historical IPO Data Demonstrates Market Cap Hurdle

Total market capitalization	$1.3T USD
Companies listed	362
Companies with over $1B USD market cap	355

Source: http://www.bmfbovespa.com.br/capitalizacao-bursatil/BuscarBursatilGeral.aspx?Idioma=en-us (as of January 17, 2012)



Source: IMF Working Paper: "Brazil's Capital Market: Current Status and Issues for Further Development" by Joonkyu Park, September 2012

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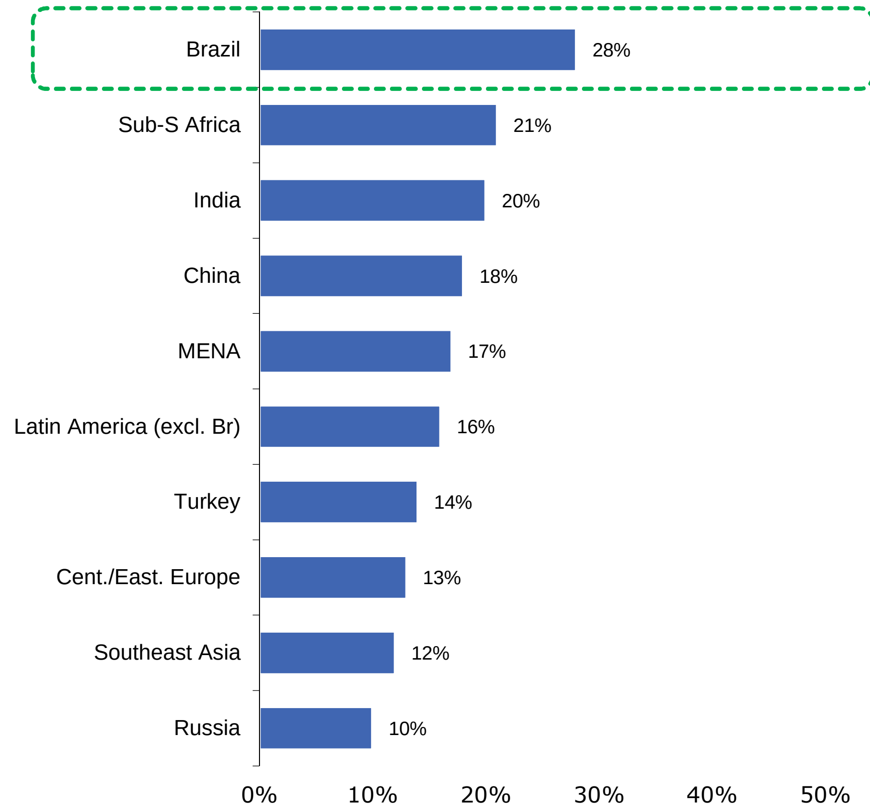
Summary of Key Findings – LP Composition and Perspectives

- **U.S. LPs dominate recent fund composition** and are seen as the primary source of fund capital
  - Many US LPs investing in Brazil are doing so indirectly through funds with global mandates and are largely passive regarding their Brazil investments
  - US LP composition is evolving; first generation were VC firm partners and high net worth individuals
  - Now shifting to include more institutional investors including corporates and fund of funds
- **Brazilian LPs are demonstrating increased appetite f**or the venture asset class,
  - The first generation of Brazil LPs were high net worth / family offices; recently there has been a shift towards institutional investors
  - In 2009, laws were amended so that Brazilian pension funds could invest in venture capital [2]
- **The Brazilian government is a major entity in the domestic LP landscape;** its investment activity will remain sizeable portion of the venture asset class moving forward
  - The Brazilian Development bank (BNDES) is invested in 14 VC funds [3]
- Firms that have raised dedicated Brazil funds **focused on the Brazil domestic market story** to market to foreign LPs
- LPs deciding whether to invest in an emerging market for the first time cite political and regulatory difficulties as the highest deterrents or concerns [1]

– "Brazil stands to see largest influx of new LP investors" –

% LPs planning to begin investing in select VC/PE markets over next 2 years



Source: Global Limited Partners Survey: Investors' Views of Private Equity in Emerging Markets, 2012, EMPEA. (106 LPs surveyed across 28 countries with $208B AUM)

Sources: 1) Global Limited Partners Survey: Investors' Views of Private Equity in Emerging Markets, 2012, EMPEA. (106 LPs surveyed across 28 countries with $208B AUM); 2) Private Equity and Venture Capital Industry – Second Brazilian Census, GVCEPE, 2011. 3) http://economia.ig.com.br/mercados/2012-04-16/bndes-vai-investir-r-1-bilhao-em-private-equity-e-venture-capita.html

Appendix: Additional detail regarding potential scenarios

Potential scenarios for the evolution of the Brazilian VC ecosystem

These scenarios can be thought of as directional indicators for the next 5-10 years to inform long-term strategic planning

Expected VC returns relative to other markets

Attractiveness of business environment[1]	Lower	Higher
Improves	**Scenario 1** ***"Mature market"*** Majority of investments made by large, experienced local VC firms *(experienced local GPs funded mostly by domestic institutional investors)*	**Scenario 2** ***"VC hot bed"*** Majority of investments led by the local offices of large, overseas VC firms *(dedicated country funds run by local GPs and funded mostly by overseas investors)*
Declines	**Scenario 4** ***"Market collapse"*** Deal flow limited and consists of local wealthy individuals and local, first-time VCs	***2012***  **Scenario 3** ***"Fragile growth"*** Deal flow led by a mix of overseas and domestic VC firms *(opportunistic investing by GPs based in mature markets)*

Note 1: Attractiveness of business environment based on Global VC and PE Country Attractiveness Index, which accounts for economic activity, depth of capital markets, taxation, investor protection / corporate governance, human and social environment, and entrepreneurial culture & deal opportunities.

Scenario 1: "Mature Market" - Improved attractiveness of business environment, with lower VC returns than other emerging markets

Major themes

Source of capital (i.e. LPs)

- Majority of capital committed to Brazilian VC originates from institutional investors based in Brazil (denominated in R$)
- US investors look to other emerging markets for high returns

Investors (i.e. GPs)

- Majority of GP investors have extensive track records and local operating experience

Deal flow

- Majority of investments made by large domestic Equity Participation (FIP) funds with experienced GP investors
- Local GPs highly selective with early and late stage investments (startups compete for VC funding)

Exit trends

- Multiple exit options materialize including trade sales, IPO, and PE Buyouts, but valuations and returns are tempered

Potential root causes

Attractiveness of VC ecosystem

- Improved tax incentives for entrepreneurs and VC investors
- Reduced labor market rigidity, along with improvements in the ease of starting, running, and exiting a business
- Perceived bribery and corruption improves significantly
- Technical human capital engineering talent proliferates
- Sustained robust economic growth paired with stable inflation and currency exchange rates
- Increase in liquidity of BOVESPA creates domestic IPO path, but valuations are tempered

VC returns relative to other emerging markets

- Wave of trade sales to multinationals never materializes, causing US LPs to lower expectations regarding exit options and suppressing foreign interest in new local Brazilian funds

Highlights for Brazilian GPs operating in this scenario

- **Large, local GPs must allocate reserves to fund portfolio companies through multiple rounds without expectation of syndication from foreign VC co-investors**
- **Domestic VCs selectively invest in growth stage deals (less competition and dispersed opportunities)**
- **Surviving VCs aim to achieve 2x and 3x returns on exits (as opposed to home runs)**

Scenario 2: “VC Hotbed” - Improved attractiveness of business environment, with higher VC returns than other emerging markets

Major themes

Source of capital (i.e. LPs)

- Majority of capital committed to Brazilian VC originates from LPs based in the US (denominated in US$)

Investors (i.e. GPs)

- Global firms run dedicated Brazil funds with local GPs
- Shortage of experienced GP investors with local perspective results in talent war by global VC firms (poaching, etc…)

Deal flow

- Majority of investments made by the local offices (country-specific funds) of established global VC firms
- Proprietary deal flow critical as local GPs fight to fund early stage investments (VCs compete for startup equity)

Exit trends

- Valuations skyrocket, making IPOs and trade sales increasingly important for generating superior returns

Potential root causes

Attractiveness of VC ecosystem

- Improved tax incentives for entrepreneurs and VC investors
- Reduced labor market rigidity, along with improvements in the ease of starting, running, and exiting a business
- Perceived bribery and corruption improves significantly
- Technical human capital engineering talent proliferates
- Sustained robust economic growth paired with stable inflation and currency exchange rates
- Increase in liquidity of BOVESPA crease domestic IPO path with strong valuations

VC returns relative to other emerging markets

- Wave of trade sales to multinationals paying strategic premiums materializes and fuels ongoing foreign interest in new local Brazilian funds

Highlights for Brazilian GPs operating in this scenario

- **This is the most competitive scenario for Brazilian VC - GPs should aggressively raise large funds and poach talent before the wave hits (e.g. extract maximum value from local operating expertise before it becomes overly competitive)**
- **Critical for firms to structure GP incentives to retain key local talent and fend off poaching in anticipation of talent war**
- **Firms aggressively invest in early stage (looking for home runs) in attempt to ride wave of successful trade sale/IPO exits**

Scenario 3: “Fragile Growth” - Stagnant / declining attractiveness of business environment, higher VC returns than other emerging markets

Major themes

Source of capital (i.e. LPs)

- Majority of capital committed to VC funds with LPs based in the US (denominated in US$)

Investors (i.e. GPs)

- More US VCs begin investing in Brazil, primarily via broad funds with global mandates
- Brazilian VCs in hot demand by US VCs seeking river guides

Deal flow

- Global VCs lean heavily on local co-investors to source deals and provide operational oversight
- Investment deal flow driven by overseas and domestic firms

Exit trends

- Late stage investment market becomes saturated due to international investor entry; increased valuations are supported by periodic strategic trade sales

Potential root causes

Attractiveness of VC ecosystem

- Limited tax improvements for entrepreneurs and VC investors
- Entrepreneurs limited by sustained labor market rigidity (difficult to hire and fire employees), shortage of technical talent, and difficulty starting, running, and exiting a business
- Lack of improvement in perceived corruption
- Reduction of government stimulus following 2014 general election causes private consumption and GDP growth to decline significantly, in parallel with devaluation of Real

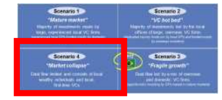
VC returns relative to other emerging markets

- Wave of trade sales to multinationals materializes, which sustains US LP expectations regarding future returns and fuels ongoing foreign interest in new local Brazilian funds

Highlights for Brazilian GPs operating in this scenario

- **Local VCs highly sought after as syndicate partners for overseas GPs due to their local operating expertise and proprietary deal flow (particularly for early stage deals)… establishing robust relationships with large overseas VCs enhances ability of Brazilian GPs to participate in large, high-profile deals**
- **Local GPs avoid overcrowded late-stage space and leverage local presence to identify attractive early-stage opportunities**
- **Ongoing frictions in business environment make it difficult for global VC firms to justify setting up dedicated Brazil funds**

Scenario 4: "Market Collapse" - Stagnant / declining attractiveness of business environment, lower VC returns than other emerging markets



Major themes

Source of capital (i.e. LPs)

- Limited funds provided by locally-based wealthy investors and government-sponsored initiatives

Investors (i.e. GPs)

- Very few experienced investors remain active in market
- Inexperienced GPs encounter extremely high failure rates

Deal flow

- Majority of deal flow consists of ad hoc opportunistic investing based on personal relationships
- Limited number of startups and VC investors results in stagnant deal flow over long periods of time

Exit trends

- Fewer exit opportunities result in long holding periods

Potential root causes

Attractiveness of VC ecosystem

- Limited tax improvements for entrepreneurs and VC investors
- Entrepreneurs limited by sustained labor market rigidity (difficult to hire and fire employees), shortage of technical talent, and difficulty starting, running, and exiting a business
- Lack of improvement in perceived corruption
- Reduction of government stimulus following 2014 general election causes private consumption and GDP growth to decline significantly, in parallel with devaluation of Real

VC returns relative to other emerging markets

- Wave of trade sales to multinationals never materializes, causing US LPs to lower expectations regarding exit options and suppressing foreign interest in new local Brazilian funds
- BOVESPA does not become a viable IPO exit option

Highlights for Brazilian GPs operating in this scenario

- **Extremely high failure rate for Brazilian VCs causes foreign investors to flee to other emerging markets**
- **VCs preserve funds and allocate reserves for multiple follow-on rounds due to lack of syndication / fundraising options**
- **The few surviving local VC firms restructure / divest their portfolios and infrequently invest in late-stage safe bets**