Venture Investing

Taking Stock
What is the Future?

The 2nd Annual Policy Seminar of the Latin American
Venture Capital Association

Inter-American Development Bank Annual Meetings

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Agenda

- Why PE/VC is Good for Latin America?
- Why Latin America is Attractive for PE/VC?
- Latin America M&A Activity (1997-2003)
- Main Recipients of PE/VC in Latin America
- Funds Raised for Latin America
- Capital Invested and Exits in Latin America
- Changing Scene of PE/VC Players
- Experience and Role of DFI's in PE/VC Investing
- Macro-economic & Political Stability
- Legal and Regulatory Framework
- Corporate Governance
- LAVCA'S Role in the Industry's Development
- Real-time Survey

Why PE/VC is Good for Latin America?

Contributions

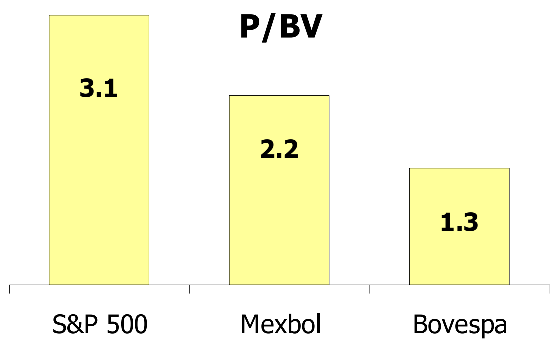
- Company creation and expansion
- Introduction of best business practices
  - Management practices
  - Financial management
  - Corporate governance
  - Strategy development
- Corporate restructurings and modernizations
  - Rescue and reactivate assets
  - Improve productivity and competitiveness

Impact

- Productivity enhancement
  - Job creation
  - Economic growth and development
  - More efficient use of capital
  - Competitiveness in global markets
- Ownership succession, diversification and broadening
- Greater transparency and management accountability
  - Increase attention to Minority Shareholder rights
  - Boost to developing equity markets

Why Latin America is Attractive for PE/VC?

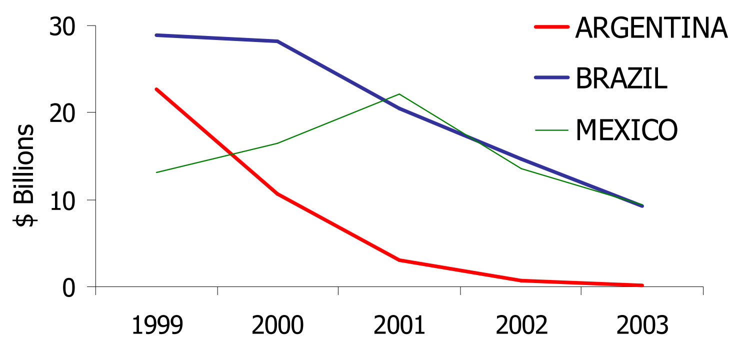
Attractive investment opportunities with potential for high, risk adjusted returns



Source: Bloomberg, March 2004

Gap in available financing for start ups, growth companies and restructurings

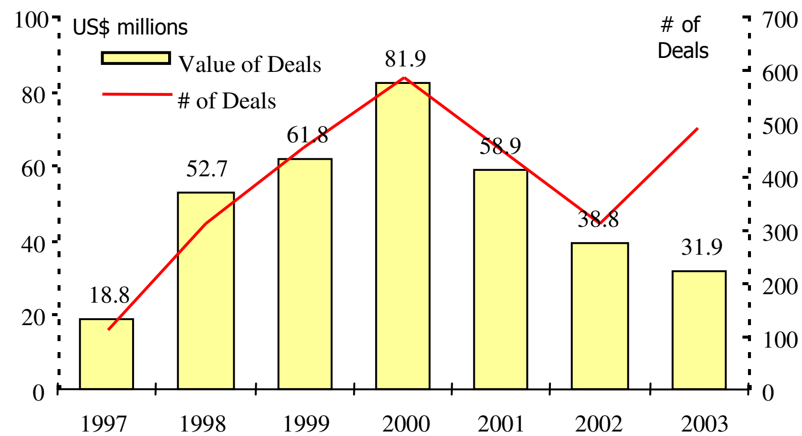
- Capital shortage
  - Risk capital under supplied by type and amount
  - Bank lending still down especially for SME's
  - IPO's sharply down in last 5 years
  - Financial investors (PE, DFI's) taking a cautious approach
- FDI dropping



Source: IIF, March 2004

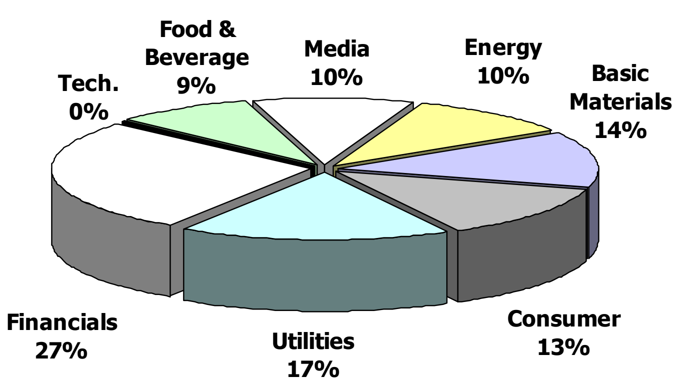
Latin America M&A Activity (1997-2003)

- $313 billion announced and completed deals
- Sharp fall from 2000 peak year



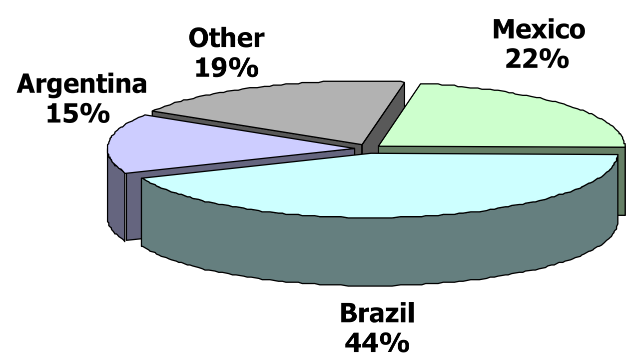
Source: Bloomberg

- By major industry



Source: Bloomberg

- By major country

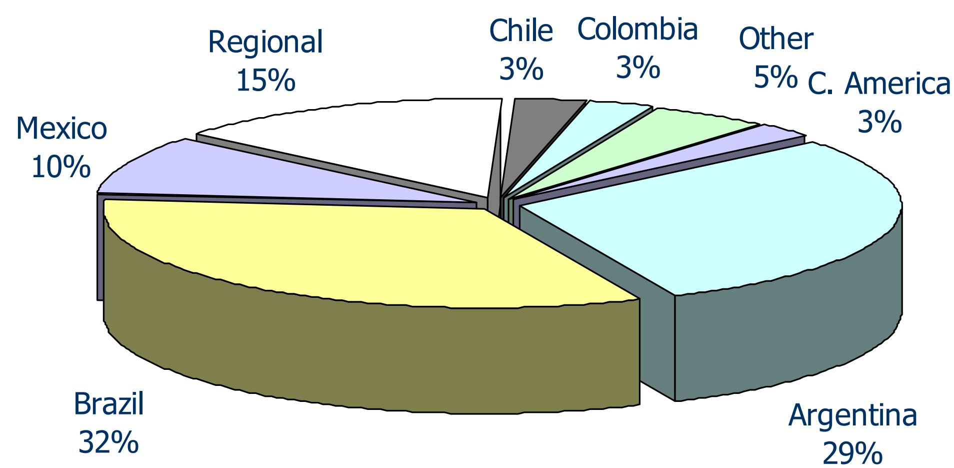


Source: Bloomberg

Main Recipients of PE/VC in Latin America

Countries (1993-2003)

- Argentina
- Brazil
- Central America
- Chile
- Colombia
- Mexico
- Peru
- Venezuela

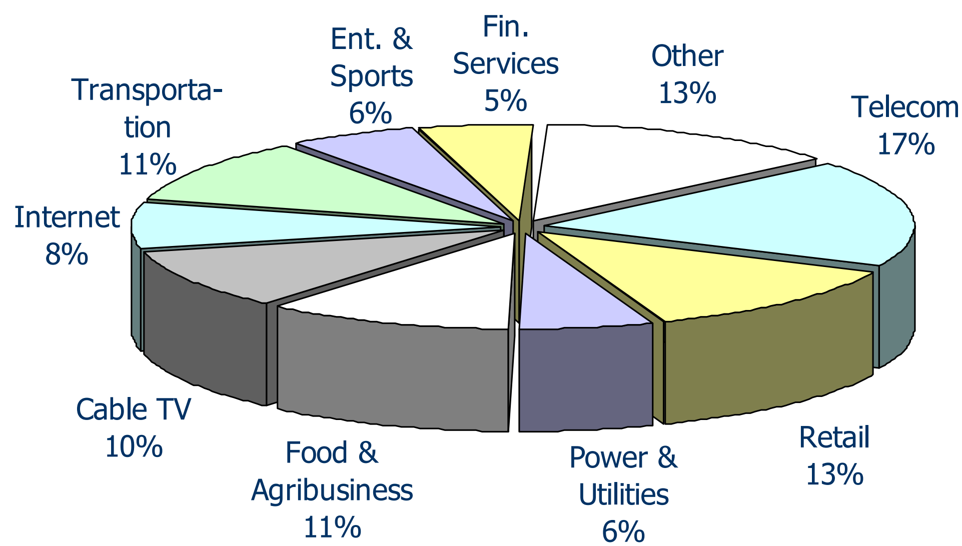


Source: AssetAlternatives, VELA

Main Recipients of PE/VC in Latin America

Industries (1993-2003)

- Telecom
- Retail
- Food & agribusiness
- Transportation
- Cable TV
- Internet
- Entertainment & sports
- Power & utilities
- Financial services

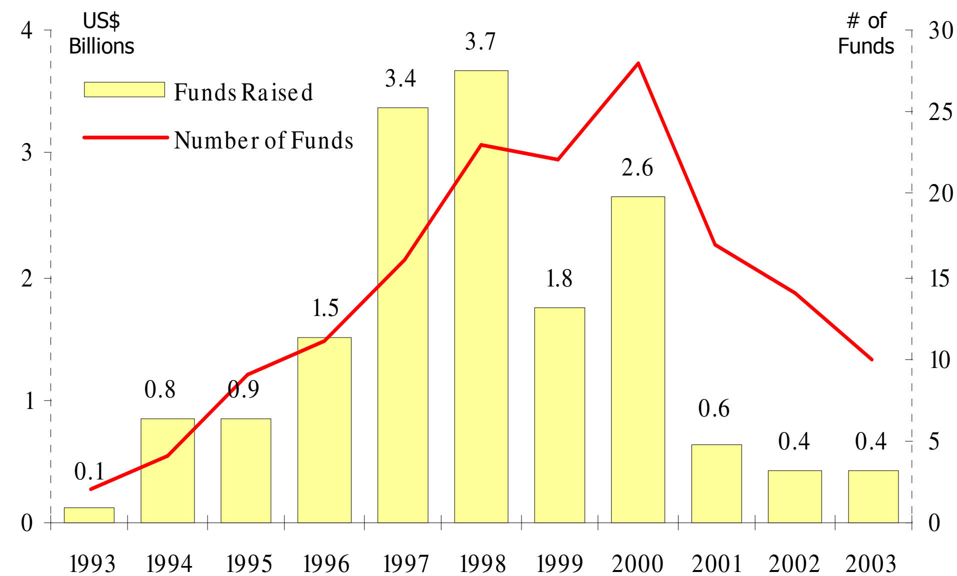


Source: AssetAlternatives, VELA

Funds Raised for Latin America

Dedicated Latin American funds

- $16.1 billion raised through 146 funds
- Peaked in 1997/1998
- Bottomed-out in 2002 with only $400 million raised

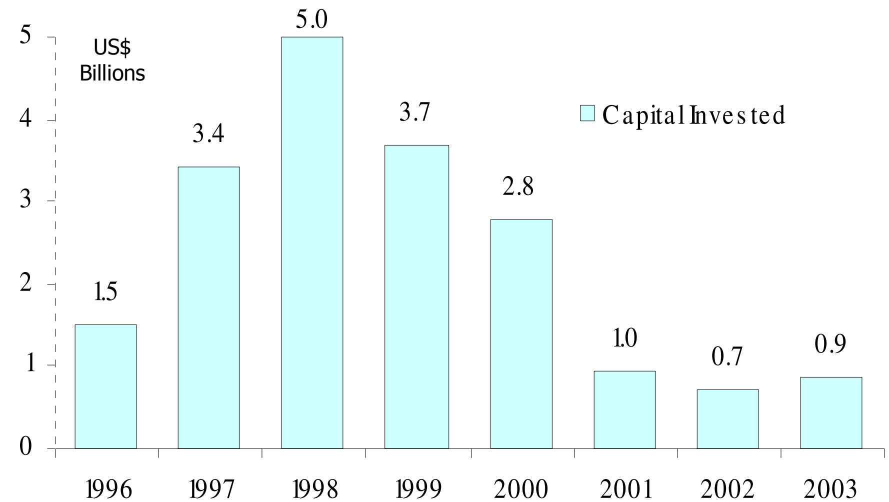


Source: VELA

Capital Invested and Exits in Latin America

Total capital invested in PE/VC deals (incl. dedicated funds)

- $18.9 billion invested, peaking in 1998 with $5.0 billion invested
- Bottomed-out in 2002, with only $700 million invested



Source: VELA

Exit track-record is still to come

- 1994/95 funds just reaching end of standard 10 year fund life
- 1997/98 funds started in peak years have 4 to 5 years remaining
- $1.1 billion in 2003 exits involving 13 companies
- Between 1996 and 2003, there were approximately 30 exits, including two IPO's in 2003

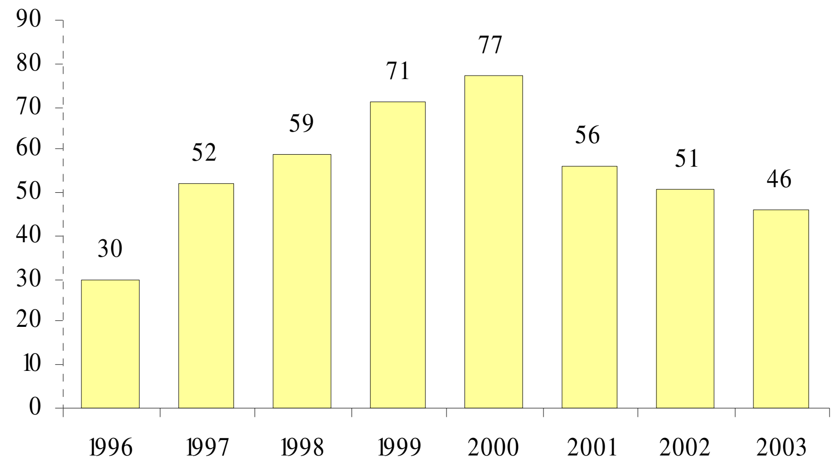
Changing Scene of PE/VC Players

- New entrants in 2003 point to increased activity in 2004 – especially in Mexico
  - The Carlyle Group (Mexico)
  - WAMEX (Mexico)
  - Protego Asesores & Discovery Capital (Mexico)

- As does a higher fund raising targets
  - 2003 fund raising target: $570 million
  - 2004 fund raising target: $2 billion

- Active Private Equity Management Firms
  - Peaked in 1999/2000
  - Totaled 46 in 2003

Number of actively investing private equity firms 1996-2003



Source: AssetAlternatives, VELA

Role of DFI's in PE/VC Investing

DFI's are in a unique position to advance the industry's growth

- Financial resources to leverage and attract commitments from private investors
- Assist with policy and regulatory reform
- Support for best-practices and governance by investors and managers

DFI Supported Latin American Private Equity Funds

	Invested (million)	No. of Funds
IFC	$430	20
OPIC	$200	2
MIF	$188	38
IIC	$157	25
CAF	$101	13
NAFIN	$144	19
FMO	$31	7

Experience and Role of DFI's in PE/VC Investing

Lessons learned after a decade of investing in Private Equity

- Timing on economic cycles and returns – vintage years
- Best equity investments generally made at bottom or just after crisis
- EM's increasingly more correlated with US market
- Avoid narrowly focused funds
- Inexperienced managers tended to under perform
- Difficulty of exits

Current investment strategies to improve results

- Select management firms with a track record and ability to exit
- Back control or shared control funds
- Emphasize liquidity and current income, hence wider use of mezzanine
- Co-invest in direct investments for more influence
- Be less developmental and more commercial
- Push for better corporate governance in fund management and alignment of interests

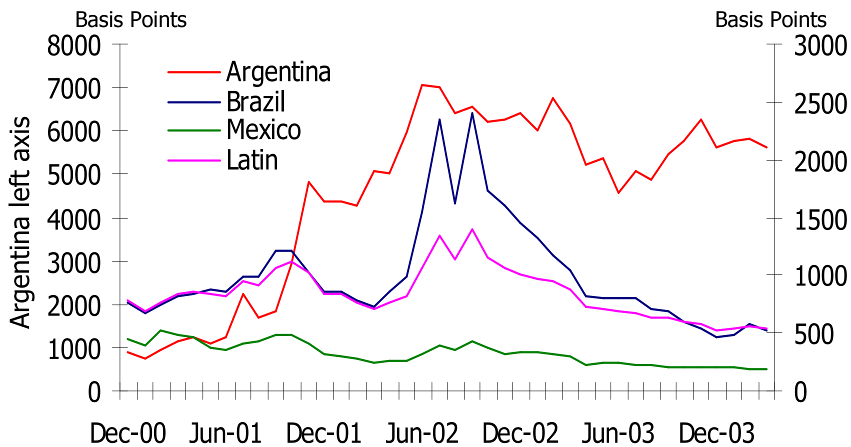
Macro-economic & Political Stability

Lowering the cost of capital for companies

- **Lower systemic risks**
  - Relative stability during economic downturns
  - Enhanced sovereign credit rating
  - Stable capital and credit markets

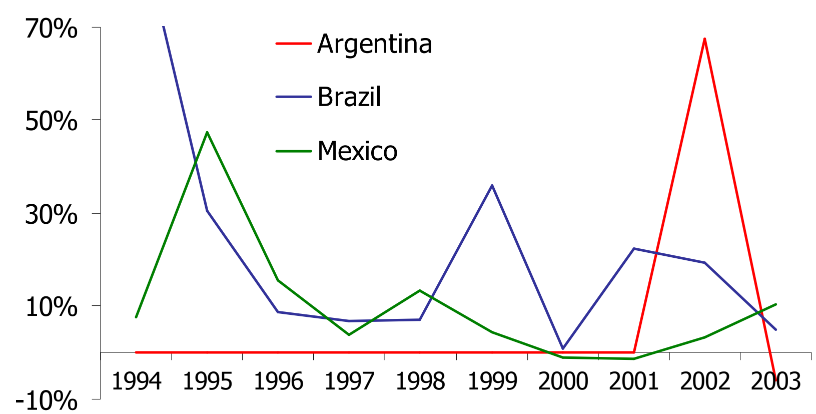
- **Sustainable economic development**
  - Long-term, stable investment flows
  - Enhance asset values

EMBI+ Country Spreads over U.S. Treasuries



Source: J.P. Morgan Markets

Annual Exchange Rate Devaluation vs. USD



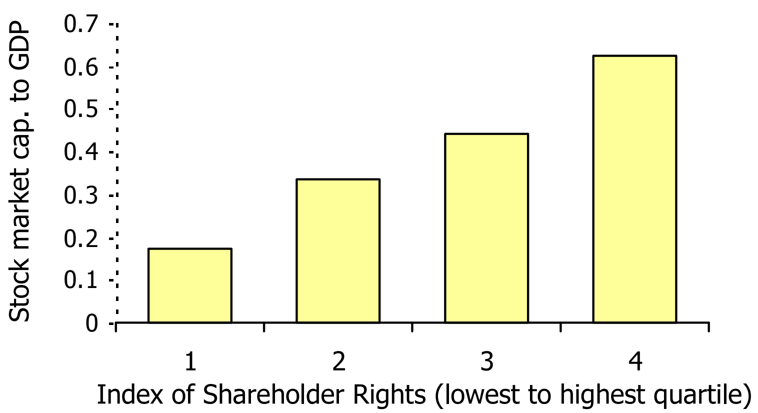
Source: Bloomberg

Legal and Regulatory Framework

Access to additional capital and increased value of investments

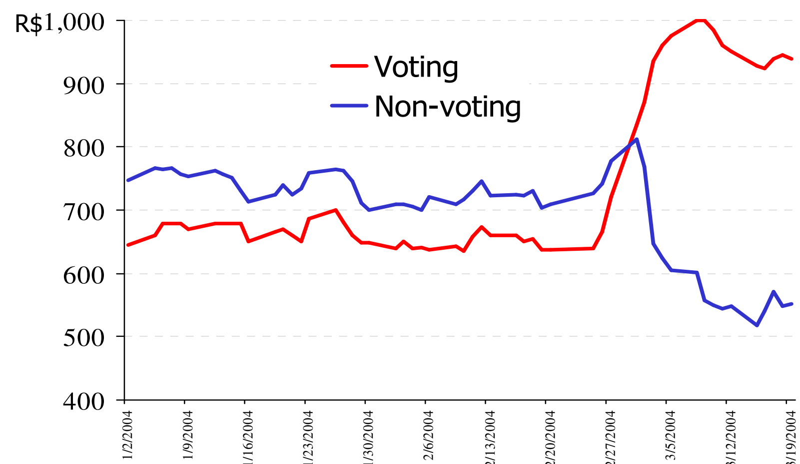
- Liberalization of investment restrictions
  - Participation of local pension funds
- Minority shareholder rights
  - Enhance security and level of confidence
  - Increases domestic and foreign trade

The better quality of shareholder protection, the larger the markets



Source: Corp. Gov. Development, S. Claessens
La Porta and Others

AMBEV Voting and Non-Voting Stock
12/31/03 – 3/19/04



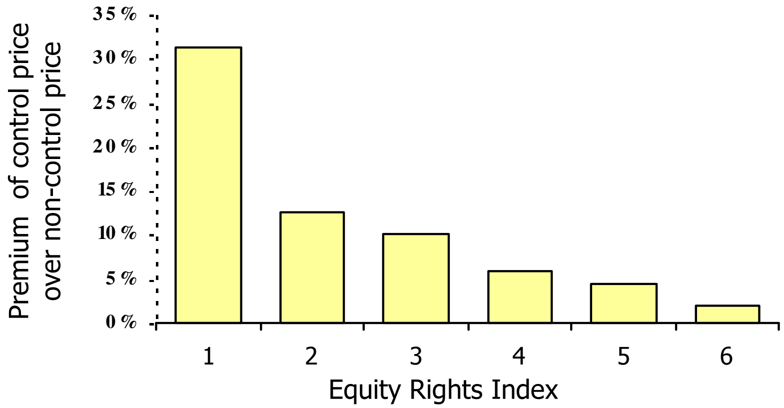
Source: Bloomberg

Corporate Governance

- At the country level
  - Accelerates capital market development
  - Strengthens access to global capital and credit markets

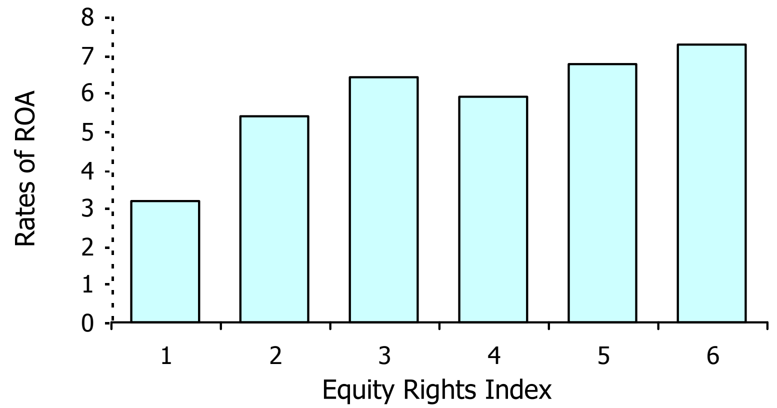
- At the company level
  - Greater access to capital
  - Lower cost of capital
  - Higher asset values
  - Increased investor confidence
  - Better resource allocation and management

Weak corp. governance results in higher cost of capital



Source: Corp. Gov. Development, S. Claessens
Dyck and Zingales

Better corp. governance results in somewhat higher ROA



Source: Corp. Gov. Development, S. Claessens
La Porta and Others

LAVCA'S Role in the Industry's Development

- Strengthening the environment for private equity/venture capital to serve as an important catalyst for economic development in Latin America
  - Advocacy
    Lobbying for specific reforms; policy papers; policy dialogues/seminars
  - Research
    Timely industry data, trends, news
  - Education
    Training courses to increase professionalization and know-how
  - Networking
    Regional conferences and seminars, as well as local events
  - Best Practices
    Develop and disseminate model documents, best practices

REAL-TIME SURVEY

1. **Most important constraint on the Latin American PE/VC industry?**
   - ☐ Lack of capital
   - ☐ Lack of attractive investment opportunities
   - ☐ Difficult exit environment
   - ☐ Lack of skilled managers (fund and/or company)
   - ☐ Other

2. **Biggest obstacle to fund raising for Latin American PE/VC?**
   - ☐ Lack of compelling track record
   - ☐ The Region's political and macro-economic volatility
   - ☐ Global investor focus on other markets
   - ☐ Regulatory environment
   - ☐ Other

REAL-TIME SURVEY

3. Causes for lackluster fund performance?

- ☐ Inexperienced fund managers/investment staff
- ☐ Political/macro-economic volatility
- ☐ Lack of exit alternatives
- ☐ Unenforceable shareholder rights
- ☐ High cost of corporate debt
- ☐ Other

4. What is the best investment style?

- ☐ Passive
- ☐ Influential minority
- ☐ Control/ Shared Control
- ☐ Buy out - MBO's
- ☐ Distressed Assets
- ☐ Other