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Insulin and Big Data Investing in Brazil

LPEJ Interviews Luiz Francisco Novelli Viana, Founding Partner and President at TMG Capital

By **Seth Fraser**



Luiz Francisco Novelli Viana,
Founding Partner and
President at TMG Capital

SÃO PAULO - LPEJ: Give us a brief background on your career experience in private equity and your firm.

LF: Prior to TMG, at 36 years old, I became the CEO of a large Brazilian conglomerate in distribution, retailing and wholesaling. Macroeconomic instability made it crucial for companies in the business of consumer finance, insurance and broker dealership to be created. These businesses were necessary to capture financial margins for the conglomerate I was leading. Hyperinflation was squeezing distribution margins and I had to start from scratch.

I then began my professional experience as a manager, attracting and hiring talent, bringing on technology and making these companies competitive. Around 1990, I decided to spin off as a shareholder from a group that at the time had sales north of \$1 billion and 14,000 employees. Subsequently I decided to start my solo career with my family office. The first thing I did was to acquire a boutique investment bank in partnership with foreign and Brazilian banks.

That's where I started the actual equity experience as a principal investor. At the time, Brazil was still undergoing hyperinflation and several mid-market companies approached me for advice as I was known for my previous CEO experience. When managing the large conglomerate I had contact with more than a thousand mid-market suppliers and industrial companies. Many of these players were family owned activities led by good industrialists whose businesses were severely wounded by hyperinflation.

Consequently, I started a business practice of providing these companies with turnaround services on a fee basis. I also provided them with banking facilities like discounting receivables and equipment financing, helping them to fulfil contracts and go back to higher performance. We worked with about 40 companies. Some two-thirds of these companies recovered performance and became profitable again. The lesson that I learned was that instead of having just a fee-based business, I would have done a lot better if I had invested equity. Based on this, I decided to start acquiring distressed

companies employing a methodical turnaround approach, hiring new talent and implementing high governance standards aligned with improved technology that would lead to improved performance.

Initially I bought two listed companies that were suppliers of the agribusiness sector and was able to bring them to performance. Upon restructuring those businesses, I sold them back to the capital market at a time when it was difficult to formulate successful exit strategies due to illiquid markets. After that, I realized that I did not just want to invest in distressed assets but thought there was an opportunity to put together a private equity fund take advantage of Brazilian opportunities as prices of real assets were very low.

One of our strategies was actually to address the issue of hyper-fragmentation. During these years of macroeconomic turmoil, companies were really fragmented because there was an implicit economic incentive to have a small company and just focus on financial returns as opposed to operating profits. And so with that we put together the first fund. I was one of the LPs, also because Brazil was not an investment destination and investors asked more of our own capital than they would normally do from a general partner. So, I founded TMG in 1997 with its first fund of \$100 million.

LPEJ: In what companies have you made some of your recent investments in Brazil? Why?

LF: In the first fund we made 10 investments and bundled them into four platforms. We exited through IPO, strategic sales and one deal was sold back to the original shareholders. The return for the first fund was 47 percent per annum representing a multiple of 15 times investors' money in Brazilian Real terms. (40 percent per annum and 12 times investors' money in US dollars).

In one deal, which is known in Brazil as perhaps one of the best private equity deals ever done – the consolidation of the dental care system in the country with Odontoprev – we achieved a multiple of 40 times investors' money in Brazilian Reais. We listed Odontoprev in 2006 and delivered a return equivalent to 57 percent per annum. That's the first fund.

Taking into account the second and third funds together, we raised close to \$500 million. In information services we actively manage the second largest credit bureau in Brazil, renamed Boa Vista Serviços. A year after investing in Boa Vista, we absorbed the domestic operation of Equifax, the global information services company. As a result, the Brazilian market ended with two companies: Boa Vista and its competitor. Boa Vista is a company with sales revenues north of 500 million Reais and is growing at double digit rates. We are minority shareholders with very strong governance standards and managing an executive committee that runs the company.

In the business of big data and decision analytics we invested in Neurotech, a company based in Recife, state of Pernambuco and founded by PhDs in data mining, neural science and statistics. Our investment in Biotechnology was made in Biomm, a company based in Belo Horizonte, state of Minas Gerais and the first producer of insulin in Brazil. Finally, our investment in e-commerce is a company called OQVestir, an e-commerce leader in its market selling premium women's fashion through the web

with the best known Brazilian brands. We are considering now to invest in supply management and also nutrition products.

LPEJ: What is your take on the opportunity set right now in Brazil given lower GDP growth?

LF: Our business is highly correlated to the growth of the credit portfolio of the economy and not exactly to Brazilian GDP. Brazil is catching up in terms of credit. In spite of 2 percent growth in GDP last year, the credit portfolio is still growing at 10 percent per annum. That is basically information from negative and positive data to support companies and individual credit.

Brazil is perhaps the last large emerging economy that doesn't have a local producer of insulin. Unfortunately, we have a global diabetes epidemic, a non-infectious one, but still an epidemic. The population is aging, eating habits are bad, and people are unfortunately becoming diabetic. Brazil imports 100 percent of its consumption of insulin. So, that's not correlated with macroeconomic facts.

Neurotech is exactly a deal uncorrelated to GDP growth rates as well. It is a company that handles large volumes of information extracted from clients data, helping them make smarter analytics based decisions and improve their performances.

OQVestir is the same. It's about selling premium brands that are desired by young people in areas where products are simply not available. These companies that own those brands don't have physical stores in several areas. Brazil is a very large country and the premium brands are located in certain areas of the country, but obviously, there are more consumers that want to buy premium merchandise. I would say we are hedged against the macro issues, but I see Brazil facing another cycle. One of the things that people in emerging markets private equity have to confront is cyclicity. Therefore, our strategy is to look for the imperfections created by exactly these macroeconomic adversities.

The credit bureau company, Boa Vista, was owned by a chamber of commerce and when they found it, about 60 years ago, there was no equity available whatsoever. The chamber of commerce is not meant to own and run a company. Therefore, by bringing this up to the private sector and creating the logic of companies that are competitive because of the quality of the human capital and the quality of technology, you end up unlocking a lot of value that is originally present in the company but hidden behind the structure that is running it.

Imperfections were created by this previous cycle of the macroeconomic scenario in Brazil like the hyperinflation phase, the financing phase, the phase where cost of funds were absolutely absurd, exactly to counteract the hyperinflation effect. Brazil had to raise the cost of domestic debt to levels that were unsustainable, creating an issue to a company that would have to deleverage severely because of the cost of funds and the small tenure of the loans.

Now we are facing a new cycle in Brazil which is one of low growth coupled with a sort of a conundrum here. We have low growth and we still have high employment. It is record employment and income for people. So, I would say, therefore, that our strategy

is and will continue to be to look for the imperfections. I use this word a lot, because it's how I see it — the imperfections that are generated and created by these underinvestment phases, underutilization of technology, underutilization of human capital and regulatory matters.

The opportunities are not really completely correlated with the cycle of the economy. If you address a bottleneck that is created by these generators of imperfections you unlock a lot of value with capital management and strategy. The mid-market deals in Brazil are exactly where we want to invest in to help these companies circumvent the bottleneck, and then grow dramatically regardless of the actual macroeconomic scenario.

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