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An Exclusive Interview with Charles Daugherty and Mary Frederickson (Stanwich Advisers LLC)

Conducted by Alyson Sheehan

Boutique investment bank Stanwich Advisors LLC helped private equity firm Axxon Group raise its second private equity fund, Axxon Brazil Private Equity Fund II ("fund II"), which reached $315 million in capital commitments and exceeded its original target of $250 million. The fund's limited partner commitments were secured from institutional investors in North America, Europe, Asia, Australia and Latin America, including endowments, public and private pension funds, financial institutions, advisors, family offices, sovereign wealth funds and fund-of-funds.

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VC Firm Ideiasnet Spreads Presence in Brazil's Tech Sector

By Dan Weil

Ideiasnet of Brazil, one of the few publicly-listed private equity fund managers active in Latin America, is expanding its venture capital investments in the country's technology, media and telecommunications (TMT) industries.

The firm, which opened in 2000, has a portfolio of 15 companies. It generally invests about $5 million in each concern. It is flexible about how much of a company it controls, but always wants a seat on the board of directors

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existence of treaty benefits and Spain's participation exemption system are among the reasons for utilizing an ETVE. Chile also provides attractive opportunities for investment through its holding company regime.

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1 This conference is presented annually by the ABA Section of Taxation, IFA-US Branch and the Latin American branches of IFA, the IBA, Taxes Committee, the ABA Section of International Law and the Institute for International Taxation, Inc. To access the reports and materials from the Conference please visit www.int-tax.org.

Nikeisha Gentles attended University of Miami School of Law and will be an associate in the tax department at Sidley Austin in Chicago this fall. She reported this article based on a panel discussion entitled "Mergers and Acquisitions: Cash is King!" presented at the recent "U.S.-Latin American Tax Planning Strategies Conference in Miami on June 15-17, 2011. To access the reports and materials from the Conference please visit www.int-tax.org.

Interview

Stanwich Advisors

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VELA: How does the Axxon Brazil Private Equity Fund II break down, percentage-wise, in terms of the types of investors and in terms of its geographical reach?
CHARLIE: Axxon's investor base was very diversified – both in terms of type and geography. North American investors accounted for the largest percentage, followed by Europe, Australia, and Asia. Local capital accounted for the smallest share. With respect to type, Endowments/Foundations, Pension Funds, Financial Institutions represented approximately the same, followed by fund of funds and SWFs.

VELA: What is the current attitude of endowments and foundations towards raising Latin America focused funds?
CHARLIE: In general, many endowments and foundations have mature private equity portfolios. As part of this asset class, endowments and foundations have been active investors since the early venture days. They were the first group to delve into private equity and were followed by corporate and then public pension funds.
As a result, a number of endowments have had previous experience in Latin America and for the most part, it has not been positive. There was a lot of money raised for private equity in Latin America at the end of the 1990s, in 1998-1999. Latin America was viewed as a very hot opportunity and as a result attracted a tremendous amount of capital. Most of that money was lost, and that experience was not positive and left a negative impression of the region for many private equity investors. There were a few funds obviously – GP, Southern Cross, Patria, Advent – that experienced a positive outcome and were able to weather the storm, but there were a lot of other investors that just went out of business.

Having said that, we recently have found a lot of interest among endowments in Latin America, both generally and in terms of Axxon's Fund II.

VELA: When working with endowments and other types of investors, how do you explain what went wrong with private equity in Latin America in the late 1990s and why you believe that won't reoccur now?
CHARLIE: The macro for Brazil in terms of economic size, population, commodities, large and growing consumer purchasing power has always been compelling and that's what attracted the capital in the 1990's and now. In the late '90's, the infrastructure supporting private equity was generally not as strong as it is today. The financial and banking system is now stronger and the tax and bankruptcy laws and the regulatory environment is much more transparent. The country is fiscally in better shape now than it was then.

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Over the last ten years Brazil has experienced a lot. There has been a boom in commodities; the pull and strength of China is a factor now, whereas ten years ago it was not. But frankly, I also think that there were a lot of investors in the late '90s who raised capital but had no private equity experience at all. There were a lot of groups that benefited from strong capital flows into the market but had no experience. In today's market, there are a number of people who do have experience. Brazil represents an attractive private equity opportunity, but it remains complex, and it is not for everyone. Successful funds will require a combination of both proven operating and investing experience. There are now some new emerging players, both local and international firms, who are responding to that inflow of growth capital and trying to raise money. Whether or not they are going to be successful this time around, I don't know.

As it relates to Brazil, specifically, there are some investors, such as pension funds, that require an investment committee seat. It is unique to Brazil as that is generally not the case in other LatAm regions, such as Colombia, Peru, or Chile.

MARY: With respect to Axxon specifically, what resonated well with investors was the part of the market that they have consistently targeted – Brazil's small to mid cap space. It's a part of the market that is underpenetrated from a private equity perspective. There is a large universe of companies operating in this space and a limited number of established PE players focused on it. The bulk of the private equity capital being raised in Brazil is for large cap strategies.

CHARLIE: There are very few people with experience who continued to remain focused on the small to mid-cap market in Brazil. Many investors now feel that's a very attractive and dynamic market, and to Mary's point, a part of the market with far less competition.

VELA: Do limited partner investors demand a great involvement in the management of funds?

CHARLIE: As it relates to Brazil, specifically, there are some investors, such as pension funds, that require an investment committee seat. It is unique to Brazil as that is generally not the case in other LatAm regions, such as Colombia, Peru, or Chile. That is also not the case for institutional investors in the U.S., Europe, Asia, Australia and Middle East.

VELA: Is the fact that some Brazilian institutional investors require a seat on the investment committee of a fund a deterring factor for potential limited partners?
CHARLIE: It is a deterring factor. The reason why I think some of these Brazilian pension funds, banks and insurance companies have requested an investment committee seat is due to their negative experiences investing in private equity in the late '90's. As a result, they seek to employ governance structures in which they have an active role.

Having said that, is it an issue from other limited partners' perspective?

If I'm an endowment or a foundation, I am making my bet on the general partner, the team on the ground responsible for taking my money, investing it, and returning a profit. I am going to hold them responsible for that. If another investor, such as a Brazilian bank or insurance company, is sitting on that investment committee, that investor may compromise the ability of the general partner to make the decisions they need to make. So yes, that could be a deterrent to any investor. If an investor thought that, in some way, having somebody else on that investment committee with a vote, with veto power, would somehow compromise the ability to execute a strategy, it would generally be reason for an investor not to make a commitment.

VELA: In recent months or years, has there been a shift in endowments' interest away from other emerging markets like Asia towards Latin America – or the other way around?
CHARLIE: I don't think that there is a shift away. Most investors that decide to invest in private equity will first focus on mature markets and specifically the U.S. and Europe. The next step is to then begin investing in emerging markets. Endowments and foundations began investing in Asia and Latin America in the late '90's. The experience was mixed at best. A lot of money has gone in and out of Asia over the years and

more so over the last 5 years. The institutional investor group globally has put a lot of money into Asia. A lot of that money has gone into pan-regional funds or China, and to a lesser extent, India specifically. But clearly China and India are the major beneficiaries of that capital flow.

I'd say over the last 3 years, people have focused on Latin America. Emerging markets are, by definition, for mature investors; if you are going to make your first private equity investment, it's not going to Brazil, China or India. It's going to the U.S. or Europe. Once you have developed those portfolios, you may allocate 10% to 20% of your total portfolio to emerging markets. Again, most of that will go to Asia and/or other markets.

Latin America was very hot 10 years ago but, because the performance was poor, it has not been a region that people wanted to pursue. Over the last couple of years, investors have again started to visit the region. A few of the funds that have been investing in the region over the last 8-10 years have strong proven track records and built very good reputations. Some would argue that Latin America is in better shape today than it has been for at least the last 20 years. The story is very compelling: strong local economies, increased transparency, stronger financial industry evidenced through banks and insurance companies, better governance and regulatory environments, legal systems, etc. All of this is perceived as not only a strong foundation and base but as a much better environment than they had seen in Latin America over the last 10 to 20 years.

VELA: Would you say that Asia's and Latin America's emerging market economies are therefore not mutually exclusive? Are they complimentary?
CHARLIE: They are just very different markets. I think that people are interested in emerging markets, in part, because if you look at global growth, the growth of the U.S. and Europe is generally flat. But if you look at the growth of the economies in specific markets outside the U.S. and Europe, the growth is positive, more like 5% to 7%. That growth, coupled with the fact that they have historically been underweighted, compels investors to see what opportunities exist.

A lot of the players in Asia, or in China and India specifically, are new. The China market is 10 years old; the India market is a little bit older, but not by much. Because these are brand new markets, people are now focusing on them and adding them to their mix.

VELA: Is it fair to say that the prospect pool for endowments willing to invest in Latin America is growing larger?
CHARLIE: I think that is true across the board: for endowments, pension funds, both public and private. There are fund-of-funds and asset managers who are now including Latin America as a part of their portfolios and those that are specifically dedicated to emerging markets or offshore portfolios. There are a number of people who are considering raising fund-of-funds for Latin America.

However, there is a very real constraint in Latin America and a constraint in all of these emerging markets.

U.S. public pension funds, given the amount of capital they have under management, often are constrained in terms of the fund sizes that they can consider.

It is hard to find general partners who actually have track records. The challenge is finding groups who have investment track records, realized track records, and/or the relevant skill sets and experiences in operating and consulting, which can serve as proxies for experience. There needs to be evidence that there is relevant experience that will allow them to be successful going forward

MARY: In terms of international investors having a presence on the ground, we are beginning see that in Latin America. Asia, specifically Hong Kong and Singapore, has historically had a large international LP community. We are now seeing some advisors and fund-of-funds opening offices in Brazil, Colombia, etc. to evaluate direct and fund opportunities.

VELA: What is the attitude of U.S. State pension funds towards investing in Latin America?
CHARLIE: We've definitely seen an increase in interest from pension funds, some of whom are "returning" to the region after negative experiences in the late '90s.

MARY: U.S. public pension funds, given the amount of capital they have under management, often are constrained in terms of the fund sizes that they can consider. If their investment bite size is $100 million, for example, then typically they'll only look at funds

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