

# BRAZIL

**CONFIDENTIAL**

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## PRIVATE EQUITY: SANTA CATARINA: REVITALISING AND MODERNISING

### SUMMARY

> **Santa Catarina's** long established manufacturing sector has been hard hit by the appreciation of the Real and competition from China. Family-owned companies in sectors such as ceramics have been slow to adapt.

> **The state government** is identifying areas that it wants to target for investment offering incentives to stimulate activity in especially depressed areas. The heartlands of Joinville and Blumenau have been most hit.

> **Private equity inflows** have been limited in manufacturing and agriculture, but there has been a flurry of activity around the relatively strong IT sector. State government promotion could accelerate development.



Florianópolis, the state capital, is a centre for tourism, IT and telecoms

### Industry in Santa Catarina is under threat from Chinese competition but the state is capitalising upon its highly-educated population to build a vibrant IT sector.

**S**mall and tidy Santa Catarina in some ways bears closer resemblance to the Germanic countries, to which much of its population traces its ancestry, than many of its fellow Brazilian states.

It has some of the best socio-economic indicators in the country – illiteracy rates are low at 4.4% and GDP per capita stood at R\$20,369 (\$12,155, £7,662, €8,919) in 2008, compared with the national average of R\$15,240. This contributes to a relatively high quality of life and means that executives from São Paulo often prefer to base their families in smaller, more manageable Florianópolis and commute back and forth.

The state's higher standard of living is based upon a diverse industrial and manufacturing base, which extends from furniture, textiles and ceramics sectors to metallurgy and engine manufacturing, together with the presence of a small, but sophisticated agricultural sector. But the ability of the Chinese to undercut on pricing together with a mixed picture on local infrastructure – the state has good ports but poor hinterland links – means that the sector is experiencing a decline. As a result the administration of Governor Raimundo Colombo (of the Social Democratic Party (PSD)) has been capitalising upon a highly-educated local popu-

lation and a strong entrepreneurial culture, which has spawned large, niche companies such as electric engineer WEG (WEGE3:SAO) and agro-industrial Duas Rodas, to push the information technology sector, and this has seen considerable investment from seed and venture capital firms.

### Transition state

Despite having industrialised earlier than much of Brazil, increased competition from the far east is of major concern, particularly in the industrial heartland around Joinville, the state's largest city, and Blumenau, in the north-east of the state. Industry declined from 42% of state GDP in 2004 to 33% in 2010. A recent survey by **The Federation of Industries of the State of Santa Catarina** (FIESC) found that 41% of the state's companies believe they are facing Chinese competition and 29% are losing space in their home market.

Glauco José Côrte, president of FIESC, acknowledges the depth of the challenge. The strong Real, tough competition from overseas, higher wages and government

### Santa Catarina in figures

Population (2010)	6.3m
GDP per capita (R\$, 2008)	20,369
Minimum monthly wage (R\$)	545
Governor (party)	Raimundo Colombo (Democrats)

Note: R\$1=\$0.6, £0.37, €0.43

Sources: IBGE, Brazil Confidential, CEPA

► taxation have all taken their toll, he says. The reluctance of companies to bring in outside shareholders, has exacerbated the problems. He sees a greater readiness by the new generation to professionalise the running of companies with better hiring and governance policies and believes this presages a greater opening to outside investors, although he cannot yet point to specific progress

*Increased competition from the far east is of major concern, particularly in Joinville, the state's largest city, and Blumenau, in the north-east of the state*

with listings on the Bovespa, for example. Consolidation in fragmented industries such as ceramics would also be desirable but there have been few such deals.

Elected last year, Paulo Bornhausen, state secretary for sustainable economic development and federal deputy, has identified poles of excellence and municipalities suffering from under-development, both of which will receive special incentives. He has also outlined measures to simplify tax for companies.

Mr Bornhausen is keen to attract investment, but so far inflows have been disappointing. One exception, however, is CRP Participações, one of Santa Catarina's largest private equity investors. In August, **CRP Participações**, one of the largest private equity investors in the state, bought 16.67% of **Librelato**, Brazil's fourth-largest maker of trailers and semi-trailers based in Orleans in the south

of the state, for an undisclosed sum.

The investment will go towards a significant expansion with investments of R\$100m planned between 2012-2014 to increase production some 50% per year to 10,000 units through organic growth and acquisition with factories planned in Goiás and São Paulo states. This year, the company expects sales to hit R\$500m, up from R\$342m in 2010. The longer-term plan is to tap capital markets to allow CRP to divest its stake.

Many private equity funds seem to be sitting on the sidelines as the state's industries suffer. **Darby Investments**, a large US-headquartered emerging market private equity company, which invested in **Cecrisa Revestimentos Cerâmicos** in 2003, exited that investment a couple of years ago and currently has no specific plans to invest in the state. Other firms that have private equity-focused arms, including Santander (SANB4:SAO) and Intel (INTC:NYSE), say they have looked closely at companies in the state without closing any deals.

As well as growing foreign competition, Mr Côte cites logistics as an obstacle for growth and provision in this area is uneven. Santa Catarina has excellent and well-developed ports, but they suffer from poor road access, symptomatic of an increasingly inadequate state and national network. ►

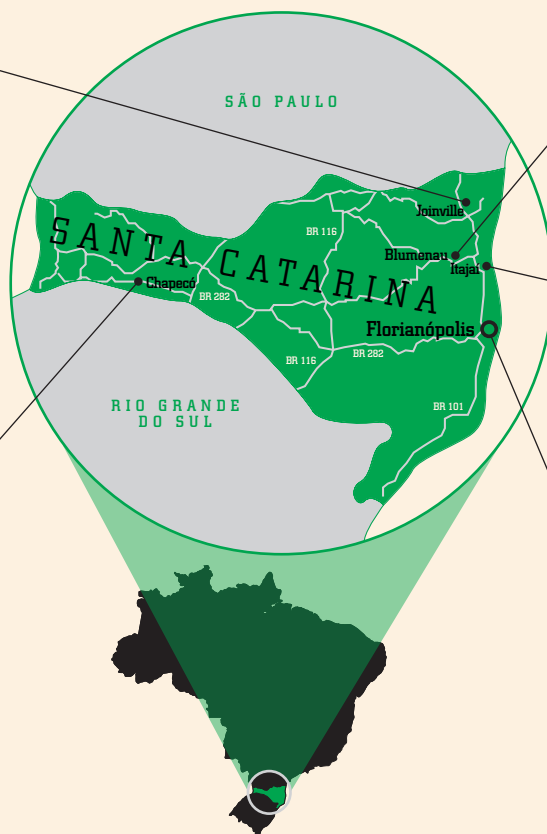
**INSIGHT  
SANTA CATARINA BUSINESS AT A GLANCE**

**Joinville**

The state's largest city and one of Brazil's major industrial poles, accounting for close to 20% of the state's GDP. Industry includes metallurgy, chemicals, plastics, textiles and software.

**Chapecó**

The largest city in the west has a high concentration of food and drink industries with close to 3,000 companies which employ some 95,000 people. Chapecó is one of the largest centres for poultry and pork processing in Latin America, exporting extensively to Russia, the Middle East and Europe.



**Blumenau**

The main rival to Joinville, Blumenau is known for its textile industry and is home to national brand names in the sector such as Dudalina and Bovespa-listed Hering.

**Itajaí and Navegantes**

Home to a growing port and naval yards, Itajaí is already starting to benefit from Petrobras contracts to build ships and platforms for the pre-salt oil finds. The area is becoming a centre for producing leisure craft and an increasingly important destination for tourists.

**Florianópolis**

State capital – a centre for tourism, public administration, IT and telecoms. Tech hub Sapiens Park is attracting Philips and IT firm Softplan/ Poligraph.

▶ The proportion of roads considered to be “terrible” has increased from 4.6% to 7.1% from 2009 to 2010, while over the same period those rated “excellent” have fallen from 13.1% to 9.6%, according to the **National Confederation of Transport**.

Given the state’s important role as an exporter – it exported \$7.58bn in 2010, or 3.8% of the country’s total, including 25% of national pork production and 14% of chicken production, despite having less than 3% of the national population, there is an urgent need for infrastructure upgrade.

*Santa Catarina has excellent and well-developed ports, but they suffer from poor road access*

Private equity is stepping into the gap. São Paulo-based **BRZ Investments** has invested heavily in port logistics, spending some R\$500m across the state since 2007. The firm

has made three port investments. The first is a greenfield container terminal project in Itapoá, in which it co-invested with Grupo Batistella, alongside Hamburg Süd and its subsidiary Aliança, in 2007. The project, which was inaugurated at the end of last year, takes advantage of a deep port and has tied in clients through long-term commercial contracts, says Ricardo Propheta, manager and co-head of private equity at BRZ.

In the port of São Francisco do Sul, BRZ invested initially in 2008 in a container and general cargo terminal and has more than doubled its capacity to 600,000 20-foot equivalent units per year. It is also working on a greenfield private grain terminal that will have eight million tonnes per year capacity to be located alongside the public terminal, although the final licenses for this project are still pending.

The investments come from the firm’s logistics fund, Brasil Logística FIP, and are contained in a holding company. The exit strategy is to grow the portfolio of assets within the holding company and IPO the latter when critical mass is reached, which will probably be in the next four years.

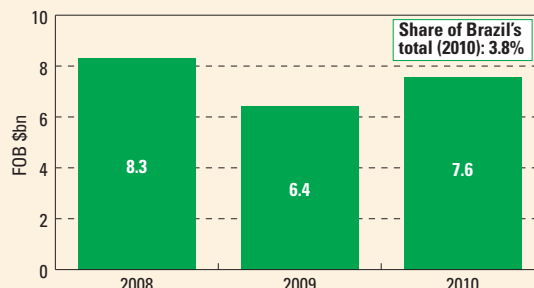
**Agriculture: small is beautiful**

Lacking the cheap land and territorial size of the states of the centre-west and north-east, Santa Catarina nevertheless has some strengths in niche areas. It has outstanding pork and poultry farming and processing, says José Pedrozo, president of the state federation of agriculture and cattle. It is also the only Brazilian state to be internationally accredited as foot-and-mouth disease free. This has been attracting Italian and Japanese investors. Mr Pedrozo was recently visited by an Italian delegation interested in exporting live cattle to Turkey and the Middle East, while the Japanese are looking at importing poultry and pork.

The state’s agribusinesses has piqued the interest of specialist private equity fund **Mercatto Alimentos**, which has a total of some R\$2.7bn in assets under management. It bought 40% of Indaial-based **Villa Germania Alimentos**, the largest producer of duck meat in the country, for an undisclosed sum last year. Vila Germania exports close to 70% of its production and will look to increase slaughter capacity from 7,500 ▶

**Exports inching towards 2008 levels**

Total exports, 2008-2010



Source: MDIC

**Food companies dominate exporters**

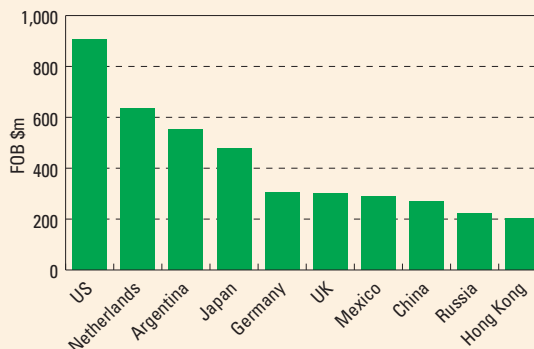
Top five exporting companies, 2010 (FOB)

Company	Total value per company (\$m)	Share of total state exports (%)
Seara Alimentos (food)	646.9	8.5
Weg Equipamentos Eletricos (electrical)	581.5	7.7
Sadia (food)	549.8	7.3
Whirlpool (domestic appliances)	524.9	6.9
BRF – Brasil Foods (food)	524.4	6.9

Source: MDIC

**US the biggest export market**

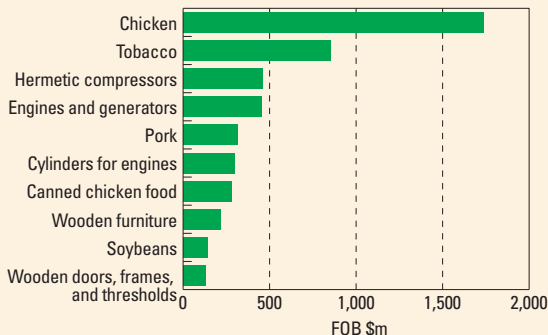
Top ten export markets, 2010



Source: MDIC

**Chicken the biggest export product**

Top ten exports, 2010



Source: FIESC

► ducks per day to 25,000 by 2013 with the money. But agro expansion is more restrained than in other states. “We don’t have the space to increase our production significantly. Productivity and efficiency gains will be the solution for us,” says Mr Pedrozo.

**Information technology**

The greatest flurry of investment activity is around the state’s nascent IT sector. It is noted for its flexibility and client-orientation since it grew on the back of the strong industrial demand for IT solutions to specific problems. Conscious of the potential of the sector to fill a gap generated by the decline of traditional industry, the government is promoting this sector. Under its SC@2022 Plan, the government aims to make the state the most innovative in Brazil within ten years.

*The new government has been mapping out the most promising locations in which to develop technology clusters and put the state’s 4,000 PhDs to work*

Mr Bornhausen says that the new government, which came to power at the start of this year, has been mapping out the most promising locations in which to develop technology clusters and put the state’s 4,000 PhDs to work. It has plans to support the development of such clusters, with the largest of these Sapiens Park, in the capital Florianópolis, having recently secured a commitment from the state’s largest IT company Softplan/Poligraph to invest R\$23m in a new building there.

The IT sector has also been attracting venture capital and seed money. The largest local fund, **CVentures Innovative Ventures and Holdings**, is a for-profit spin-off from the innovation technology centre CERTI, located on the state’s federal University campus in Florianópolis. CVentures works in partnership with private sector firms CRP Participações of Porto Alegre and BR Investimentos of São Paulo to identify, negotiate and manage investments. CERTI has a 49% stake, Instituto Sapiencia holds 30% while Instituto Certi Amazônia has 21%.

Last year, CVentures started raising cash for two funds, an R\$80m seed fund, which will invest only in south and south-eastern Brazil, and a R\$200m early stage venture capital fund, which can invest throughout the country, says Felipe Mattos, CIO. Investors include high net worth individuals, family offices, pension funds and development agencies such as the Brazilian Innovation Agency FINEP.

In Santa Catarina, the funds will focus on IT, telcoms, digital media including gaming, clean energy and life sciences. “After São Paulo, Santa Catarina is probably the most developed state for IT and many funds are realising just how many opportunities there are here,” says Mr Mattos.

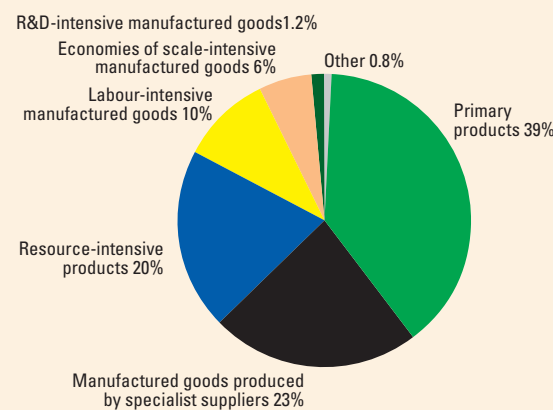
He is keen to avoid some common pitfalls of the venture capital industry in Brazil. He intends to provide more capital per company than the norm and to offer longer-term support through further rounds of investment, as many companies find the first round of investments insufficient for sustained growth. “We realised from our experience that to really help companies to

succeed, you need to put in a decent amount of cash. Most seed funds invest just half a million Reais and that’s not enough.”

The longer-established **Criatec**, funded via the National Economic and Social Development Bank (BNDES) and Banco do Nordeste do Brasil (BNBR4:SAO), also ►

**Primary products dominate exports**

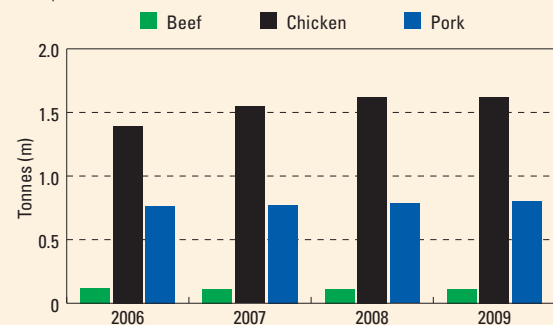
Technological Intensity of Santa Catarina’s exports, 2010



Source: FIESC

**Chicken dominates local meat production...**

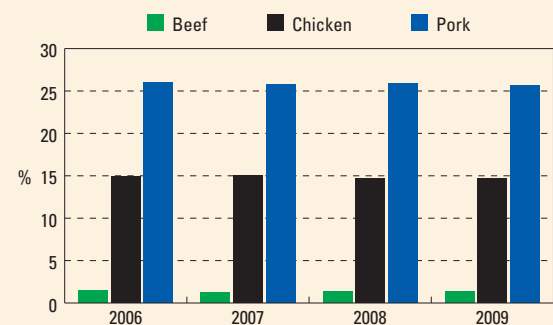
Meat production, 2006-2010



Source: Cepa

**...and state is major pork producer**

Santa Catarina’s meat production as proportion of Brazil’s, 2006-2010



Source: Cepa

*“Santa Catarina is the regional leader. There is a real cluster of quality businesses here”*

uses an outside fund manager, Antera Gestão de Recursos, to help select investments for its existing R\$100m fund. Criatec focuses on innovation technology and Reinaldo Coelho, manager for the fund’s southern region says, “Santa Catarina is the regional leader. There is a real cluster of quality businesses here.”

The fund, with a mandate to invest across the south is heavily skewed towards Santa Catarina. Of the five investments made, or underway, in the region, four are in the state, which has the region’s smallest geographic area and population. Very small IT companies in the state are growing fast and looking to exploit windows of opportunity to grow organically and acquire competitors, Mr Coelho notes. Two of these local companies, Arvus Tecnologia and Cianet, received second rounds of financing, which Criatec provides only for a very select handful of companies. Arvus has received a total of R\$3.5m and Cianet R\$4m.

Bernardo de Castro, director at Arvus, sees a growth of demand for his precision agriculture technology. This helps farmers control application of fertiliser and pesticide through the use of on-board tractor computers. Arvus counts some of the largest forestry companies as its clients including Fibria (FIBR3:SAO) and Grupo Suzano (NEMO3:SAO) who use the technology for planting eucalyptus.

The company more than doubled sales last year from R\$1.1m in 2009 to R\$2.4m and expects to repeat that feat this year with predictions of R\$7.2m in profits. As well as growth in existing forestry and agro sectors, Mr de Castro sees opportunities in sugar cane, mining, and construction and may create spin-offs in those sectors. Today, Criatec has 40% of the firm and the firm’s partners 60%. Future investments will come mostly from government financing, although if the firm does spin off subsidiaries, they may involve funds.

Cianet produces home phone-line networks and fibre-optic solutions in broadband, working with internet service providers and telecoms operators. Billing has moved from R\$5m in 2009 to R\$8m last year and José Francisco dos Santos, president, estimates sales of R\$16m this year. Cianet posted profits of 9.8% of sales in 2009 and 12.1% last year. Brazil is expanding broadband penetration, particularly among low-income groups in metropolitan regions as a result of the National Broadband Plan, leading to an increase in broadband availability of some 170% in the next four years, according to Mr dos Santos. “This is the era of Brazilian broadband and we need to exploit it now and become a mid-sized firm. We cannot wait,” says Mr dos Santos. The company is looking at expansion into the rest of Latin America next year, he adds.

Until six years ago, Cianet had not sought external investments. Today, Mr dos Santos is speaking to two funds that are keen to invest as well as a Colombian company that is looking to gain a foothold in Brazil’s subscriber TV market.

Criatec also invested R\$1.5m in Welle Laser, which

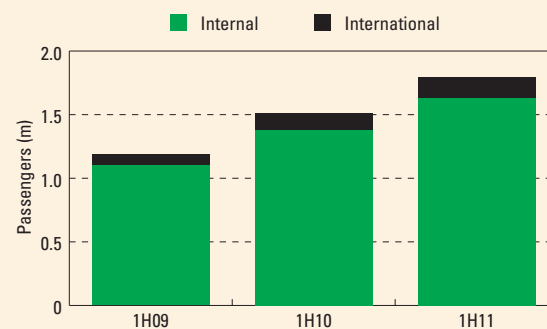
uses laser technology to engrave metals and polymers, and is working to close a deal in the nanotechnology sector in Florianópolis, which is pending approval.

Other funds focused on the IT sector include **DLM Invista**, headquartered in São Paulo but with a small office in Santa Catarina. The firm recently bought a 20% stake in Chaordic Systems, which develops software that helps select commercial real estate, for an undisclosed sum. The money will be used partly to help increase staffing levels.

Santa Catarina is a particularly attractive state for IT, believes Paulo Caputo, partner at DLM. ▶

**Air travel on the rise**

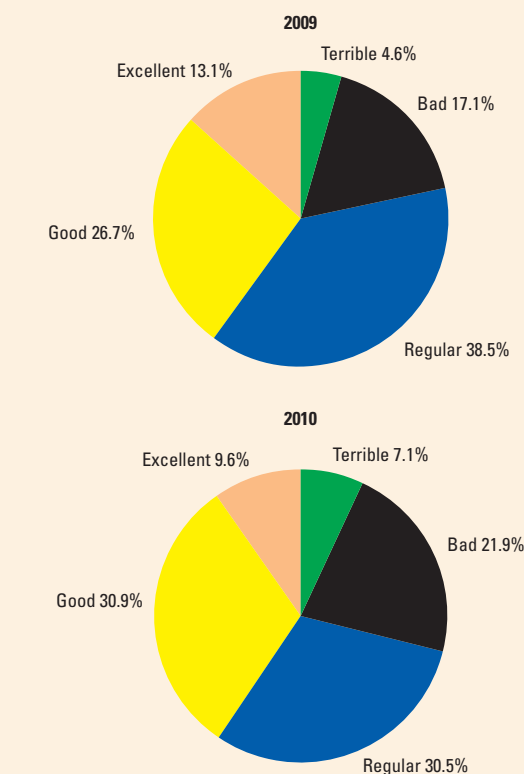
Total passengers Florianópolis International Airport, 1H09-1H11



Source: INFRAERO

**Road conditions worsening**

General condition of the roads, 2009 and 2010



Source: CNT

There are a large number of companies in the state that specialise in business-to-business (B2B) applications, which he believes have better growth prospects than more established business-to-consumer (B2C) companies.

DLM is finishing fundraising for a new R\$200m venture capital fund and sees Santa Catarina as a prime focus, particularly for businesses developing software as a service, cloud computing and e-commerce applications. The plan is to invest in some ten companies and the firm is in talks with two foreign partners as co-investors. Providing financing will also help accelerate rapid consolidation in the IT industry in the

state, which is highly fragmented, and that should produce companies with the critical mass to compete, Mr Caputo says.

Smaller funds are here too. BZPlan was founded in 2003 as a consultancy in the IT sector, but Marcelo Wolowski, a founder of the Florianópolis-based company, quickly realised the best opportunities lay in running funds. The company raised R\$12m for a technology fund, with support from FINEP and the state government. Mr Wolowski has already identified four companies in areas including e-commerce, logistics tracking, virtual publishing and e-procurement. "The greatest difficulty is in fundraising, not in spotting opportunities in tech-rich Santa Catarina," he says.

Investors in the south, including FINEP, the state government of Paraná and the regional Development Bank of the Extreme South (BRDE), are interested in putting together another fund similar to Criatec, which may have more to play with at R\$200m. The BNDES is also looking to set up a new Criatec-style fund in 2012 with capital in excess of R\$250m.

Despite excellent prospects, a shortage of talent limits the speed of growth in the IT industry. While the federal university is seen as one of the best in the country in many engineering and computing fields, companies are already finding it tough to find qualified staff. Mr de Castro notes that finding workers, even in Florianópolis, is a headache and the most significant constraint on his company's growth. That means state government plans to woo international players – it is courting Philips (PHG:NYSE), which may build a light factory in the state – are not welcomed by local players who fear these large companies will sap the talent pool further.

Moreover, there is often a mismatch between expectations from seed and venture capital firms and IT companies. Rui Gonçalves, president of the Association of Technology Companies of Santa Catarina, says that many funds want to take a very large stake for little money and offer little commitment to the development of the businesses in which they invest. ■

## ACTION POINTS

**01 Outside São Paulo, few states offer as much potential for investors in information technology as Santa Catarina. New technology funds, such as those run by CVentures, provide more capital per company than the norm elsewhere in the country and are prepared to offer long-term support.**

**02 A relatively large number of technology companies specialise in B2B applications, which have relatively good growth prospects.**

**03 BRZ Investments is investing in the state's port infrastructure and aims to launch an IPO for a specially dedicated holding company within the next four years.**

## Paper, food and metals take lion's share of investment

Amount invested in different types of industries, 2010

	Investment (R\$m)	Share of total (%)
Pulp, paper and paper products	183.4	18.1
Food and beverage	163.4	16.1
Basic metallurgy	153.1	15.1
Clothing	98.9	9.8
Machinery, equipment and electric materials	76.0	7.5
Machinery and equipment	71.6	7.1
Textiles	53.6	5.3
Non-metallic mineral products	51.8	5.1
Furniture	32.5	3.2
Electronic materials and communication equipment	30.9	3.0
Publishing and printing	29.0	2.9
Rubber and plastic	23.4	2.3
Metal products, except machinery	11.0	1.1
Leather and leather products	9.3	0.9
Wood products	6.9	0.7
Technology and IT	6.4	0.6
Vehicles	6.4	0.6
Chemical products	4.0	0.4
Others	1.0	0.1
<b>Total</b>	<b>1,012.4</b>	<b>100.0</b>

Note: R\$1=\$0.6, £0.37, €0.43  
Source: FIESC

## Who's who in Santa Catarina

Organisation	Contact	Job title	Telephone no.	Email
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Source: Brazil Confidential