

ALTERNATIVE
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Issue 18 - October / November

The World's First
Diamond Fund

Ken Fisher on
LatAm

Brazilian Wines
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Wealth Management
Special Issue | In Search of
Transparency

Where the policy makers meet the industry heavyweights

30 October - 1 November 2012 Buenos Aires, Argentina

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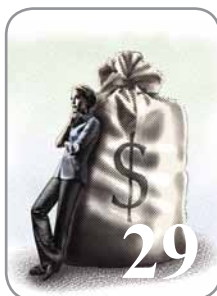
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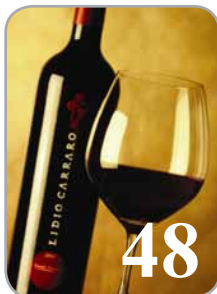
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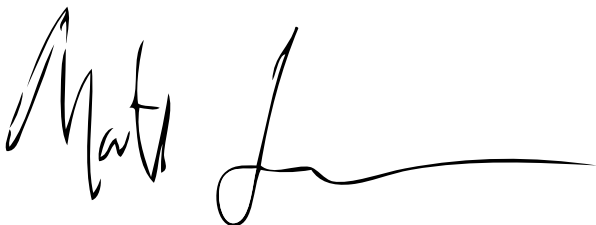
“What happens when an unmovable object meets an unstoppable force?” The question has been posed since the era of Zeus. Yet we have arrived at no suitable conclusion, which leads me to believe that some problems cannot be fixed, some questions cannot be answered, but instead must be accepted.

I raise this question to address the re-election of Hugo Chavez and the increasing instability of Argentina's Kirchner administration. While there are several factors to take into consideration, we can focus on the most relevant to our investor audience: the diaspora of capital, skilled workers and wealthy individuals. As a publication, Alternative Latin Investor strives to increase transparency, awareness and ultimately growth within the region. Argentina may have the inauspicious honor of being the first country to be censured by the IMF for providing false inflation data. In addition, among G-20 countries, Argentina accounts for 84% of pending cases at the International Centre for the Settlement of Investment Disputes. If we look at the Heritage Index of Economic Freedom, of 179 ranked countries, Venezuela is listed at No. 174, 5 spots above North Korea and 2 above Libya.

How should the investment community address these nations that seem to be doing everything possible to make themselves investment red flags? We have seen nothing, no specific investment or instrument, that can offset the formidable level of political risk in these regions. That is not to say opportunities don't exist, but if they do, they're hiding very well.

However, beyond the shadows of Argentina and Venezuela, the rest of the region continues to shine. In this edition of Alternative Latin Investor we focus on the wealth management sector, which is growing not only in size, but also in sophistication and regulation. This growth has reached the point where not only are assets in the region growing, but additionally, US-based service providers are venturing south in order to capitalize on demand for financial services support.

We are very excited to have had the opportunity to chart these changes and advancements over the past 3 years and thank you for your continued interest, which allows us to continue doing so.



Saludos,

Nate Suppaiah

ALTERNATIVE LatinInvestor

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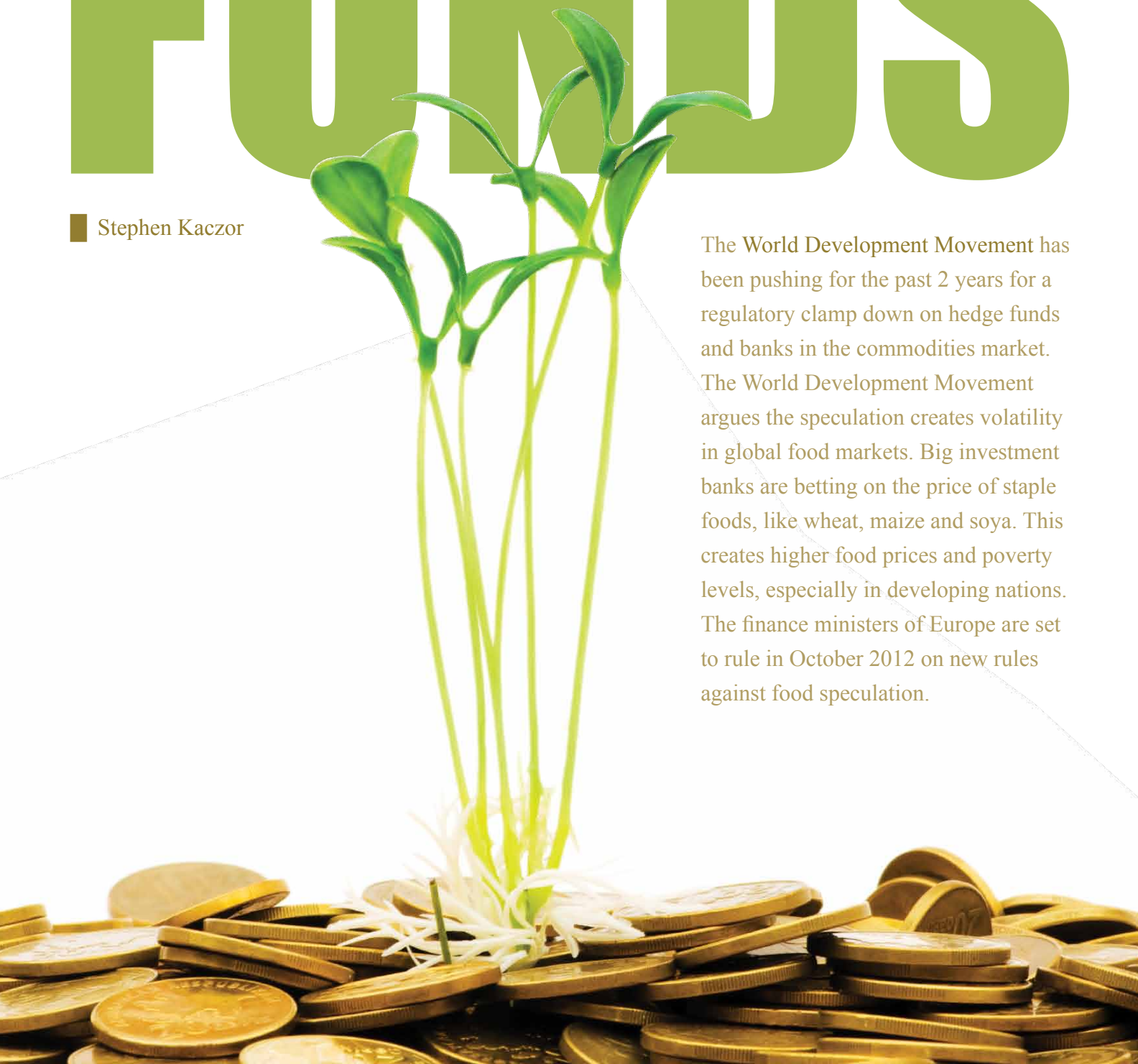


FRASER YACHTS

AGRICULTURAL INVESTMENT FUNDS

■ Stephen Kaczor

The World Development Movement has been pushing for the past 2 years for a regulatory clamp down on hedge funds and banks in the commodities market. The World Development Movement argues the speculation creates volatility in global food markets. Big investment banks are betting on the price of staple foods, like wheat, maize and soya. This creates higher food prices and poverty levels, especially in developing nations. The finance ministers of Europe are set to rule in October 2012 on new rules against food speculation.



According to The Guardian, at Britain's oldest food market, Borough Market in London, fund managers at one of the biggest investment groups in the world are telling a different story. BlackRock is rolling out its World Agriculture Fund for small investors who, it says, can profit from the long-term increase in food prices as rising affluence in China, India and Brazil dramatically changes dietary habits.

BlackRock is not alone in seeing agriculture as an industry ripe for attractive investment returns. Last year, Baring launched a global agriculture fund that allowed its early investors a 30% gain. Speaking about BlackRock and Baring, The Guardian's Patrick Collins wrote an article titled *Is Agriculture the Next Big Investment Thing?* He said, "Both groups see their funds as appropriate investments for British pension funds over the long term."

But there are many agricultural investment funds. We will take a look at the concept in general and introduce 3 examples. A report from the Food and Agriculture Organization (FAO) framed the challenge this way:

"Investment is essential for the growth of the agricultural sector if there is to be enough food to feed the world population of 9 billion in 2050. In 2007, food commodity prices climbed to record levels, which, among other reasons, contributed to the current global food crisis. Against the background of the high food prices, it is estimated that in 2008, the world's hungry increased by about 80 million to approximately 1 billion people. During the first half of 2009 only, the number of hungry increased by another 105 million."

This figure equals the increase in the number of hungry during the previous 17 years, according to The Economist. "And this number has been rising by an additional 4 million people every week" (Aloisi, 2009).

With such increase in demand among a growing global population, there is clearly a role for agricultural investment funds. But many believe the traditional speculative aspects of investment funds have no place in global food markets. This is leading to a new type of investment fund, a change that many believe is justifiable.

The FAO believes Agricultural Investment Funds have underscored the public and private sector's interest to help address the resource constraints for achieving food security. One of its recommendations is limiting the role of speculators. "The volatility in financial markets and the volatility of commodity prices, which have been partially caused by speculation, must be contained as

ies, which offer commercial credit to agricultural cooperatives. The credit guarantee will be phased out step-by-step during the following loan cycles of the recipient. The local bank finances the client on the basis of the sales contract with the off-taker and does not require the borrowers to provide fixed assets as collateral.

The fund is operating in 5 countries (Peru, Nicaragua, Honduras, India and Mozambique), where it has established partnerships with 7 banks and has issued guarantees in the total amount of US\$30 million. A specific example is SAGF's funding guarantee in Peru to local institutions dealing with Cepi-cale, a cooperative organization consisting of 71 smaller member organizations, which

BlackRock is not alone in seeing agriculture as an industry ripe for attractive investment returns.

far as possible. Markets for complex financial instruments related to agriculture will remain attractive for investors. However, from a developmental perspective, there should be a focus on thoroughly assessed investment opportunities in agriculture with a sustainable impact. The FAO report provides detailed case studies, but we will take a brief look at 3 examples:

In 2008, Rabobank International established the Sustainable Agriculture Guarantee Fund (SAGF) with a grant contribution of the Directorate General for International Cooperation of the Netherlands (DGIS). The fund has been set up to improve access of cooperatives to formal finance in developing countries through a guarantee scheme for pre-export finance. SAGF issues partial credit guarantees as a risk-mitigating instrument for local financial intermediaries,

which represent a total of 5,000 producers of coffee, cacao and sugar cane producers. In terms of impact, it is estimated that the fund has benefited approximately 27,000 producers during the first year of operations.

The Burlington Capital Group's Agribusiness Partners International (API) focuses on agribusinesses in emerging markets. With the fall of communism, the API recognized the opportunity to develop an agribusiness investment fund in the former Soviet Union. It was formed as a \$100 million private equity investment fund. The fund enjoyed the support and partial guarantee by the Overseas Private Investment Corporation (OPIC). API invested in 8 food and agribusiness sector operations. These investments were primarily early-stage investments or startups. The private equity fund invested in companies that acquired

8 Agribusiness

old Soviet assets, invested in upgrades and developed modern, world-class competitive companies. Despite severe economic crises, 7 of the 8 are thriving today.

According to its website, API seeks to invest in established agribusiness companies that have the potential to become leaders in their markets with distinct business models, but also have transformational opportunities such as:

Look at the constants: diminishing yields, population growth, lack of farmland, growing demand for agricultural commodities from the energy sector.

- Investing for growth
- Operating improvement opportunities
- Implementing practices that promote sustainable agriculture
- Expanding geographically
- Repositioning strategically
- Capitalizing on shifting product trends or end users
- Acquiring add-on businesses or product lines

Just this year, TIAA-CREF finished raising \$2 billion for its agricultural investment com-

pany including commitments from pension funds in Sweden and Canada's British Columbia and Quebec. According to Amy Or reporting for the Wall Street Journal, "It was set up as a company instead of a fund and focuses on farmland in the US, Australia and Brazil. It aims to invest about 70% of the \$2 billion in land that grows annual crops like cotton and soybean and the remainder on land for permanent crops like apples and almonds." One of the focuses is on protein crops, which we've written about in this space previously.

Jose Minaya, head of global natural resources and infrastructure investments at TIAA-CREF, says, "We see increased protein consumption in developing economies and alternative energy mandates driving increased demand for food, fiber and fuel from a limited resource: land. Direct investment in farmland provides access to the key driver of food production. We believe farmland offers investors excellent portfolio diversification given its low correlation to traditional asset classes like stocks and bonds. Farmland also acts as hedge against inflation within a portfolio," Mr. Minaya said. The journal Institutional Investor believes this team may have launched the future of institutional investing.

Look at the constants: diminishing yields, population growth, lack of farmland, growing demand for agricultural commodities from the energy sector. These constants create opportunities where infrastructure can be developed through financing, irrigation and distribution efficiencies.

Latin America has the climate, soil, labor structure and financial climate to feed more of the world, driving increases in agricultural exports to neighboring countries as well as Africa and Asia. What is missing is financial and logistical support for cooperatives and small companies to become players in export markets. Agricultural Investment Funds have the potential to join investors' ROI expectations with the need for development of the global food supply.



AUTHOR BIO

Stephen Kaczor is Chairman of the Big River Foundation, a non-profit focused on river and watershed ecology conservation initiatives throughout the Americas. He is an organic farmer, eco-entrepreneur, consultant, and a writer with a documentary film in production in Central America. As a Panama-based consultant, Stephen's focus is sustainable organizational development, research & management. In addition to consulting and writing, he is passionate about sustainable agriculture, Latin American culture, travel, and ecology.

www.BigRiverFoundation.org

Foreign companies eyeing a slice of Brazil's World Cup and Olympics infrastructure bonanza face a unique set of Foreign Corrupt Practices Act (FCPA) risks. Facilitation payments and bid rigging are particular concerns for investors seeking not to run afoul of the US anti-corruption statute.

Infrastructure projects involve a lot of permitting and licensing, and those are "ground zero" for FCPA violations, according to Matthew Feeley, an attorney specializing in the FCPA at Buchanan, Ingersoll & Rooney, a US law firm headquartered in Pittsburgh, Pennsylvania. Furthermore, the time pressures surrounding major sporting events such as the World Cup create added risk. Brazil has already come under criticism for the construction of the facilities needed for the 2014 World Cup and the 2016 Olympics being behind schedule.

Feeley said the further along you get without sound infrastructure, the more pressure there is to do things quickly. Such scenarios raise the issue of facilitation payments — money paid to expedite or facilitate the performance of routine governmental actions by public officials — which are permissible under the FCPA. Such payments are particularly common in emerging economies where government officials earn low salaries.

However, Feeley said there is a distinction between paying something to be done on an expedited basis and outright bribery. Whenever you are paying a government official to do a task they are already obligated to do, then you necessarily implicate the FCPA or another law, he said.

While the Department of Justice (DoJ) has declined to specify a dollar value on what constitutes facilitation payments, Feeley said the conventional wisdom reflected in corporate compliance programs limits such payments to US\$100.

Brazil's Olympics and World Cup Projects Highlight FCPA Risk

■ Raymond Barrett, Policy & Regulatory Report

Once that threshold is passed, there is at least the perception that the government official is being paid to do something more than they are obligated to do, he said.

Retail behemoth Wal-Mart is currently the subject of an FCPA investigation. While

some commentators have proposed that Wal-Mart may have a facilitation payment defense because the company paid to receive licensing permits in Mexico, Feeley pointed out that the alleged payments involved tens of thousands of dollars and were cumulatively in the millions.

10 Infrastructure

"I don't think there is anyway the enforcement authorities consider those to be ... facilitation payments," he said. And he added that in light of the Wal-Mart case, companies need to be "extremely careful" about facilitation payments.

Changes in the global regulatory environment are also making facilitation payments an increasingly risky tool for companies to deploy overseas. Feeley said there was an "explicit rejection" of facilitation payments in the 2010 UK Bribery Act. Therefore, if a US company is committed to entering Brazil beyond the World Cup and the Olympics, Feeley said making investments to understand the local culture is "money very, very well spent."

Along with the World Cup and the Olympics, Brazil's flagship Growth Acceleration Program (PAC 2) has earmarked more than US\$500 billion for key infrastructure investments from 2011 through 2014, and US firms are keen to be involved. Brazilian President Dilma Rousseff has taken an aggressive stance on corruption, and several government ministers recently were fired for alleged corruption.

While a new anti-corruption law the Clean Company Act is currently winding its way through the Brazilian Congress, Brazil is also in the midst of a high-profile bid-rigging scandal involving local construction giant **Delta Construcoes**. Delta faces allegations of bribing senior politicians to win government infrastructure contracts.

As such, US companies looking to invest in Brazil are "hyper-aware" of the FCPA, according to Reeve Wolford, managing director for Latin America at the Altrius Group consulting firm in Washington, D.C. Wolford said the big, top-tier companies are most aware of the FCPA. "Smaller companies figure they are off the radar screen," he said. While bribery is less prevalent in Brazil than in other emerging economies like Russia, it is still a significant issue, as Brazil ranks alongside India on global corruption indexes. And within these economies, infrastructure is a particularly high-risk sector. "In infrastructure, definitely ... wherever you don't see US companies, that's generally where there's the most corruption," Wolford said.



Wolford said corruption in the construction sector often involves a consultant being paid a fee but “no one knows what that fee covers and what the costs might be.” He also pointed out that in a large country like Brazil, with many regional governments, norms towards bribery can vary in different parts of the country.

for an event. Despite the potential quagmire of FCPA risk, Feeley said there are also broader political factors at play. He said the US has a commercial interest in welcoming Brazil into the “big leagues of world affairs.”

“I don’t think the US enforcement authorities are going to be very keen to bring an

There is a distinction between paying something to be done on an expedited basis and outright bribery. Whenever you are paying a government official to do a task they are already obligated to do, then you necessarily implicate the FCPA or another law.

Another aspect of high-profile sporting events that creates particular FCPA risks is corporate hospitality. According to Feeley, hosting government officials at high-profile sporting events carries all types of risk, and under no circumstances should a government official be given a freeticket

enforcement action or initiate an investigation that might embarrass the Brazilian government,” he said. “I think the US will tread lightly, not in relation to Brazil in general, but in relation to these two specific events,” Feeley added.

AUTHOR BIO

The Policy and Regulatory Report (PaRR) is an intelligence and analytical news service that focuses on the development and adaptation of competition law around the world. Our coverage spans North America, South America, Europe, the Middle East, Africa and the Asia-Pacific region. PaRR focuses on the intersection of global competition law with intellectual property, trade and sector-specific change in which there is a direct impact on the fair market practices of governments and corporations worldwide. To learn more about PaRR, visit www.PaRR-Global.com. For information on becoming a subscriber or to arrange a free trial, contact sales@PaRR-Global.com.



Social unrest in Latin America

Opposing hydroelectric projects

Protests against hydroelectric plants in Latin America may not have attracted as much attention as those against opencast mining, but names such as Brazil's Belo Monte have made headlines beyond the region. One thing is certain: Latin America is going after hydroelectricity in a big way. Many of the projects are in the large to "mega" categories, and these are most likely to be the main target of protest actions in coming years.

The Center for International Environmental Law (Ciel), in a study of hydroelectric projects planned for the Andean Amazon area, has identified 151 plants with more than 2MW-installed capacity. Of these it has classified 47% as having a high environmental impact. The study has also revealed a clear trend toward building bigger hydroelectric plants.

In Peru, where two-thirds of the existing plants have less than 15MW, two-thirds of the 79 planned new ones are either large or "mega." While Peru's largest existing plant has 798MW, 11 of the planned new ones are

bigger than that. Ecuador has 16 hydroelectric plants, of which only 4 have more than 100MW, one of them exceeding 1,000MW. Of the 18 planned new ones, 5 are in the "mega" category. In Bolivia only one of the existing plants has more than 100MW, while 8 of the 10 planned new ones are in the large or "mega" brackets.

Reaching further downstream in the Amazon basin is the hydroelectric complex of the Madeira River, which has been billed as the main initiative by the Initiative for the Integration of the Regional Infrastructure of South America (IIRSA) and the biggest anywhere in the basin, with 4 interconnect-

ed plants — 2 in Brazil, one in Bolivia and one on the river that serves as the boundary between Bolivia and Brazil.

South of the Amazon basin and east of the Andes, major hydroelectric expansion is planned in Brazil, partly on its own, partly with Argentina, the latter also planning expansion jointly with Paraguay. Over the coming 10 years, in order to meet the projected increase in demand for electricity, Brazil will need to install new generating capacity equal to 3 times that of the Brazilian-Paraguayan Itaipú.

In the Uruguay River basin there are already 5 hydroelectric plants with a joint installed

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capacity of 5,181MW. Apart from the planned 2,700MW Garabí-Panambí complex there are 2 other projects on the drawing board, which will jointly add 1,469MW. On the Paraná River, which already has 2 mega-hydros (the 14,000MW Itaipú and the 4,050MW), a 3rd project, the 4,608MW Corpus, is likely to be reactivated fairly soon.

In Central American countries, developments in 2 countries are particularly significant. In Guatemala 4 new hydroelectric plants are being built, 17 more have been authorized but have not yet started building, and 7 are awaiting approval. There are also more than 125 small and ‘micro’ hydroelectric projects with less than 5MW installed capacity in the pipeline. The union representatives on the board of INDE, the national electricity board, say that if expansion of hydroelectric generation were to be entrusted to INDE, it could build 23 new plants with its own resources, which could jointly add 1,200MW to currently installed capacity. In Panama the government has granted 39 concessions to build new hydroelectric plants and is processing 45 applications.

Protests against hydroelectric projects have become widespread enough to prompt the creation of a Latin America-wide network of “movements against dams” because

of their perceived — and sometimes evident — social and environmental impacts.

Perhaps more than the anti-mining protests, those against dams (meaning hydroelectric projects) have been able to influence governments, if not entirely as much as protesters have demanded. Many factors are at play, and both sides have valid arguments. Governments do invoke economic imperatives and tend to play down, as do the private companies involved, potential environmental and social impacts. Some are quick to repress protest actions that they often portray as politically motivated; others argue that protesters are all too frequently misinformed.

Protesters tend to portray all hydroelectric projects as “mega-dams” and on some occasions mount protests against the effects of reservoirs that are not part of run-of-the-river projects. In common with anti-mining campaigners and other movements, they accuse governments of seeking to “criminalize social protest,” even when their actions are clear and substantial breaches of the law.

Note: This is an extract from LatinNews Special Report: Social Unrest in Latin America: Opposing Hydroelectric Projects (www.latinnews.com).

ABOUT LATINNEWS

LatinNews [historically known as Latin American Newsletters] has been at the forefront of respected political, economic, security and strategic analysis since 1967. We provide a comprehensive intelligence resource on 33 countries in Latin America and the Caribbean; covering political, security, economic and strategic issues. LatinNews is the de facto intelligence source for serious Latinamericanists, executives, governments and academics worldwide.



A client recently told me he was through with China, after more than 6 years trying to make money in the environmental and clean-tech sector. Reluctantly, he had become an adherent to short-term capitalism — if you have knowledge and expertise to sell, do it as quickly as you can for as much as you can, because that is all you will be able to do. However, I was struck by what he went on to say: Brazil is his next market. He sees a much greater appetite for equitable exchange, rather than forced transfer of people and practices.



His timing is good. With the Olympics and World Cup coming, Brazil is crying out for good partners:

- AECOM, the company that designed London's Olympic Park, already has the Rio master plan contract.
- The Organising Committee is keen to reach out to international firms with an established track record in IT and security projects.
- Development of the country's enormous pre-sal oil reserves requires foreign expertise even more than foreign money.
- The government's plan to educate a generation of engineers and scientists abroad will create new opportunities for the foreign firms in the countries where they studied.

In addition President Dilma Rousseff is prepared to confront her own Workers' Party over the future direction of infrastructure investment, having just announced R\$133 billion worth of concessioning to fund 10,000km of new railways, and the improvement or construction of 7,500km of roads. A World Cup and an Olympics are the excuse, but this is really a gutsy vision of creating a legacy, to compensate for decades of underfunded, inefficient and badly executed state involvement in infrastructure, and one that is necessary to keep growth rates at 3.5% to 4%.

However, the biggest threat to Brazil's "partnering economy" could be government interference, and policy decisions are becoming harder to predict. The government has just announced lower electricity tariffs in order to boost industrial competitiveness, and proposed changes to the concessioning process, which could prove counterproductive to the ability of utilities such as Eletrobras, CTEEP and CEMIG to improve infrastructure. The regulatory risk is that enforced price reductions lead to lower cash

flow, which results in less reinvestment in the sector and new entrants harder to find.

The Brazilian government is no stranger to announcing measures simply to see how both the domestic and international markets might react; in fact it floats more ideas past analysts and journalists than a Cowes Week PR girl. And a hallmark of Brasilia is its tortuous legislative process that means proposals often never see the light of day. However, such meddling echoes changes in the oil and gas sector in Brazil a couple of years back, when contracts moved from being predominantly royalty-based to production sharing. And you can see similar double-think in macro-economic policy: Sensible ideas to reform needlessly complex fiscal policy are accompanied by crudely slapping an arbitrary series of tariffs on foreign products to improve the trade balance.

In Dilma Rousseff, Brazil has a master tinkerer. Perhaps her most important difference to Lula is not ideology (although differences exist), but personal style (and I'm not talking about her taste for Celso Kamura's hairdressing). Rousseff's predecessor was both a pragmatist and a delegator to those he trusted. Rousseff is neither; she wants to be involved in everything. Someone even said to me that she's not really a politician in the proper sense of the word, but an administrator. That may work when you're Chief of Staff, but becomes more difficult when you are leader of the world's 6th-largest economy and need to set out a clear vision.

Brazil has the potential to reward its partners well. But partnerships are best formed over time. The current hyperactivity, and tendency to tweak rather than look at the bigger picture, is exactly what could put them off and leave my client scratching his head after another 6 years.



AUTHOR BIO

James Knight is a LatAm-based journalist and consultant with 10 years' experience of working in and with emerging market countries. He is Director of Pionero Partners, a Buenos Aires-based risk and strategic advisory consultancy serving international clients. Prior to his current role he acted as an advisor to Chinese clients on various LatAm projects and previously worked at Barclays Bank Plc. He has acted as a strategic consultant to the World Bank and the United Nations, while his investigative and analytical skills were honed with journalism for Reuters, The Economist, Africa Confidential and BBC Online covering business, investment and conflict. He holds an undergraduate degree from Cambridge University.

Overview

Investors like the transparency that originates from access to timely, reliable, relevant and detailed information. Full transparency means that the investor has access to all the data necessary to make informed investment decisions and to monitor the investment's performance. Almost any risk system is useless without some level of data transparency. Lack of transparency in Brazil's market for Fundos de Investimento em Direitos Creditórios (FIDCs – Brazilian ABS) has presented major challenges for investors, especially foreign investors, since the market developed over 10 years ago.

This changed for the better in 2011 when the Comissão de Valores Mobiliários (CVM – equivalent of the SEC in Brazil) enacted Instruction 489. Instruction 489 was published in January 2011 and applies to taxable years beginning on or after August 1, 2011 (KPMG, Brazil Accounting – International Funds and Fund Management Survey). Instruction 489 significantly tightens up the regulations that govern FIDCs by clarifying the rules for recognizing gains and losses, specifying classification of the transferred credit operations as “acquired with or without risk and benefits,” identifying the administrator's responsibility for implementing the new measures and improving reporting.

New “Informe Mensal”

Article IV of Instruction 489 mandated significant changes to the Informe Mensal (Monthly Report) for FIDCs. The Instruction called for administrators and issuers to supply much more information about FIDC collateral and monthly operations. The Monthly Report is very useful because anyone can download it from the CVM website by clicking on Fundos de Investimento at www.cvm.gov.br and accessing the desired FIDC. This article reviews the changes to

CVM Instruction 489 Brings a New Level of Transparency to Brazilian ABS Investing

Vernon Hamilton Budinger

the Monthly Report and shows investors how to use it to understand FIDC performance.

Credit operations or debts in Brazil are called direitos creditórios or “credit rights” when translated literally. A credit right is technically one payment of a financial ob-

ligation that can be issued in many forms: loans, credit notes, finance letters. We have found “credit operations” a more apt description for the entire spectrum of debt that can be sold into FIDCs. The FIDC's administrator is responsible for publishing the Monthly Report and must organize the data collection with the issuer.

Section I - Total Assets in the Portfolio

Adjustments to Total Assets

Total Credit Assets

- Credit Assets acquired with Risks and Benefits
 - Credit Assets not Matured and Current
 - Credit Assets not Matured and with Payments Past Due
 - Total Value of the Payments Past Due
 - Credit Assets Past Due
 - Credit Assets that Need to be Performed
 - Credits matured and unpaid when transferred to the fund
- Credit of Companies in Bankruptcy Protection
- Credit based on receipts of public payments
- Credit whose constitution or judicial validity is an important consideration for the fund
- Other credits of diverse nature that do not fit in Article 2 of ICVM 356
- Credit Assets acquired without Risks and Benefits
 - Credit (specify the issuer when it represents more than 10% of the Net Assets)
- Liquid Assets
 - Debentures
 - Certificates of Real Estate
 - Promissory Notes
 - Finance Letters
 - Shares (Cotas) of other Funds (ICVM 409)
 - Others
- Public Bonds
- Bank Deposit Certificates
- Applications in Compromised Operations
- Other Fixed Income Assets
- Shares in other FIDC

Exhibit I - Monthly Report Section I - FIDC Assets

The first section of the new report provides 29 lines of summary level data about FIDC's credit operations versus only 2 or 3 lines in the previous report. Whereas the old instructions required only basic information such as the value of the credit operations and total net assets, Section I now requires the FIDC to report the following:

- existing credit operations (not matured) and paying on time
- existing credit operations that have at least one late payment
- the value of the late payments
- defaulted credit operations
- credit operations that have yet to be performed (companies securitize their contracts with firms, like Petrobras, where the terms of the contract have not been fulfilled)
- credit operations from companies going through bankruptcy
- five other fields (see Exhibit I)

Section II - Portfolio by Segment

- Industrial
- Real Estate Market (not finance company)
- Commercial
 - Commercial
 - Commercial - Retail
 - Mercantile Leases
- Services
 - Services - Private
 - Services - Public
 - Educational Services
 - Entertainment
- Agro-business
- Financing Companies
 - Personal Credit
 - Payroll Loans
 - Corporate Credit
 - Middle Market
 - Vehicles
 - Commercial Real Estate Loans
 - Residential Real Estate Loans
 - Others
- Credit Card
- Factoring
 - Personal Factoring
 - Corporate Factoring
- Public Sector
 - Precatórios (Payments owed by government for settlements)
 - Tax Credits
 - Royalties
 - Others
- Judicial Actions
- Intellectual Property, Trademarks, and Patents

Exhibit II - Monthly Report Section II - Credit Portfolio by Market Segment

In addition, we first encounter the key new feature of the Monthly Report in Section I: the distinction between credit operations “without acquisition of risks and benefits” and credit operations “with the acquisition of risks and benefits.” This important addition aligns FIDC reporting with international reporting standards. The classification is critical for the Brazilian FIDC market because it is common for Brazilian issuers to buy back failing loans and substitute new current loans. In CVM Instrução No. 489, the CVM gives the following tests for distinguishing between the 2 classifications.

Tests for acquisition with risk and benefits:

1. The unconditional assignment of credit rights including the right to sell it at fair value in its entirety, independently and without imposing additional restrictions on the sale transaction;
2. The unconditional assignment of credit rights along with resale option at fair value at the time of resale.

Tests for acquisition without risks and benefits:

1. The assignment of credit rights together with a commitment to resell the same asset at a fixed price or the original purchase price plus any added

“ Brazilian administrators are famously slow in adopting new conventions. We hope that the CVM will begin stricter enforcement of Instruction 489 in the future to give the new rules some teeth.”

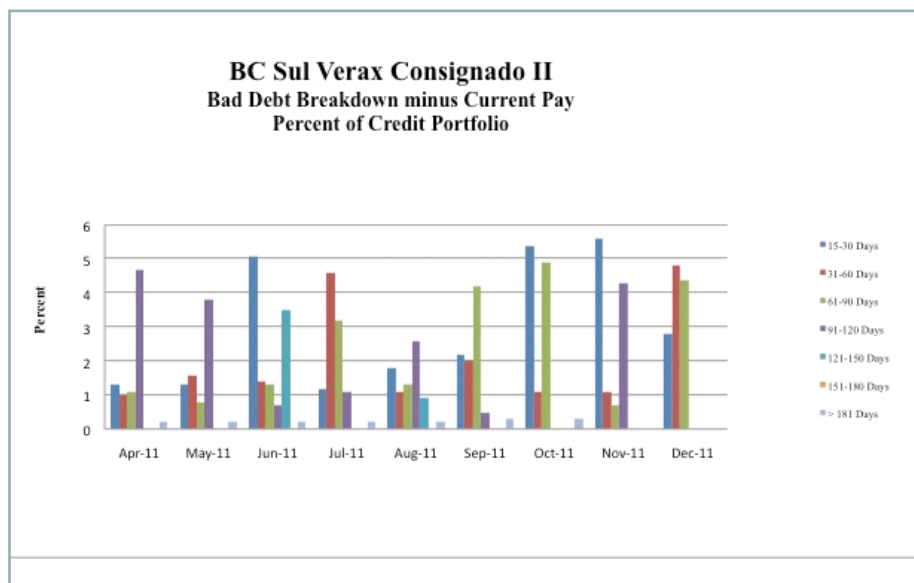


Exhibit III

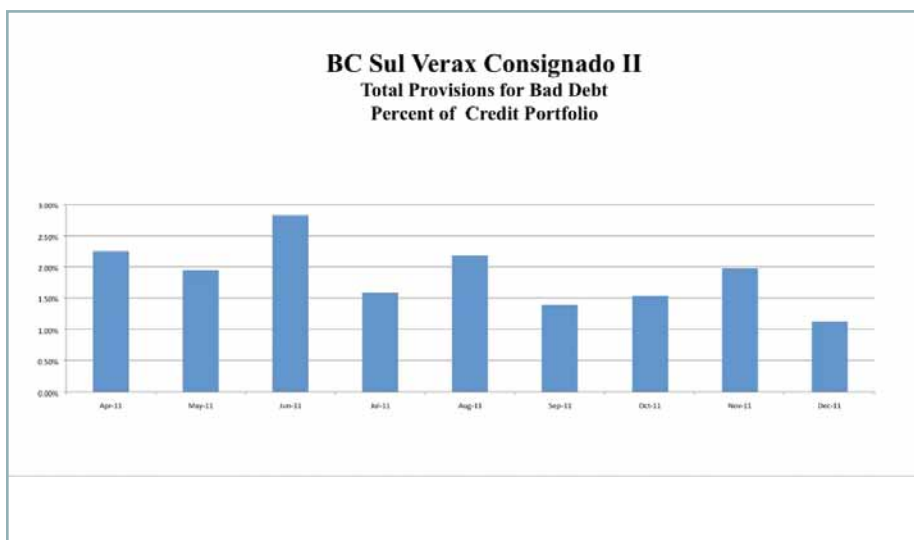


Exhibit IV

2. The assignment of credit rights with derivative transactions or insurance in which the transferor or a related party guarantees a minimum return to any class of shares or transfers the exposure to market risk or credit risk back to the transferor or a related party;
3. The assignment of receivables for which the transferor or related party guarantee in any way — including the acquisition of subordinated shares or compensating the FIDC for the minimum credit losses likely to occur;
4. Other mechanisms outside the normal

market conditions, aimed at mitigating exposure to market risk or credit background, such as repurchase, substitution or transfer of credit rights or investment in subordinated shares by the transferor or a related party, in a recurring or systematic form.

FIDCs commonly contain clauses in their bylaws (regulamentos) or prospectus that specify that any loan must be repurchased at the original sale price plus accrued interest. The ability to repurchase bad debt has been at the center of various FIDC contro-

versies. Banco PanAmericano hid problem loans by swapping them between the bank and their FIDCs. The FIDC BCSul Verax Crédito Consignado II (BCSul Verax II) is another example. The issuer, Banco Cruzeiro do Sul (BCSul), is being liquidated by the Banco Central do Brasil (BCB). Uqbar, the Brazilian company that provides FIDC information to the market, alleges that the bank stopped buying back loans from the FIDC at the end of 2011/beginning of 2012. Uqbar contends that the administrator for the FIDC should have reclassified the loans as “with acquisition of risks and benefits” at

the time that repurchases stopped. (See Orbis, “Cruzeiro do Sul e as questões abertas para o Mercado do FIDC”)

We queried the CVM database and pulled results for 290 FIDCs. Of those FIDCs, 117 reported that the credit operations were transferred with acquisition of risk and benefits, 140 reported that credit operations were transferred without risk and benefits, and 29 FIDCs did not report on either section. Four FIDCs reported assets in both sections (with and without the acquisition of risks and benefits).

Section I also calls for the administrator to list all of the loans that are more than 10% of the portfolio. In addition, they need to specify other types of securities held by the FIDC: debentures, mortgage pass-through securities (certificados de recebíveis imobiliários), promissory notes, finance letters, shares of other funds, government bonds, certificates of bank deposit and holdings of shares in other FIDCs. Finally, Section I requires that the administrator report any options, futures contracts, swaps or other financial contracts. This section of the Monthly Report will provide investors and analysts with insights into how the FIDC is being managed.

Section II is completely new and specifies the credit sectors for classifying the collateral. These sectors are similar to the BCB classifications: Commercial, Service, Agro-Business, Financing Operations, Credit Card, Factoring, Public Sector, Judicial Actions, and Intellectual Property. Each of these sub-sectors is further divided to define the assets more clearly. The sector Financing Operations has the biggest sub-sub sector breakout. The administrator must classify Financial Operations as Personal Credit, Payroll Loans, Corporate Credit, Middle Market Credit, Vehicle Loans, Commercial Real Estate Loans, Residential Real Estate Loans, and others. See Exhibit II below.

Section II will help ABS researchers and modelers understand the characteristics of a given FIDC. First, it allows the analyst to match the collateral to categories in the BCB database that provide data on late payments. This more precise classification permits better estimates of expected defaults on the collateral. In addition, the underlying credit operation can be modeled more precisely since Brazilian credit has some unusual features. For instance, vehicle loans amortize with level principal payments so the payments change over the life of the loan with changing interest. On the other hand, real estate loans amortize as in the United States, with constant payments composed of decreasing interest and increasing principal.

Section III covers the liabilities of the FIDC, shares or cotas and any derivatives that can be considered liabilities. One interesting and somewhat confusing part of the new report is the request for options, futures and swaps positions in Section III as in Section I. We surmise that the derivatives sub-sector in Section III represents derivatives and hedges against the liabilities, whereas the sub-sector in Section I lists derivative positions that hedge the assets.

Section IV is similar to the Section 2 of the old report and lists the net assets for the end of the reporting month and the average of the net assets reported over the last 3 months. This brings us to Section V and Section VI, which are identical to each other except that Section V is for assets that were acquired with substantial risks and benefits and Section VI is for assets acquired without substantial risks and benefits.

These sections are the other key improvements in the Monthly Report. While the value of loans past due broken down by length of time past due was available in the FIDC's balance sheet, sub-sub-section B in Sections V and VI gives the value of the payments past due. We feel that this measure is incom-

plete because the administrator should write off the entire loan. As a result, a monthly-pay one-year loan with 3 bad payments will have the same weight as a monthly-pay 3-year loan with 3 bad payments.

The administrator is also responsible for providing sub-section A with the term structure of the assets and sub-section C with the percentage breakdown of the assets that are prepaying.

Administrators must also report the transactions involving the FIDC's credit operations during the month in Section VII. This entirely new section requires the following: Data on any acquisitions or sales for revolving FIDCs;

Classification of the purchases as an acquisition with or without the risks and benefits, detailed information on the acquisition or disposal of any credit operations with delinquent payments, and to whom the credit operations were sold in the case of disposals; With regard to the last item, the administrator must identify any recipient of the credit operations based on the following criteria:

- The recipient is the issuer or someone related to the issuer.
- The recipient is the servicer or a party related to the servicer.
- The recipient is a third party.

Note: BCSul is accused of selling past due payments to 3rd parties and allowing the loans to be reclassified as current. Banco Morada (another bank failure) sold payroll loans for securitization as Bank Credit Notes to finance companies owned by the executives of the bank.

In summarizing the rest of the Monthly Report, Section 8 reports the value of the 25 largest debtors of the funds. Section 9 provides the yields on the assets and the discount rates used to calculate the price for transferring the assets into the FIDC. Section X provides information about the

shares or cotas sold to investors and the subordinated shares (generally held by the issuer).

■ The Negatives

While the new Monthly Report has been positive overall, there are some negative developments. One negative is the confusion between the Monthly Report and the Balancete (Balance Sheet). Before the end of 2010 the 2 reports usually tied out to the penny. This was very useful because the Balance Sheet contained the information that allowed analysts to dig deeper into the FIDC's operations. Now, for some reason, the new Monthly Report does not tie out to the Balance Sheet report for all of the FIDCs that we tested.

We have noticed that the divergence has been getting worse over time. Now we find it very difficult to tie out the Monthly Report to the Balance Sheet. In fact the 2 reports are very confusing. This is important because the assets in the FIDC must be adjusted for Provisions for Dubious Debtors (PDD) based on the government-specified accounting standards (COSIF accounting, the same accounting system that the banks use). The CVM removed the PDD calculation from the Monthly Report, and now many firms are neither reporting the PDD nor the PDD Breakdown (see the legend in Exhibit III for the breakdown) in the FIDC's Balance Sheet. This makes it difficult to understand some of the adjustments that are being made to the assets to reflect losses.

The importance of tracking the PDD Breakdown can be seen in Exhibit III, which shows the breakdown for BCSul Verax II during 2011. When BCSul surreptitiously sold late payments to third parties, the custodian then reclassified those loans as current. Plus, auditors recently found over R\$40 million in loans that did not exist in the FIDC. The savvy investor that studies the PDD breakdown would have known something was amiss in 2011.

Exhibit III shows the PDD breakdown without the loans that are current or up to 15 days past due. We omitted the current loans because the amount was so much larger that the graph did not provide a clear picture of the volatile performance of the FIDC's credit portfolio. Most investors only look



at the total PDD in Exhibit IV below. This would have made them feel very comfortable because the PDD was stable. However, this stability came from the fraudulent transactions used to deceive the custodian that the 90% of the loans were paying on time.

When we use the PDD breakdown to look under the hood, we can see that distributions were very unstable. The distribution of the breakdown in a well-run credit process is very stable over time. The bad loans migrate to the lower buckets in a stable and statistically organized manner in a large portfolio of small borrowers. It is clear in Exhibit III that the same 5% of the portfolio rolls through every 4 or 5 months and is then cleaned up through the sale of the delinquent payments to a 3rd party. The PDD breakdowns for the FIDC PanAmericano Veículos I exhibited similar behavior in 2008 and 2009.

Note: This same analysis can be utilized for analyzing the breakdown of late payments in Sections V and VI of the new report.

The point of this analysis is that representatives of the CVM told us that FIDCs administrators were required to publish this very useful data in a meeting at the CVM in May 2011. They knew that many FIDC administrators (including the administrator for this FIDC) had stopped publishing the data because we sent them a list — a case in point of how report design is useless without enforcement to ensure compliance with regulations.

With regard to the new reports, we rarely have found a Monthly Report with all of the data supplied. We saw this in the data for Sections V and VI: 29 FIDCs did not report detailed information in these sections (we are checking, some could be future flow deals). We frequently find entire sections of data missing in the reports for some FIDCs. Apparently, the CVM does not publish Sec-

tion VIII (names of the top debtors) on its website because we cannot find it in any of the Monthly Reports. In addition, we rarely see a Monthly Report with a Section IX completely filled in.

We can only hope that the CVM is giving FIDC administrators the time to adapt to the new instructions and that these omissions are temporary. Brazilian administrators are famously slow in adopting new conventions. We hope that the CVM will begin stricter enforcement of Instruction 489 in the future to give the new rules some teeth.

Summary

The CVM declared its determination to improve transparency in the FIDC market with the release of Instruction 489. The instruction provides new, clear definitions for classifying credit operations as “with” or “without” risks and benefits. The instruction also clarified guidelines for recognizing losses and income. Finally, it provided a new, much improved Monthly Report for communicating with investors.

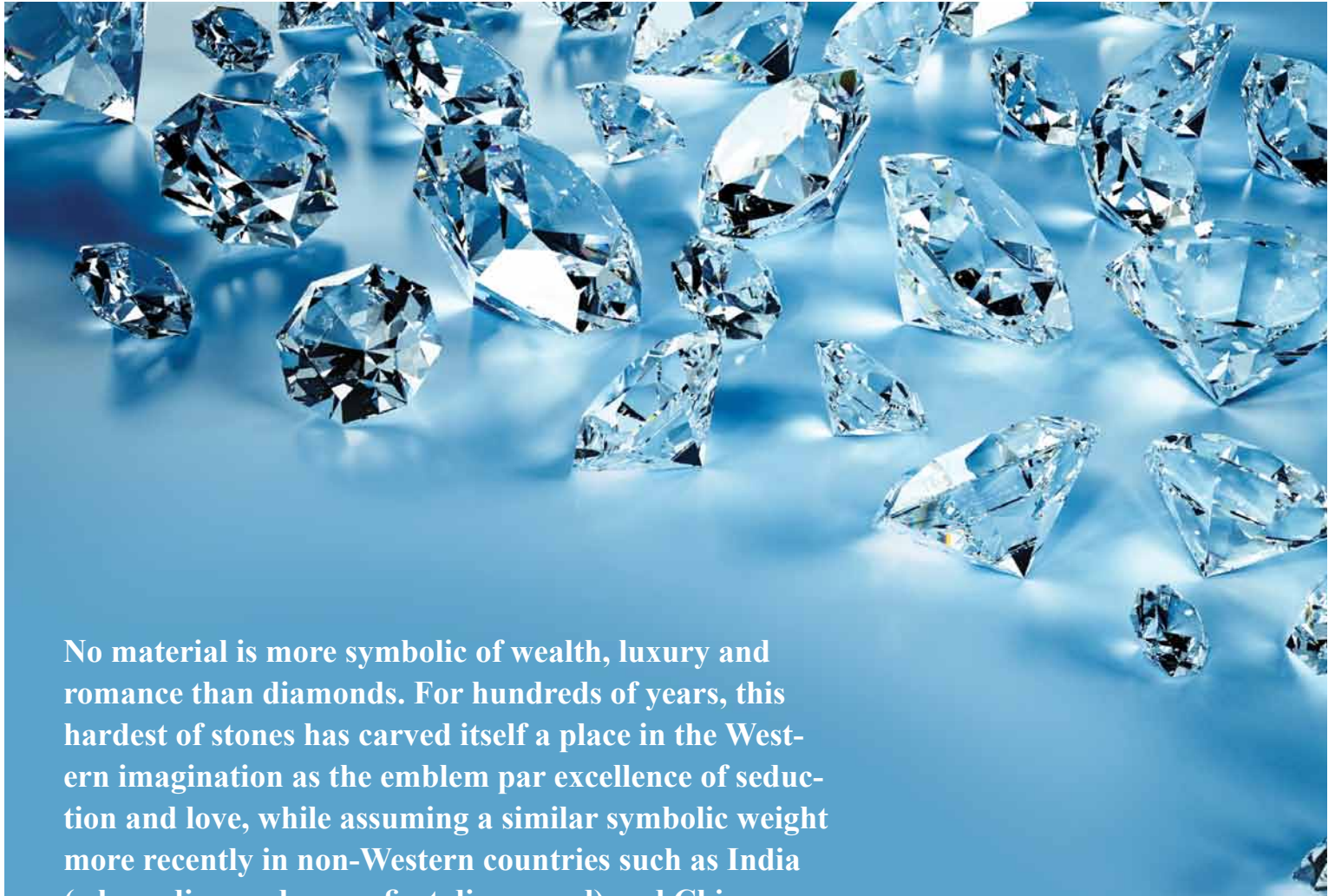
Investors will understand FIDC risk better because they will be able to combine BCB reports with the FIDC’s Monthly Report to better evaluate their FIDCs. They will be able to diversify collateral underlying their investments more effectively because administrators and issuers now need to classify the underlying collateral with predetermined definitions.

We hope that the CVM lives up to its declaration by enforcing Instruction 489 and charging administrators that do not comply. The FIDC market has been littered with problem FIDCs, and new instructions alone will not be enough to set the market on a path that gives investors the faith to supply needed capital to the Brazilian economy through the FIDC market.



AUTHOR BIO

Vernon Hamilton Budinger, is the CFA and Principal Partner at Latin America Structured Finance Advisors, LLC. LatAm Structured Finance is an investment advisor specializing in Latin American asset-backed securities. We use our proprietary technology and experience to identify unique investment opportunities and to protect our clients from risks embedded in complex structures. Vernon Budinger is an investment professional and a CFA with more than 28 years of experience. Prior to forming LatAm Structured Finance, Vernon worked at Western Asset Management and spent the last 3 years working for Western in Brazil where he evaluated Brazilian structured finance.



No material is more symbolic of wealth, luxury and romance than diamonds. For hundreds of years, this hardest of stones has carved itself a place in the Western imagination as the emblem par excellence of seduction and love, while assuming a similar symbolic weight more recently in non-Western countries such as India (where diamonds were first discovered) and China, corresponding to the expansion of the upper and upper-middle classes there.

An Investor's Best Friend

*Swiss Asset Management Launches the
First-of-Its-Kind Diamond Investment Fund*

In recent decades, global investors have been lured to diamonds as a strong investment commodity, as well, attracted to its consistently inherent and rising value, durability, stability, non-correlating independence and low volatility as compared to that other age-old shiny inflation hedge: gold.

Now the possibility of investing in diamonds has entered a new paradigm with the formation of the Diamond Investment Fund, which became the first such fund recognized by the Commission de Surveillance du Secteur Financier (CSSF), the main regulatory body in Luxembourg. The recognition of the DIF as a first-of-its-kind fund essentially makes diamonds a new and distinct alternative asset class for investors and paves the way for the DIF's imminent launch this November.

The DIF was initiated and co-founded by Michael Blank, Managing Director and Founder of Miami-based Swiss Asset Advisors AG, an expert of diamond trading in his own right, and currently the most prominent exponent on the advantages of diamonds as an alternative asset class. The fund plans to launch with approximately US\$100 million AUM, Mr. Blank tells ALI, and he is confident it will grow to US\$300-400 million within the next 2 years. Swiss Asset Advisors, which is registered with Polyreg in Switzerland, will act as investment adviser and manage the fund in conjunction with a management team in Antwerp (Belgium), consisting of leading experts in the diamond industry. Rothschild Bank in Luxembourg will act as custodian and administrator.

The fund was constructed, Mr. Blank explains, as a portfolio management tool for diversification, and "the main challenge has been integrating a fully transparent, regulated instrument with an historically nontransparent industry." It invests in 1-5 carat round brilliant diamonds, purchased

directly from polished manufacturers at costs well below retail prices and housed in the Geneva Free Zone. "We're not investing in fancy shapes or colors," he explains. "We're standardizing diamonds within a certain range so they can be sold on a daily spot market or up the value chain. We have a commodity that people can recognize and understand."

He adds that the DIF only purchases from polished manufacturers who are licensed and compliant, thus guaranteeing that so-called "conflict diamonds" are avoided. Each diamond is accompanied by a GIA certificate, the industry standard for verifying authenticity.

Having access to polished manufacturers in an industry notorious for its high barriers to entry gives DIF investors a distinct advantage over investors who buy higher up the value chain, he says. The fund offers the advantage of strong liquidity, allowing it to purchase its diamonds in cash on the spot and giving its investors comfortable redemption options in cash. They can also redeem "in kind" and take physical possession of the diamonds in the portfolio.

"The investment advantage of our fund is that diamonds don't correlate," Mr. Blank explains, "meaning portfolio managers are attracted to them. They really are an independent asset class. When you purchase gold coins, bullion, certificates, the spot market price is the same, whereas diamonds are all unique entities, unique investment vehicles."

In addition to being a non-correlating and liquid asset class, Mr. Blank points to the high returns diamonds have yielded. In his writings on the subject, Mr. Blank has spoken of diamonds as the "new gold, the only comparable asset class that has exceeded diamonds in recent years." He quotes Bloomberg and Rapaport, the lead-

ing industry metrics expert, showing that diamonds have consistently outperformed the S&P 500 and other indices in the last decade, appreciating 50% since 2008 and 100% since 2004, and posting 25% returns during the world financial crisis, all while maintaining significantly lower volatility than gold.

Mr. Blank adds that the macroeconomic situation undergirding the diamond market currently favors investors and will do so for the foreseeable future. Retail demand for the stones continues to skyrocket worldwide, fueled mostly by China, India and other emerging markets, even as no new diamond sources have been discovered in the last decade. Experts do not foresee any new discoveries in the coming years, either, and as it takes years to bring a new mine into production anyway, it is safe to say that diamond supply will not be rising anytime soon.

Mr. Blank expects LatAm investors to be interested in the DIF because of their particular expertise and concerns as investors. "What is important about LatAm is that it understands commodities," he says, "and the region hasn't suffered the same recessionary environment of their northern neighbors. There's excess liquidity looking for transparency and diamonds have an historical record of appreciation." But the fund promises to have global appeal, he says, as managers seek the transparency, liquidity, returns and diversification that the DIF was created to provide.

"There's a lot of interest; investors can't wait for the fund to be launched. We didn't structure the fund for the retail public or the jewelry buyer, we structured it for professional investors that are looking for diversification in their portfolios. It's a new alternative asset class and investors are very excited about the Diamond Investment Fund."

Lack of Transparency in Colombia Root Causes

■ Felix Villalba

The slight cultural differences of the Colombian market versus the US create some interesting conflicts. A foreign investor will have to deal with these differences if trying to do small-company private equity investments. These differences will affect transparency. Also, issue resolution at the executive management and shareowner levels will be a challenge. These effects are most noted the smaller the company. The issue is exacerbated because the company may not have access to strong international legal advice.

Good legal advice in Colombia (especially outside of Bogota) is hard to find. I define good legal advice as that which comes from a partner-level lawyer that is business savvy. Usually legal advice comes more in the form of “legal” with minimal business sense. Hence on the issuance of contracts, for example, the lawyer will advise you to have a good contract; however what the lawyer means is that if that contract is involved in a lawsuit, it will pass muster against laws. Little thought is given to whether in practice the contract will help guide both parties. In fact the more wording

a contract has outlining possible issue resolution, the more anti-Colombian it will be. Mainly because parties tend to think about contracts as lawsuit material rather than a document that will help guide the business relationship.

The other pressing transparency item is that of the ownership. There is an oversized sense of ownership by entrepreneurs running a Colombian company. Traditionally in Colombia, companies are family financed, even larger ones. Therefore, in some cases being an “employee” is almost an insult for a company owner. (There is some classism in Colombian culture). This sense of ownership may become apparent in some strategic decisions that you may face. The challenge then is to turn this sense of ownership into a good thing. Sometimes this can be accomplished with a well-thought out capital structure. However, this may prove hard to accomplish. Given Colombia only now is beginning to have a nascent institutional private equity market, it is understandable that the entrepreneurs, lawyers and investors are not familiar with complex capital structures. In other words, preferred shares are a rarity and government officials will

get easily confused with their existence in a small entrepreneurial company. This undoubtedly will create problems for the day-to-day running of the company. Adding to that is the fact that the entrepreneur will not share in the notion of last money in, first money out. There is next to no knowledge of classes of stock for most entrepreneurs. There is only the simple common stock issuance, which presents obvious issues to hands-off investors.

The last and perhaps the toughest transparency issue is trust. Wherein the US the system is built around trust, in Colombia one could argue that the system is built around mistrust. I am specifically arguing about the system and not about personal relationships. Take for example the extensive use of notary publics to sign most contracts. In fact the government has made several attempts at creating laws so folks don't

have to sign legal documents in front of a notary public. Bad habits die hard and so many still request the notary public involvement.

The challenge then is schooling your entrepreneur. Perhaps one of the better ways is to issue your investor agreements under US law. Also, make sure that the "Representante Legal" (US equivalent of company President) has limited authority especially with regards to stock issuance. Also make sure that someone from the investor team is also named co-Representante Legal. This may never be used but it is good insurance. This way a takeover is much smoother if it comes to that ... else you have to prove to a third party (Chamber of Commerce) that you own the company. This is a position you do not want to be in if things take a turn for the worse and you urgently need to protect your investment.



AUTHOR BIO

Felix Villalba has over 15 years of experience on both the operating side and the investment side of business transactions. After his MBA, Felix worked for captive financial services companies at Dell and Whirlpool, and later spent over five years as CFO with two venture backed technology companies. Dell's successful effort to start Dell Financial Services marked Felix's official involvement in the venture industry in 1997. It was after that when he joined an Austin Ventures backed company that later led to his joining Pacesetter Capital Group. At Pacesetter, Private Equity firm, he was Vice President and served as Portfolio Manager for several inherited deals, some of which required intervention strategies. In 2009, Felix formed his own Private Equity management firm, Accordo LLC and raised Accordo Fund 1 and 2 placing investments in residential and hospitality developments in Colombia.

Against the Grain

Kenneth Fisher on Prevailing Trends in the Wealth Management Industry

In the world of global wealth management, few managers command as much attention and respect as Kenneth Fisher. Listed on Forbes' 400 wealthiest Americans, the firm he founded in 1979, Fisher Investments, is widely regarded as the largest founder-run registered investment advisor (RIA) in the world, with more than US\$44 billion in AUM. In spite of his and his firm's immense success, he describes it as a "conventional" asset manager, sticking to fundamentals over the long term, owning principal securities instead of building or buying profitable products, and

avoiding much of the herd mentality that plagues the investment world all too often.

The author of 8 books on investing, including 4 New York Times bestsellers, as well as a popular column in Forbes Magazine for the past 28 years (making him the magazine's 4th-longest-running columnist), Mr. Fisher has established himself as one of the industry's most respected, trenchant and contrarian voices. In his conversation with ALI, he spoke in general terms about some keys to managing high-net-worth clients, and gave his views on the major trends in

wealth management worldwide, including the role of fixed income in portfolio management, the increasing preference for boutique wealth managers over large firms, the much-touted rise of transparency in the industry and LatAm's promise in the years ahead.

■ Knowing the Client

Of the 38,000-plus customer accounts that Fisher Investments manages, about two-thirds are high-net-worth clients and the others are conventional institutional clients.

Mr. Fisher sees a distinct difference between the 2 when it comes to what they are looking for out of a manager. Institutional investors, he says, tend to hire a given manager to perform a very specific task within a larger institutional strategy, while high-net-worth families and individuals often hire a manager to develop and execute a strategy as a whole. He used an analogy from baseball to explain the distinction: Institutional clients, he says, tend to hire a firm like Mr. Fisher's to play a single position in the field, while "high-net-worth clients think they are hiring you to play the game for them; they don't think so much about subset micro-positions like small-cap growth, emerging markets ... they expect you to do it all."

At the same time, many of these high-net-worth clients are under the impression that investing in fixed income is easier than other, riskier investments – and that they can therefore handle such investments on their

own. "High-net-worth investors in particular don't tend to hire managers to do fixed income," he says. "They think they can buy bonds themselves. The irony there is that, theoretically and in actual fact, it's harder to beat bond markets than equities markets because they are inherently more efficient."

■ Flight to Fixed Income

Despite that misconception regarding the difficulties of fixed income investing, that asset class is increasingly the destination of high-net-worth wealth, Mr. Fisher observes, even though decreasing interest rates coupled with inflation rates are resulting, in some cases, in negative yields. This flight to fixed income, he says, "is the biggest single trend right now in the wealth management industry. The world as a client base has become increasingly frightened and they're more concerned about the return of their money than the return on their money."

The flight has meant a loss of business for wealth managers across the board, even as smaller, independent firms, as many experts have noted, are increasingly the preferred choice for high-net-worth investors.

"The industry has moved more toward independent brokers and RIAs as opposed to big mega-firms," Mr. Fisher says, "and some of the big mega-firms have had more trouble than others. According to most sources, the small independent RIA space has gone faster than the independent broker space. The irony, of course, is that at the same time the number of RIAs has shrunk; the money has moved toward them but there is less total revenue because money has shifted from greater exposure to fixed income."

The same general sense of fright that Mr. Fisher says is leading investors to fixed income even at the expense of positive returns is being projected on sophisticated investment vehicles, which many investors believe – wrongly, Mr. Fisher points out – were responsible for the recent global financial crisis. "High-net-worth investors hate sophisticated vehicles: they are hard to understand, they clearly aren't very transparent, and they remind these investors of the downturn. In their mind it was precisely these sophisticated vehicles that caused the downturn, even though it's demonstrably false that that was the case."

He notes that if investors were open to such vehicles and wanted one that "promised them the moon, there would be a huge rush toward variable annuities."

■ Apparent Transparency

Asked for his thoughts about the industries trend du jour — transparency — and the way it has increased since 2008, Mr. Fisher pulls out the stops.

"I think that's categorically false. The industry is increasingly prone to pretend it's



Kenneth Fisher is the Founder, Chairman and CEO of Fisher Investments

transparent, but I don't think it's any more transparent than before."

He says the industry for the most part has always had a lot of hidden fees, and that has been more true in recent decades outside American than inside, but true in both.

"One of the reasons [certain government and industry players] do the nonsense they do," he adds, "is that they don't want the fiduciary standards applied to the broker world because they would have to be more transparent and the client would understand the dilemma that is otherwise self-serving. "This industry has never been very transparent and it's not becoming more transparent; it's peddling a phony illusion of transparency. My view of the integrity of the industry is not very high."

■ Speak Softly

Mr. Fisher also spoke briefly about marketing strategies, a hot topic now as the industry awaits the US Securities and Exchange Commission's interpretation of the recently passed JOBS Act, one proposition of which will free up hedge funds to advertise in mass media. ALI has covered this issue in recent months, including a webinar with industry experts, and it is clear that in spite of the uncertainty regarding the SEC's final word, the industry is poised for a watershed moment. Marketing will soon be a vital aspect of each firm's success in winning clients, and when it comes to attracting high-net-worth clients, firms that advertise themselves will have to toe a fine line, conveying their unique strengths without violating potential clients' discerning tastes and sense of trust.

Mr. Fisher's is, again, a voice to be heeded here as his firm, he says, is the biggest direct marketer among asset managers in the country, in compliance with the Investment Advisor Act of 1940. Asked to give some marketing advice to funds in advance of

the JOBS Act announcement, specifically regarding how much or how little they should reveal about their performance, he employed another apt and colorful analogy, applicable well beyond the portfolio: "Regardless of the advertising format, the more you try to promote returns, the worse your ad works. The client or investor doesn't always understand that; their attitude is: If you're so great, why aren't you advertising your returns? The analogy I like to use is that if a member of either sex walks into a

This industry has never been very transparent and it's not becoming more transparent; it's peddling a phony illusion of transparency. My view of the integrity of the industry is not very high.

*Kenneth Fisher
Founder, Chairman and CEO
of Fisher Investments*

bar and starts talking about how great they are at sex, regardless of the outcome, it won't be the one they wanted."

■ LatAm Horizons

Finally, Mr. Fisher spoke about the LatAm region and its growing importance in the global wealth management industry. He agrees with the widely held belief that the region's prospects are bright, saying that, "in the long term, when you look out past my career span, I'm terribly optimistic." However he has some unique insights as

to the reasons for his optimism as well as the specific markets within the region that promise to perform best.

Looking beyond mere growth numbers from the last year or two, he says he is most optimistic about Brazil and Chile, and less so about Mexico, whose success is tied too closely to the price of oil, about which he is bearish. He also sees relative deficiencies in Mexico in certain areas where Brazil and Chile are the regional leaders, including respect for property rights and the stimulation and support of entrepreneurship.

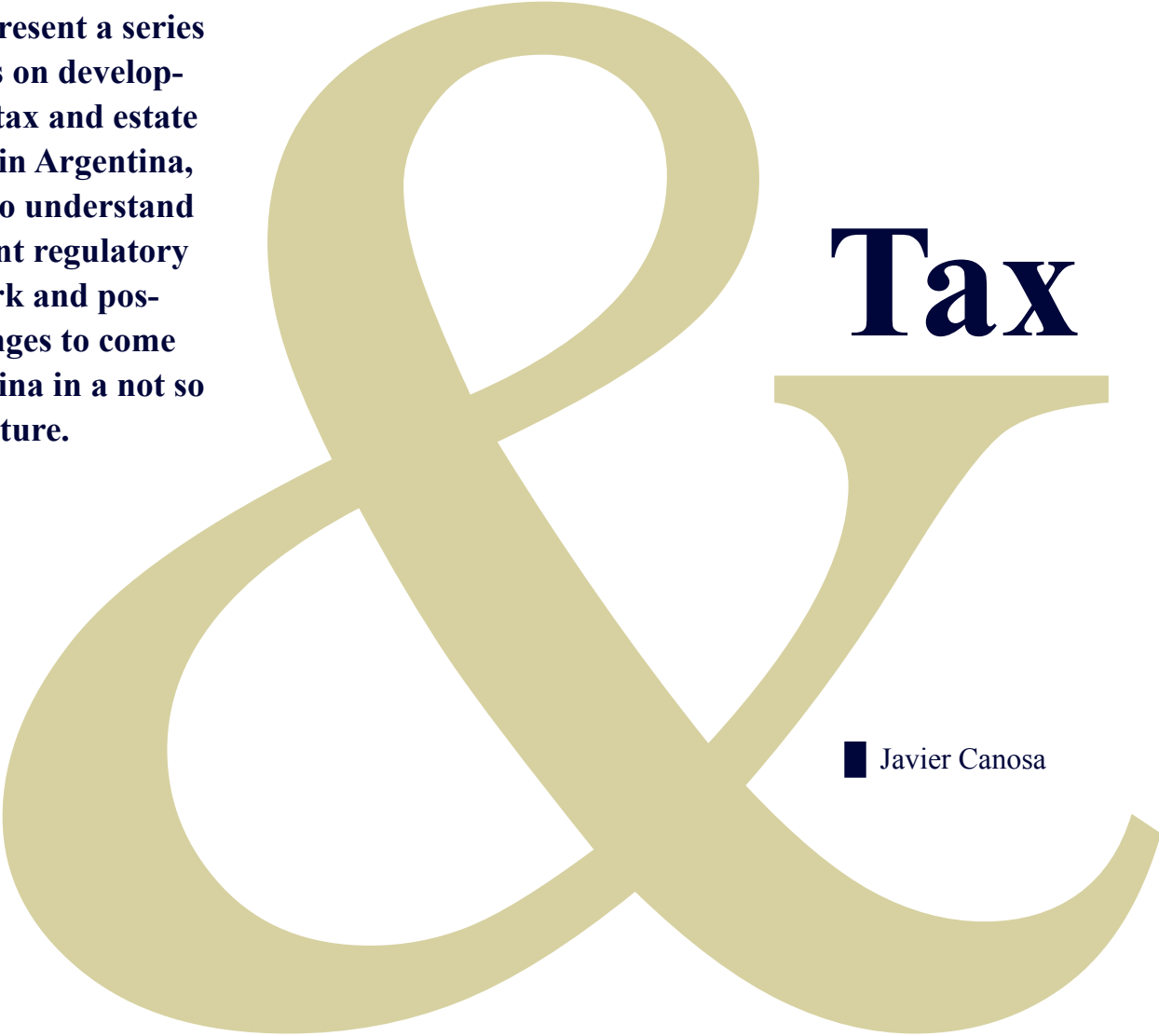
He believes Chile is particularly strong in those respects, making it a sort of southern hemisphere counterpart to Mr. Fisher's home state.

"I like to think of Chile as a bit like California flipped around and turned upside-down: Santiago is like Los Angeles, and going south in Chile is like going north in California. Chile also has the property rights and a respect for entrepreneurship that California has. Mexico doesn't have that yet."

In Brazil he sees a country with a similar respect for entrepreneurship and property, and he believes it is finally getting over the hump of being perpetually the "country of the future" only to slide back again. The structure and spirit of the country have reached a level of depth where growth and maturation will be able to continue over the long term, he says. And in this case, the analogy he finds is with the US:

"America has certain features basic to its core such that even when we screw things up we manage to come out ahead. There's this endless supply of daring entrepreneurs, classic American characters who create entire industries and jobs that no planner could have envisioned. I think that concept is instilled in places like Brazil, too. So even if it finds ways to screw things up, usually for some social goal, I see a great long-term future there."

We will present a series of articles on developments in tax and estate planning in Argentina, in order to understand the current regulatory framework and possible changes to come to Argentina in a not so distant future.



Tax

■ Javier Canosa

In this first piece, in terms of taxes and reporting regimes, we have news on inheritance tax and the trusts reporting regime.

■ Inheritance Tax

We start with inheritance tax. This is a tax that generates divergent opinions. On one hand, its defenders affirm this is a progressive tax, and quite liberal, as it tends to put people “on a level playing field.” Defenders further argue that most developed countries have some form of tax on capital received with no consideration (such as Germany, Belgium, the United States, Finland, France, Ireland, Norway, the United Kingdom and Switzerland, among others). Critics, however, say it is regressive, that it does not encourage wealth creation nor investment, and also in the specific case of Argentina there would be double taxation as the owner of property must also pay annually a tax on personal assets (personal asset tax) which does not exist in

Estate Planning in Argentina: Part One

the countries where there is inheritance tax. In both cases, wealth is being taxed.

The inheritance tax had been eliminated in Argentina in 1976 and reinstated in 2009 in the Province of Buenos Aires, one of the largest and most relevant states of Argentina. Its application brought much criticism to Argentina due to the above arguments and

because there was not a period of adaptation and explanation of the objectives sought by the tax. The law was passed without much debate about its convenience and legality.

The tax's extraterritorial effects are noteworthy. A resident of the Province of Buenos Aires is subject to inheritance tax on their worldwide assets, and a resident of

another Argentine province — that is, a nonresident of the Province of Buenos Aires — is subject to inheritance tax on their property in the Province of Buenos Aires. We believe this will dictate in the medium-term that other jurisdictions — notably the city of Buenos Aires, a federal state that is different from the Province of Buenos Aires — progressively incorporate an inheritance



tax to make up for the loss of fiscal resources in comparison with other provinces.

As for the rates in the Province of Buenos Aires, the law provides for a fixed rate plus a percentage of 4%-22% of the assets transferred. The tax allowance is AR\$125,000 (between US\$19,800 and US\$26,000 depending on the exchange rate used). On the personal assets tax, which is paid annually and moreover is a federal tax, the rate will include between 0.5% and 1.25% per annum depending on the taxpayer and the value of goods, so that in a relatively short time the inheritance tax would be “amortized.”

Finally, in terms of opportunities, it is worth noting that the law of the inheritance tax states that “the transfer of property of a company upon death, whatever may be its form of organization, including one-person operations, whose total revenues obtained in the previous fiscal period do not exceed the amount specified in the Tax Law, when produced in favor of the spouse, parents and/or children, including adopted children, or spouses of the mentioned, and they maintain the effective exploitation of the same during the five (5) years following the death of the deceased, except if the purchaser dies within this period. Otherwise, these persons must pay the liquidated tax for years still pending to benefit from the exemption.” That is, if the deceased is the holder (even personal holder) of a commercial exploitation and said exploitation bills no more than the minimum stated by law (AR\$5 million, or US\$1 million or US\$793,000 depending on the change), and successors maintain the exploitation for 5 years, then the transfer of these assets shall not be taxed by the inheritance tax.

■ Trusts Information Regime

Continuing with the “news,” we have a new reporting regime from the Argentine Tax Authorities by which the current system of providing information on trusts is updated and expanded. This system was previously

only applicable in respect of trusts created in Argentina.

Besides trusts, financial and nonfinancial, constituted in Argentina, governed by Law 24,441, the following are added: fiduciary figures, trusts or contracts of equivalent legal nature, constituted abroad, where one of the participants (trustee, settlors or beneficiaries) are residents of Argentina.

The Argentine authorities established 2 information regimes:

- (I) an annual regime (as of December 31 of each year), and,
- (II) another regime defined as “registration of operations,” in which the following should be reported in the mandatory period of 10 working days from the date of completion of the transaction
 - a. initial establishment of trusts,
 - b. income and expenses of trustees and/or beneficiaries, which occur after the establishment of the trust,
 - c. free or paid transfers or assignments of shares or rights in trusts,
 - d. supplies of goods made to trusts, after its constitution,
 - e. amendments to the initial contract, assignment of benefits, and
 - f. extinction of trust agreements.

Those obligated to provide information are (i) the trustees on financial and non-financial trusts set up in Argentina, or (ii) Argentine residents acting as trustees (trustees/fiduciaries or similar), trustor (trustors/settlors or similar) and/or beneficiary (beneficiaries) of trusts formed constituted abroad (fiduciary figures, trusts or equivalent legal status established abroad in accordance with the current legislation in the country concerned are included). This means that the regime is applicable only to the Argentine trustees and any Argentine resident having some type of intervention in a trust abroad.

In the next edition of *Alternative Latin Investor* we will discuss developments regarding treaties to avoid double taxation and agreements for the exchange of tax information.



AUTHOR BIO

Javier is a partner in the BA firm *Cano-sa Abogados*. Javier's practice develops in corporate law issues, advising several national and foreign companies in various corporate matters, including investment vehicles, corporate management, directors' duties and responsibilities, audits, risks' detection and distribution, documents, policies and corporate contracts, and design and implementation of a suitable corporate form for each business.

LatAm Wealth Management Overview

The world has gotten wealthier, but not the whole world. The engine of growth for private wealth is by far the emerging markets such as LatAm and, particularly, East Asia ex-Japan, which is outpacing the rest of the world by a long shot. The most recent edition of The Boston Consulting Group's world wealth report shows that, while North American wealth dropped by 0.9% in 2011, LatAm's grew by 10.6%. Indeed, the report's title this year, "The Battle to Regain Strength," applies more to sluggish developed markets than to LatAm, where the battle is to manage it.

As Jorge Becerra, Senior Partner and Managing Director at BCM and head of the firm's Latin American Financial Services practice, says, "We're facing a world at 2 speeds: wealth on a global scale is growing at 2%, but if you break it down, it's about negative 1% in the developed markets, while the emerging markets are providing growth above 10%. We expect that same trend in the next 2 to 3 years. We expect LatAm's growth to be higher than the developed markets'."

But, he stresses, the LatAm story doesn't end with the usual suspects. "In the past,

we thought about LatAm as just Brazil, with US\$2.2 trillion GDP, and Mexico with US\$1 trillion. The rest was not relevant, just fragmented and not very credible markets. But now the Andean/Pacific Alliance of Colombia, Peru and Chile are growing and changing the whole outlook of the region, and many are observing this with a lot of interest."

Corresponding to the rise and spread of wealth has been the region's maturing wealth management industry. No longer does regional wealth management consist of U.S. mega-firms entering the region to

Jorge Becerra, Maria Pia Leon and George Wachsmann on Managing the Region's Emerging Wealth

serve Brazil, Mexico and possibly Chile. “Now they need to design strategies for Colombia and Peru and develop more of a local understanding and presence to compete with local and regional champions,” Mr. Becerra says.

A few years ago most of our institutional and family office clients in Latin America only liked to discuss real estate and private equity transactions. Now the conversations include hedge funds, separately managed accounts and credit-related opportunities, and I think that this is simply a reflection that they see and better understand the benefits of alternative assets in their overall portfolio.

James A. Feeley III Partner at Tri-cap Partners & Co. in New York

To serve the extremely wealthy, of which LatAm has a higher concentration per capita than any region in the world, Mr. Becerra sees a growth in independent multi-family

offices, a movement that began in Chile but has spread to Brazil and Colombia. And in the wake of 2008-2009, the independence of these firms is what is most attractive.

“It’s not about the asset provided, but about the client. They’re telling the client that they’ll be truly independent; they’ll get a flat fee and give back to the client any rebate they receive from mutual funds or other products; they’re truly on the buy side representing the client and not on the sell side pushing the proprietary holdings of a bank.”

In addition to the emerging and developing wealth in the region and the new approach to managing that wealth, Mr. Becerra sees 2 other fundamental trends: “the push in these countries toward newly created wealth out of entrepreneurship activities,” and the de-

sire for transparency from wealth managers. And yet, in spite of these changes, asset class preferences remain somewhat conservative and in line with the region’s history. The BCG report notes that cash and deposits as well as managed fund bonds remain the region’s most popular asset classes. “The growth profile is still primarily cash, so it’s still a bit more old-fashioned in that way. The growth of alternative investments is good but from a small base. Most profitable banks, however, have higher penetration with alternatives as well as advisory services, and that’s been profitable for them and their clients.”

More than 25% of the region’s wealth is kept offshore, he adds, citing the report – more than 25% of total AUM. “Offshore vehicles are used in many LatAm countries,



34 Wealth Management

more than in any other region in the world, mostly because of the lack of trust in the region's institutions and lack of rule of law in some, and the corruption of some local institutions in challenged countries. The growth of offshore assets will be lower than the one of total wealth in the coming years, but it's not something you can ignore. There continues to be the expectation of offshore services, and global players will continue to provide that platform because it's most profitable for them."

Overall, Mr. Becerra says the LatAm outlook is very positive, with the sustained growth of the region and the trends he mentions. "There's a good tension between global players and consolidating local players fighting for this emerging wealth; it's positive in terms of growth and margins but also keeps pressure on the cost side. And there's attrition and movement of executives from one bank to another, and that has a refreshing effect on the cycle." He adds that local family offices are best-positioned to compete for the region's emerging wealth. "It's a good space for everyone with a segmented view of the market on the customer side," he says, "and the emerging wealthy with between US\$1 million and US\$5 million is where the competition and growth is happening and where small local players can have something to say."

■ Brazil: Coming out of the Shade

George Wachsmann has been at the forefront of maturation of the wealth management in Brazil both as a manager himself and as an advocate for the industry. An economist by training, he had worked for Unibanco and Itau before starting his own wealth management shop in 2004. That firm quickly became the largest fund of funds manager in the country, but, as he describes it, something essential was missing from his relationships with clients:

"We had 400 managed accounts, including Unibanco and Citibank, as they were not allowed to have a fund of funds on their own. But I was away from the client, at the end of line that started with the private banker, the assistant, the director; I only actually met a

"What's happened in Brazil in the past 10 years is that the economy has stabilized, and the new money is not going offshore anymore but staying in Brazil, where the rates are better, the economy is safe and strong, our currency is strong, our government is strong. For the first time we are on the right side of the equation."

George Wachsmann, Founder & CIO, BAWM Investments

few clients in person. And how could I really be doing something customized to the client's profile if I did not even know the clients themselves?"

To come closer to the client, he founded BAWM Investments in 2005, a multi-family office that initially handled concierge services, wealth preservation, legal aspects of succession, etc. but currently focuses more on wealth management.

Mr. Wachsmann also serves as the Chair of the Wealth Management Committee at AN-BIMA, the Brazilian Financial and Capital Markets Association, where he is trying to solidify and raise status of wealth managers in the eyes of the regulators. Currently, he explains, independent wealth managers are considered equivalent entities to megafirms operating in the same space, and they must acquire multiple licenses in order to open a family office.

"We're trying to bring this to the attention of the CVM [Brazil's equivalent of the SEC and FINRA combined] so they can recognize wealth managers as something distinct, as long as they meet certain criteria. That's our goal with the authorities: trying to raise the bar and bring this activity above the water."

Mr. Wachsmann sees a greater need for competent wealth managers because high-net-worth individuals and families are suddenly finding themselves in a radically different environment where a more robust investment strategy is needed.

"Before," he explains, "no one had to go through the process of setting up an investment policy. Why? Because if you left your money in CDs in a bank, you'd get 12% or 13% a year, or 6% or 7% in real terms, and why bother taking risk or investing with longer maturities if you can have those returns? Now, with the dramatic change of real interest rates dropping 400 basis points, individual and institutional clients are all faced with hard job of having to do asset liability management for real for the first time. "The individual client now realizes that someone took the tree and the shadow is gone, so he has to find where to sit, and that

probably means an increase in risk-taking and thinking about those limits.”

The abundance of investment options inside Brazil means that investors there are less apt to maintain cash deposits and/or offshore accounts than in other countries, he says.

“For 2 generations, everyone in Brazil had an issue with inflation, hyperinflation at times, and a lack of trust in institutions: people used to send money offshore as a safety net in order to protect their purchasing power. What’s happened in the past 10 years is that the economy has stabilized and the new money is not going offshore anymore but staying in Brazil, where the rates are better, the economy is safe and strong, our currency is strong, our government is strong. For the first time we are on the right side of the equation.”

■ Establishing Trust

In spite of the improving and proliferating investment and wealth protection options in the region, many families still prefer to keep their assets offshore. Florida-based GenSpring Offices is one example of an offshore manager that is attracting LatAm families seeking privacy and security, among other qualities. As Maria Pia Leon, the firm’s Senior Vice President, explains, these families are also looking for family offices that can appreciate their wealth beyond merely financial terms.

“After the recent financial crisis,” she says, “families are looking for more transparency in their investments and they are looking for other benefits not always financial. Families want to ensure that they are holding the most compelling investments available in the market. They are tired of paying advisors for investments or services they don’t understand, and they want their wealth to have a positive impact on their family. In most cases,

their wealth has become too complex and they need someone to take care of family matters when they are not able to do so. In a nutshell: they want somebody they can trust.”

GenSpring manages about US\$22 billion, of which about US\$20 billion is from US clients and US\$2 billion from non-US clients, including LatAm families whose liquid assets are US\$25 million and above.

“Our main concern is the sustainability of wealth along generations. If you want to sustain wealth, then the definition of successful investing centers on the core concept of protecting capital to keep it compounding through thick and thin.”

*Maria Pia Leon, Senior Vice President,
GenSpring Family Offices*

Ms. Pia Leon says the firm is receiving more interest from LatAm clients.

“This is a good time for us to find new clients, especially in Latin America, with new fortunes emerging, the wealthy getting wealthier, the financial crisis still in their memories, and a better understanding of the concept of a multi-family office throughout the region.”

At the core of the firm’s approach is a more expansive understanding of what family wealth means, she says. “My definition of wealth is not based on how many financial assets a family has. It’s a more holistic approach: you have to include the family human capital, their values, their potential as human beings, their dreams.”

She says the firm’s main concern is the preservation of wealth from generation to generation. “If you want to sustain wealth, then the definition of successful investing centers on the core concept of protecting capital to keep it compounding through thick and thin. We focus extensively on how the core risks of inflations, fees, taxes, opportunity cost and inherent risk in the underlying investments might work against the family objectives and lead to unexpected surprises. As a result our primary responsibility is to build and maintain a customized investment portfolio designed to deliver the appropriate risk-adjusted returns for the client.”

She says many LatAm families value offshore family offices because of the privacy and confidentiality they can ensure. And she echoes other experts in emphasizing the importance a family office’s being totally independent, as GenSpring is.

“When a family decides to hire a family office, they should ask the candidates several questions: First, does anyone other than your client – like investment manager or financial product manufacturers – pay you a fee or other form of non-fee incentives? Second, are people in the firm compensated – either directly or indirectly through bonuses – based on how much of a particular product they sell in a given year? And third, are any of the investment products you offer to your clients proprietary? If the advisors answer yes to any of these questions, they may not be working on the family’s best interest.”

ART FUNDS

Provided by Artvest Partners LLC

In 2011, total global art sales reached \$64.9 billion. High-net-worth individuals looking for alternatives to the stock market are increasingly turning to fine art and other hard assets, including wine, silver and gold (also known as SWAG), which have all seen considerable appreciation over the past 10 years.

On the whole, art is not correlated to other financial markets, such as the S&P, bonds and REITs, except during times of dislocation. Art, in times of inflation and/or rising interest rates, acts as an effective hedge and performs well.

What is an art fund, how are assets selected, who decides when they are sold, how is the fund regulated, what is the tax implication?

An art fund is a structured investment vehicle with offering documents that is open to third-party investors for the purpose of financial gain. Properly created, an art fund will share similarities in structure to financial asset funds yet take into account the crucial difference that art is the underlying asset. The main benefits of investing in an art fund are that

the structure allows for overall portfolio diversification with a relatively small capital commitment and does not require the investor to have art collecting expertise. Additionally, investing in an art fund mitigates the cost of security, transaction fees, insurance, storage, research and tax related to traditional art purchases made by an individual.

What should investors be wary of when looking for an art fund?

Investors should look to a fund's track record and verify that they practice a certain degree of transparency. It is wise to be wary of undisclosed and unapparent conflicts of interest. For example, if a private dealer is on an art fund's investment committee, how can fund investors be assured that he is not reserving prime property for personal gain, or diverting less-quality property in which he has an

THE ART MARKET HAS RETURNED TO ITS PRE-CRISIS SIZE

Total Global Art Sales 2002 - 2011

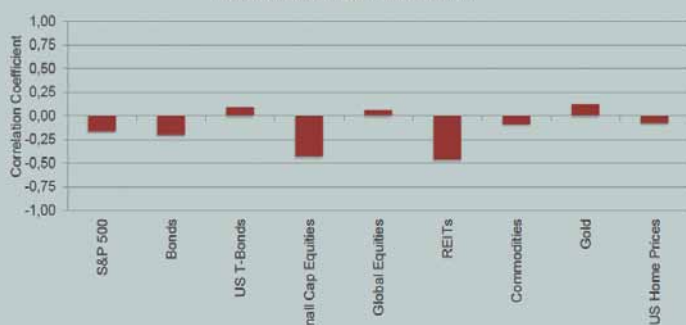


Source: The European Fine Art Foundation & Artvest Partners

ARTVEST INVESTMENT ADVICE FOR THE ART MARKET

THE ART MARKET IS NOT CORRELATED TO OTHER ASSET CLASSES – AMR INDEX

AMR Art 100's Annual Correlation To:



*Based on data from past 25 years (31 December 1986 – 31 December 2011)

ARTVEST INVESTMENT ADVICE FOR THE ART MARKET

undisclosed stake? There have been quite a few fund failures and instances of fraud and mismanagement, so investors need to engage in thorough due diligence prior to any capital commitments.

Is there any regulatory body or resource for art funds?

There is no regulatory body for art funds but the Art Investment Council, a nonprofit organization, is an excellent resource. In response to the significant growth of global interest in art as an investment, the AIC was founded to promote a greater understanding of art as an asset class

...interest in art funds continues to grow and the future will see more vehicles coming to market, especially as global economic uncertainty and low returns on other investments lead investors away from traditional financial vehicles.

by encouraging transparency, best practices, education and consistency of terminology and reporting. The AIC provides a forum for open discussion about current issues in art investment as well as a platform for publishing, seminars and events related to this mission. You can find out more about the AIC at www.artinvestmentcouncil.com.

What is the connection between auction houses and funds? Is there any conflict of interest?

To date, none of the major international auction houses have successfully entered the art fund space, as it is particularly complicated and rife with conflicts of interest. Should an auction house proceed with developing its own fund, Chinese walls between auction house specialists and the fund must be put into place to prevent saddling the fund with lesser-quality property and reserving premium property for auction sales.

Are there any industry standards for art funds? Redemption periods, minimum investment, etc.?

There are no industry standards for art funds, but funds are typically closed-end, opportunistic, and employ an active asset management strategy. “Buy and hold” funds, where the art is put away for long

10-YEAR RISK / RETURN (DECEMBER 2001 – DECEMBER 2011)



*Based on Art Market Research's index data from past 10 years (31 December 2001 – 31 December 2011)

ARTVEST INVESTMENT ADVICE FOR THE ART MARKET



periods, have become less common. Art funds are, however, generally viewed as long-term investments, with investors committing capital for 5 years and anticipating distribution of returns to begin after the 3rd year, with the possibility for extensions at the fund manager's discretion.

What are the top 5 things to look for when performing due diligence on a fund?

When considering an art fund investment, many critical questions must be answered such as:

- How is the fund structured?
- Are there adequate risk controls?
- How often is the fund valued and what is the methodology?
- What is the liquidation strategy?
- How and where is the fund sourcing its property, is it through knowledgeable industry insiders?
- Who are the principals and advisors, how are they compensated and what are their potential conflicts of interest?

This is not by any means a comprehensive list. The questions are many and engaging a true expert before committing any capital to an art fund is crucial.

Do you see art funds as a growth industry? Are we going to be seeing more of these?

At present, the scale of the art fund industry is commonly believed to be significantly larger than it is, and limited viable art fund options actually exist. There are not many operational art funds investing meaningful capital. Traction has been slow because of apprehension about investing in a little-understood market, concerns about the unpredictability of tastes and trends, and a scarcity of art fund structuring expertise. Despite these issues, interest in art funds

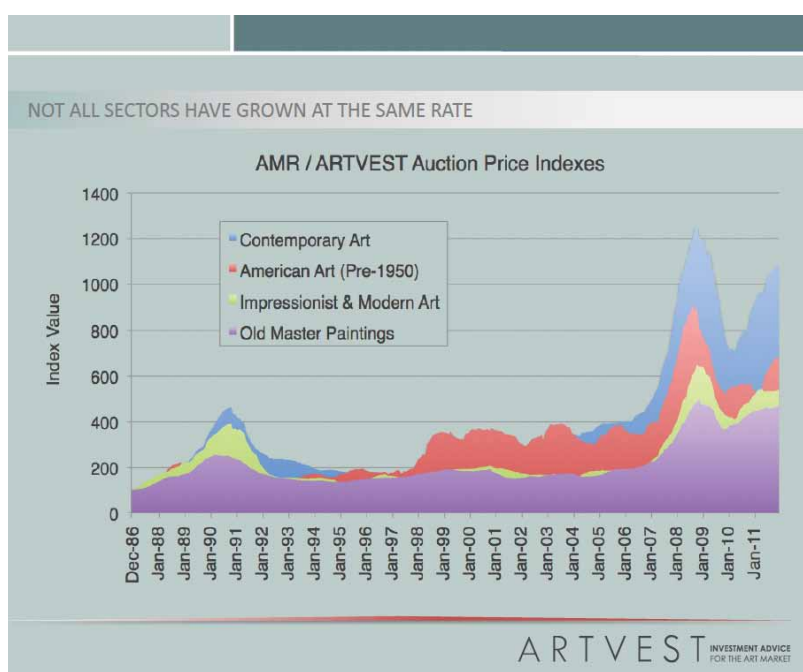
continues to grow, and the future will see more vehicles coming to market, especially as global economic uncertainty and low returns on other investments lead investors away from traditional financial vehicles. Several fund companies in the US and UK are in the process of raising capital for their 2nd or 3rd generation funds and finding it much easier to do so now that they have established track records.

When looking at the management structure of an art fund, where is a good medium of expertise between financial/investment knowledge and art knowledge?

When Artvest advises clients on art fund investments, we stress the importance of dealing with professionals who have substantial experience with both financial and art assets and who adhere to strict risk controls, calculated portfolio diversification, active management, open architecture and strict governance guidelines.

Are there funds to match different risk appetites? That is to say, the ‘classics’ always demand, high prices, etc. versus investing in new/undiscovered artists.

Each art sector is unique and performs differently. Old Master Paintings, for example, is the most stable sector of the market but has been sluggish recently, while Post-War & Contemporary art, especially works by emerging artists, has the highest price volatility. Asset allocation and sector focus are important considerations when assessing risk and reward of a particular art fund. Certain funds focus on individual sectors, such as specific emerging markets like Latin America or categories such as photography, while other funds are a composite of art from different genres, geographies, time periods and price points to further diversify and mitigate risk.



ART PORTFOLIO VOLATILITY CAN BE MITIGATED THROUGH DIVERSIFICATION

Art Market Sectors' Annual Correlation To One Another

	Pop Art	Russian	Contemporary	Post-War	American	Impressionist	Modern	Latin American	Old Masters	19th Century
Pop Art	1.00									
Russian	0.76	1.00								
Contemporary	0.82	0.81	1.00							
Post-War	0.80	0.78	0.86	1.00						
American	0.67	0.43	0.53	0.49	1.00					
Impressionist	0.61	0.82	0.80	0.88	0.47	1.00				
Modern	0.75	0.72	0.74	0.91	0.34	0.78	1.00			
Latin American	0.26	0.29	0.36	0.42	-0.21	0.26	0.57	1.00		
Old Masters	0.62	0.62	0.67	0.78	0.42	0.81	0.78	0.22	1.00	
19th Century	0.77	0.77	0.86	0.91	0.59	0.86	0.83	0.31	0.77	1.00

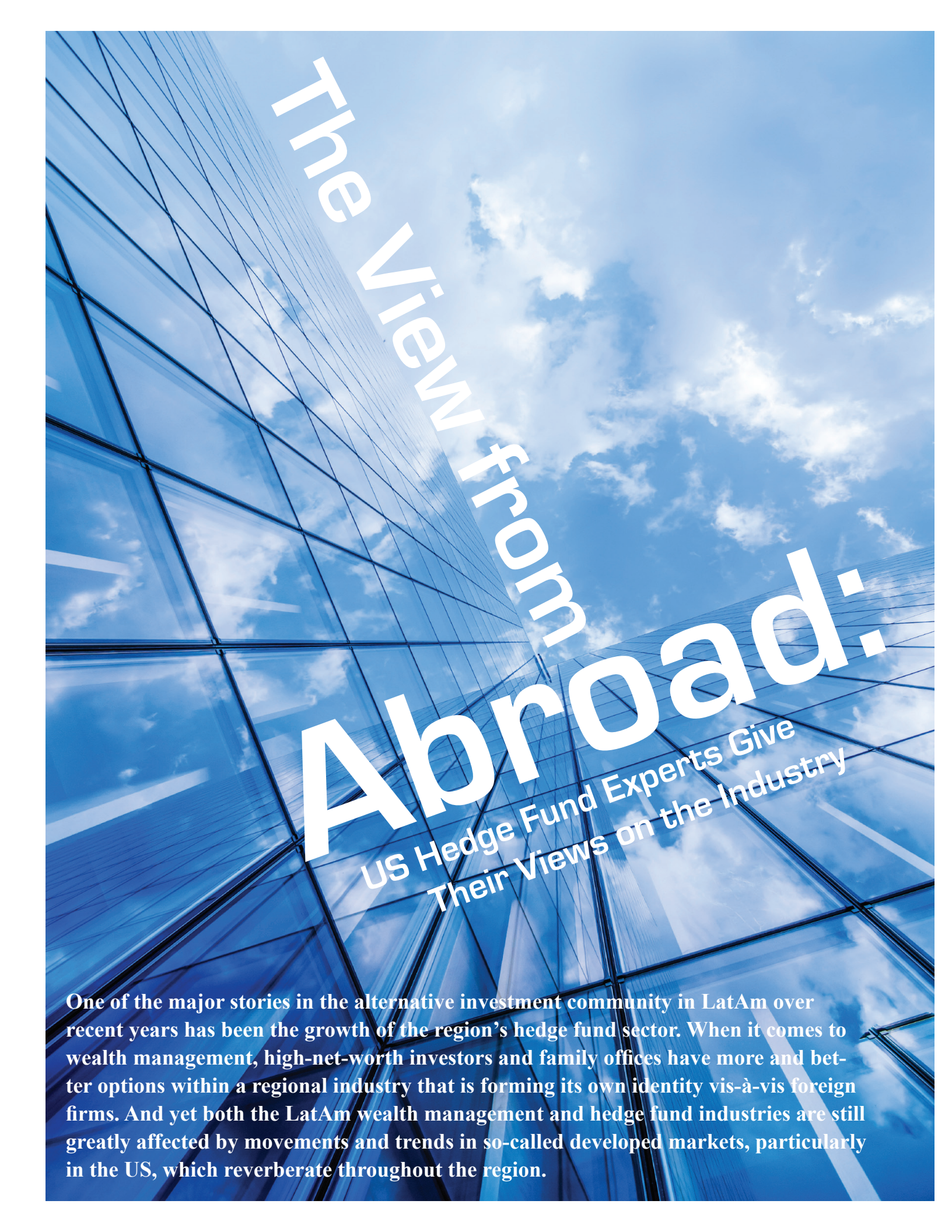
*Based on Art Market Research's data from past 25 years (31 December 1986 – 31 December 2011)

ARTVEST INVESTMENT ADVICE FOR THE ART MARKET

ARTVEST INVESTMENT ADVICE FOR THE ART MARKET

AUTHOR BIO

Artvest is an independent advisory firm that provides investment advice for the art market. With 3 decades of experience in art and finance, Artvest offers impartial guidance and custom strategies for acquiring and selling, protecting art wealth and passing it on to future generations. Artvest fills a need in the market by introducing a disciplined financial focus for collectors at all stages.



The View from Abroad:

US Hedge Fund Experts Give Their Views on the Industry

One of the major stories in the alternative investment community in LatAm over recent years has been the growth of the region's hedge fund sector. When it comes to wealth management, high-net-worth investors and family offices have more and better options within a regional industry that is forming its own identity vis-à-vis foreign firms. And yet both the LatAm wealth management and hedge fund industries are still greatly affected by movements and trends in so-called developed markets, particularly in the US, which reverberate throughout the region.

Recently, ALI spoke to 2 of the US hedge fund industry's most successful managers to hear their views on the relationship between the global hedge fund industry and wealth management, as well as hear how their firms have so successfully weathered the storms of the last 4 years.

Craig Drill and Steven Reynolds, of Craig Drill Capital, a New York-based hedge fund that is one of the world's oldest and most proven, discussed how their firm has maintained success without altering its overall strategy and identity, as well as their concern for a US economy that remains perilously close to a double-dip recession. Inna R. White, CIO and Founding Partner of Althea Group, a New York-based hedge funds advisor and fund of hedge funds manager, spoke of her firm's great success with managers in the volatile, post-crisis credit space, and offered an interesting viewpoint on the contentious issue of fees in the fund of funds industry.

■ Craig Drill Capital

Craig Drill Capital manages a long-short domestic hedge fund of moderate size that has maintained more or less the same characteristics since it was founded 25 years ago. As Mr. Reynolds, the firm's Chief Investment Officer, noted, the fund's duration and steadiness makes it unusual among hedge funds worldwide. The fund is also unusual for having more than weathered the storm in recent years, making money in 2008 and 2011.

The fund's clientele comprise mostly high-net-worth individuals who have been with the fund the whole time, Mr. Reynolds says, and the fund invests mostly in long-short equities, with a generally conservative approach in terms of chasing returns. "One of our main challenges and duties is to protect the capital of our limited partners," he stresses. "Secondarily, it is to provide them

with absolute returns relative to the appropriate benchmarks. We emphasize the preservation of capital over the maximization of profit."

Mr. Drill, the firm's founder, says that having sophisticated investors who have been with the firm for the long haul gives them

"Investors care about transparency and knowing what they own. It's like the old adage: 'A man will make the same mistake twice but not twice in a row.' The investment public is avoiding the things done in the lead-up to 2008-2009, such as putting money in hedge funds with side pockets, which limited partners didn't know existed and now do."

Steven Reynolds, Chief Investment Officer, Craig Drill Capital

a distinct advantage. "Our investors are sophisticated and understand that making money in markets over time is difficult," he says. "It's good having investors who don't believe in the Tooth Fairy." Part of that so-

phistication means not chasing short-term returns: "Recent performance whets greed, but that's always a bad way of investing because high performance is usually followed by a poor period. Chasing performance is very dangerous."

Yet even as Craig Drill Capital's clients have built up a trust with the firm and are pleased especially with its performance during and in the wake of the global crisis, Mr. Reynolds concedes that the hedge fund industry as a whole has not fared as well in terms of trust and reputation. He sees caution on the part of fund managers and LPs alike, and a demand for transparency from investors.

"Investors care about transparency and knowing what they own. It's like the old adage: 'A man will make the same mistake twice but not twice in a row.' The investment public is avoiding the things done in the lead-up to 2008-2009, such as putting money in hedge funds with side pockets, which limited partners didn't know existed and now do."

Mr. Drill says the election year in the US is adding to that uncertainty and caution: "The political process is very polarized and partisan, with very little attention on actual policy, and that creates uncertainty in system and slower growth." He says the firm is particularly concerned about the so-called fiscal cliff that the US economy is headed toward, with a combination of automatic tax increases and spending cuts set to go into effect at the end of 2012, barring action from the US government, and which some experts say will cause a double-dip recession in the country in 2013.

"The economy is still recovering from subpar performance," Mr. Drill says, "and it can't take an important hit from fiscal policy without slipping back into a double-dip recession, which would be really soggy ground to stand on. It makes us more cau-

tious in terms of asset mix: coming into this morning [in August], we're only 15% net long; if it weren't for the fiscal cliff and the debt ceiling 6 months later, we'd be substantially longer."

Nevertheless, Mr. Drill says that, in spite of the political uncertainty in the coming months, his firm is poised to grow in important ways, while sticking to its proven bread and butter. "We have an organization in place that can handle more clients without changing its structure," he says, "and we have a lot of ideas we can put to work."

■ Althea Group

Ms. White's Althea Group is a hedge funds advisory and consulting service for high-net-worth individuals and family offices, helping these clients pick managers for their portfolios. The firm also has a fund of hedge funds product that is focusing primarily on credit- and fixed-income-oriented hedge fund investments, including residential mortgage-backed securities (RMBS) managers, long-short high-yield managers, and emerging market sovereign debt managers. Investors in this vehicle are mainly from the US, though the fund has a global mandate.

Ms. White tells ALI that all of the managers her firm have worked with have had great success raising money in the last 4 years — with one, for instance, starting at US\$50 million in 2009 and now having over US\$500 million, and another starting with proprietary capital in 2007 and now managing US\$2.5 billion in external capital. "In general, hedge fund managers that trade these instruments have been more successful at raising capital since 2008 than some of their counterparts that trade equities," she says. "They are delivering strong returns post-2008 through their ability to take advantage of the credit crisis."

As an example, she gives the US RMBS space, where spreads have tightened sig-

nificantly since the crisis. "Prior to 2007-2008, all the managers could do was engage in highly leveraged transactions

"A significant number of investors have been sitting on the sidelines post-credit crisis and have missed a really large rally in the US RMBS and high-yield spaces. There seems to be 2 groups of investors now: those who think they have already missed the rally and think they might as well sit on their cash, and those who missed one opportunity and don't want to miss it again."

Inna R. White, Founding Partner
and CIO, Althea Group

to generate attractive returns. Post 2007-2008, a huge amount of opportunities opened up that didn't exist before. Managers that trade in these securities have been able to benefit from the sharp sell-

offs during the credit crisis and generate attractive returns."

There have been selloffs and volatility during the 2009-2012 period as well, she says, and more successful managers have been able to capture the post-selloff upside. "For example, there was a significant spread widening in the US high-yield space in October of 2011, which was followed by a strong rebound. The US RMBS space had a sell-off last year with a strong rebound this year. The key is to be able to benefit from these selloffs."

The benefits can still be had, she says.

"A significant number of investors have been sitting on the sidelines post-credit crisis and have missed a really large rally in the US RMBS and high-yield spaces. There seems to be 2 groups of investors now: investors who think that they have already missed the rally and think that they might as well sit on their cash, and those who have missed one opportunity and don't want to miss it again."

Concerning emerging market sovereign debt, Ms. White says her firm invests only in managers that trade fixed-income securities in those markets, not equities. "It is my perception that it is harder to justify going into an equities-based emerging market manager," she says, "because you don't know how much of their returns is beta vs. alpha. On the fixed-income side, it is harder to find those securities, so I'm much more inclined to hire a manager to invest in the emerging markets debt."

As both an advisor/consultant and fund of funds manager, Mr. White has a unique perspective on the attitude of high-net-worth investors and family offices toward hedge funds. She says there is a trend in the US for such investors to invest directly in hedge funds, instead of investing through

a fund of funds. She also says that larger family offices and institutional investors that used external fund of hedge funds advisors in the past are now hiring staff internally to look at hedge fund managers and build a portfolio internally. Larger institutions, she adds, are hiring consultants to evaluate hedge funds and then to make direct investments.

Many high-net-worth investors, family offices and institutions are investing directly in order to avoid fees, which have become a contentious issue in the industry. But Ms. White believes these fees are, in many cases, necessary — so long as they are justified. And they are justified when these funds of funds are able to do what investors cannot do on their own.

“Although fund of hedge funds do charge an extra fee,” she says, “they provide a service,

“The political process is very polarized and partisan, with very little attention on actual policy, and that creates uncertainty in system and slower growth.”

*Craig Drill, founder,
Craig Drill Capital*

too. The hedge fund industry is very fragmented and it is hard to find good manag-

ers. It is especially hard to find and analyze managers with the specialized expertise, not multi-strategy, and this is what Althea Group does.” The question is whether those multi-strategy managers perform well from the return standpoint, she says.

“If they don’t, you need someone working full time to find smaller specialized managers, and that takes time and a lot of effort. It’s not so easy to create a portfolio of 10 or 15 specialized hedge funds that are performing well. So fund of hedge funds provide an economy of scale in terms of resources, and a double layer of fees is not an issue as long as the net returns are compelling.”

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THE BRAZILIAN LAW ON MONEY LAUNDERING

Brazil has recently altered its money laundering law. The new bill has tightened the government's grip on most of the investment operations and has significantly broadened financial institutions' and investment brokers' duties to report suspicious activities.

Since the reporting of suspicious activities may trigger an investigation, it is important for foreign investors to understand how they can, at the same time, keep their privacy and still benefit from the Brazilian market, especially the Brazilian stock market.

■ Know your customer way too much

In 2000, the Brazilian Monetary Council (CMN) published Resolution 2.689, which regulated investments made by nonresidents in the Brazilian stock market.

In 2005, the Brazilian Stock Exchange Commission (CVM) issued Instruction 419, which created a simplified registration for nonresident investors.

The aforementioned rules were balanced and adequate. They did ask for identification of the investor but did not request it to provide excruciating details about the origin of the funds or, in case of companies, the complete list of its shareholders or beneficial owners.

Since then, the scenario has changed dramatically. In March, the Brazilian Central Bank (BACEN) issued the Carta Circular n. 3.542. This regulation advanced a list of suspicious activities that banks should monitor in order to prevent money laundering by its clients.

AND THE PRECAUTIONS INVESTORS MUST TAKE WHEN INVESTING IN BRAZIL

■ Adler Martins

Among an endless list of activities, one is certain to call the attention of Latin American investors: Article 1 states that the simple fact of being located in a tax haven or in a country that enforces secrecy more vigorous-

ly is enough to characterize the investor as a potential money launderer. That is to say: Any investor who chooses to concentrate his or her pool of funds in any of the many Latin American tax havens is automatically subject

to scrutiny by Brazilian banks, who will treat her/him as a potential criminal.

Article 1 also prescribes that the beneficial owner of the investment must be identifiable at all times; otherwise the investment shall be characterized as highly suspicious. The beneficial owner, in this context, means the original owner of the funds, after any layers of corporate veils have been lifted. In other words, the individual who owns shares in a company that has a subsidiary in a tax haven cannot, in principle, invest through the tax haven's subsidiary without identifying himself first.

Those rules sprung from a similar provision of the Law 9.613 from 1998, the original money-laundering bill. In July of this year, the law 12.683 was published, altering some provisions of the money-laundering bill. In what concerns the foreign investor, which was already subject to the BACEN rules described above, the new money-laundering provisions brought 2 very important implications:

I. From now on, any activity with the purpose of concealing money originated from any kind of felony or crime will suf-

fice as grounds for accusation of money laundering.

This is very drastic, because the expression “concealing” may have several meanings, among them:

- take the money away from the banking system;
- not offering funds to taxation;
- detach the possession of the money from oneself, either through a chain of companies or through the use of proxies or representatives.

Also, since the origin of the money now



must be 100% pristine, it is reasonable to fear that the incorrect collection of taxes or mistakes in the filing of tax forms might be used by the government as an excuse to taint the origin of the money, even when the underlying transaction is legitimate.

Any investor who chooses to concentrate his or her pool of funds in any of the many Latin American tax havens is automatically subject to scrutiny by Brazilian banks, who will treat her/him as a potential criminal.

II: The list of whistleblowers has been expanded. Now, any advisor that deals with financial transaction, including accountants and economists, is obliged to report suspicious behavior or activities to the government. Moreover, brokers in real estate and other transactions (such as art, cattle or oth-

er auctions) must also keep records of their clients and report suspicious activities.

The only professionals that, theoretically, are exempt from this duty to report are lawyers (although other classes are currently discussing the issue in Brazilian courts).

■ I want to remain legal. What do I do?

In the current Brazilian scenario, the challenge is not to remain legal (that is, to make legitimate investments) but to look legal, to transpire transparency and credibility in order to avoid investigations.

The best ways to do so is make initial contacts with brokerage firms, banks, etc, and explain the legitimate origin of the funds, as well as testify on the investment's legitimacy. Keeping sound records of the origin of the funds and of the payment of applicable taxes in Brazil is also a good way to protect oneself from future investigations.

In the case of real estate investments, the investors should always select the broker with utmost care and formalize all previous negotiations with him, stressing the legality of the funds. The same is true for contacts with stock brokers.

And, above all, hire a good lawyer and trust him. He will act as your ambassador before the Brazilian financial system.



AUTHOR BIO

Adler Martins is a Law graduate from one of Brazil's greatest Law Schools: The Federal University of Minas Gerais (UFMG). He is also a MBA by Fundação Getúlio Vargas. Presently attending Masters Course credits (LLM) at Pontifical Catholic University of Minas Gerais and a Post Graduation Course in Financial Planning at São Paulo City University. He can speak English, Spanish, Portuguese, German and some Chinese (Mandarin). Adler has working experience in Argentina, Mexico, India, England, China and Dubai, aside from extensive experience in Brazil.

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Caipirinha to Cabernet

Brazilian Wines Go International

■ Tiffany Joy Swenson

It should come as no surprise that Brazil has been cultivating fine wines since its colonization. With a vibrant culture, diverse and ample terrain, and a booming economy, this South American powerhouse has all the necessary components for a viticulture victory.

Although Brazil is considered the 5th largest wine producer in the southern hemisphere, there is surprisingly little buzz about Brazilian wines on an international level, something that the Brazilian wine industry is looking to change. In this glimpse into the world of Brazilian wine, Alternative Latin Investor sought insight from Patricio Carraro, a 3rd generation wine grower, from the boutique winery Lidio Carraro and Andreia Gentilini Milan, the Export Manager for Wines of Brazil, an organization created to promote the quality of Brazilian wines in the international market. The Brazilian efforts to make a mark on the international wine scene are quite recent, as up until now, the industry was almost entirely focused on domestic success. In the initial years of wine production in Brazil, growers were exploring mainly autochthonous grapes and cultivating “table wines” for personal use. It wasn’t until just 4 or 5 years ago that the world began to see Brazil as a solid competitor in the international wine export market.

As the middle class continues to boom in Brazil, there appears to be a correlation in the growth of the fine wine industry within the country. Furthermore, with the World Cup and 2016 Olympic Games on the horizon, Brazil is highly aware of the unique opportunity to showcase the quality, capability and identity of their wines.

“We are doing now what Chile and Argentina did 15 years ago, said Ms. Carraro. “Of course we are hoping that Brazil develops faster.”

As the middle class continues to boom in Brazil, there appears to be a correlation in the growth of the fine wine industry within the country. Furthermore, with the World Cup and 2016 Olympic Games on the horizon, Brazil is highly aware of the unique opportunity to showcase the quality, capability and identity of their wines.

It is worth noting that surprisingly, unlike other wine regions, Brazil does not have a signature grape. In fact there is no native Brazilian grape, giving Brazilian wine producers the unique opportunity to evaluate and develop grapes from other regions. The majority of grapes introduced into Brazil were of French or Italian origin: traditional grapes such as Merlot (Brazil’s most popular red wine), Cabernet Sauvignon, Cabernet Franc, Pinot Noir, Chardonnay and Tannat. More recently, as investment potential has been identified in

the industry, excellent grapes have been introduced such as Malbec, Teroldego, Touriga Nacional, Tempranillo and Sauvignon Blanc.

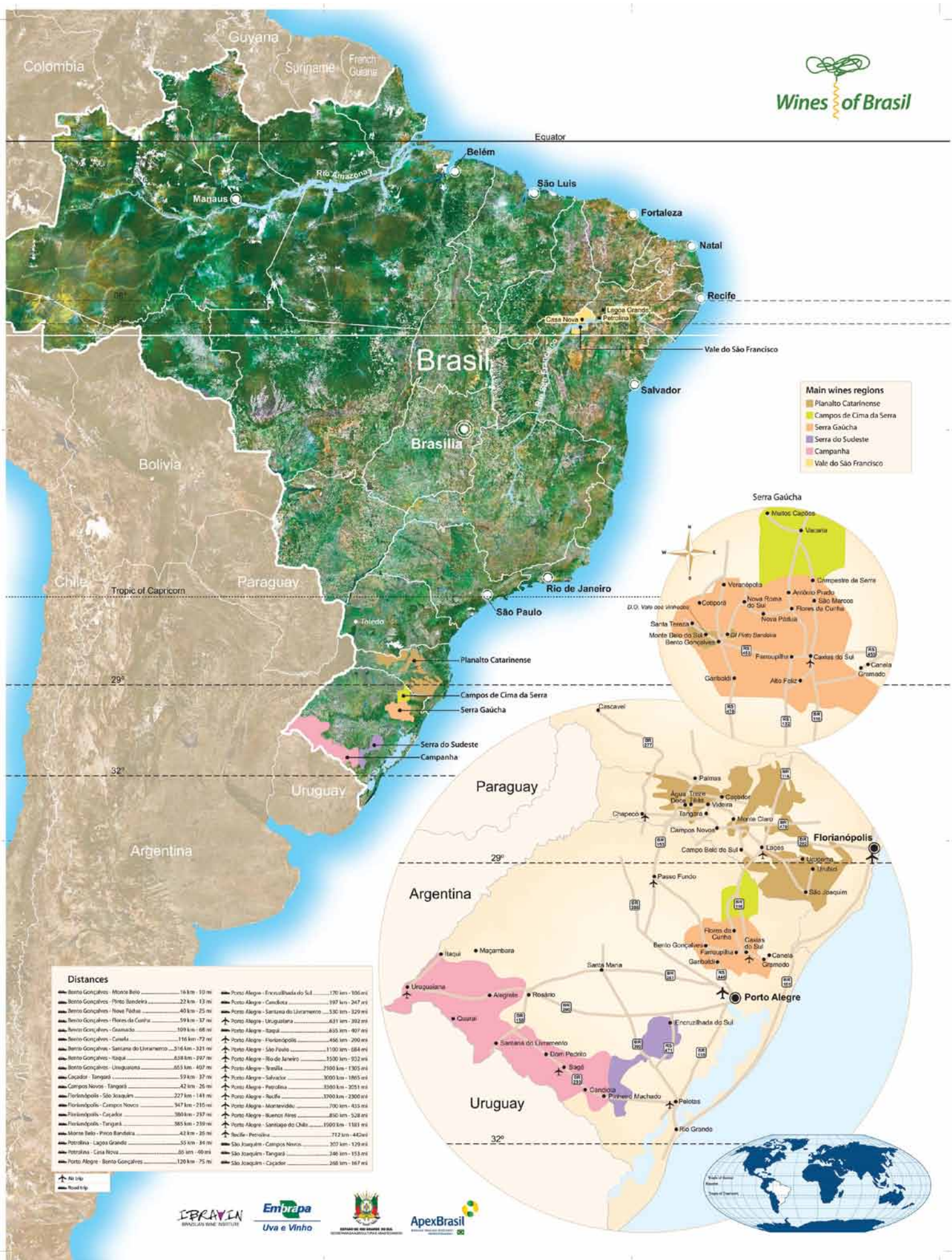
“The strength of the Brazilian wine industry lies in the diversity of climates and soils,” said Ms. Carraro. “Brazil is a huge country. As of now we don’t believe we will have a signature grape. The idea is to sell the image of diversity in this region. We believe our wines reflect the identity of our country. Brazil is joyful and vibrant, and the idea is to invite people to experience Brazil through the flavors of its wines.”

■ Location and History

In 1857, heavy immigration from Italy spawned the growth of Brazil’s self-proclaimed “wine country.” Settlers found themselves at home in southern Brazil, a mini-Tuscany in terms of climate and terrain. Today there are over 1,100 wineries around the country, mostly based on small, family-run farms. Brazil has 6 major wine-producing regions, and due to its ideal conditions for the production of fine wines, Rio Grande do Sul is home to 4 of these regions:



Patricia Carraro – Export Manager, Lidio Carraro



Distances

• Belém - Manaus	16 km - 10 mi	• Porto Alegre - Encruzilhada do Sul	170 km - 106 mi
• Belém - São Luís	22 km - 13 mi	• Porto Alegre - Canoas	97 km - 60 mi
• Belém - Fortaleza	40 km - 25 mi	• Porto Alegre - Santa Rosa do Livramento	530 km - 329 mi
• Belém - Recife	59 km - 37 mi	• Porto Alegre - Uruguaiana	631 km - 392 mi
• Belém - Natal	109 km - 68 mi	• Porto Alegre - Itaquí	635 km - 395 mi
• Belém - Salvador	116 km - 72 mi	• Porto Alegre - Florianópolis	466 km - 290 mi
• Belém - Brasília	516 km - 321 mi	• Porto Alegre - São Paulo	1100 km - 684 mi
• Belém - Itaquí	638 km - 397 mi	• Porto Alegre - Rio de Janeiro	1500 km - 932 mi
• Belém - Uruguaiana	653 km - 407 mi	• Porto Alegre - Brasília	2100 km - 1305 mi
• Caxador - Tangará	59 km - 37 mi	• Porto Alegre - Salvador	3000 km - 1865 mi
• Campos Novos - Tangará	42 km - 26 mi	• Porto Alegre - Petrolina	3300 km - 2051 mi
• Florianópolis - São Joaquim	227 km - 141 mi	• Porto Alegre - Recife	3700 km - 2300 mi
• Florianópolis - Campos Novos	347 km - 215 mi	• Porto Alegre - Montevideo	700 km - 435 mi
• Florianópolis - Caxador	380 km - 237 mi	• Porto Alegre - Buenos Aires	830 km - 516 mi
• Florianópolis - Tangará	385 km - 239 mi	• Porto Alegre - Santiago do Chile	1500 km - 1181 mi
• Itaipava - Petrolina	42 km - 26 mi	• Recife - Petrolina	712 km - 442 mi
• Petrolina - Lagoa Grande	55 km - 34 mi	• São Joaquim - Campos Novos	307 km - 191 mi
• Petrolina - Casa Nova	85 km - 53 mi	• São Joaquim - Tangará	346 km - 215 mi
• Porto Alegre - Bento Gonçalves	120 km - 75 mi	• São Joaquim - Caxador	268 km - 167 mi

✈ Air trip

🚗 Road trip



Serra Gaúcha, Campanha, Serra do Sudeste and Campos de Cima de Serra. Referred to as the heart of the Brazilian wine industry, Rio Grande do Sul is the most southerly state of the country, bordering both Uruguay and Argentina. This region has a unique microclimate with 4 defined seasons, very similar to the northeast regions of Italy, the birthplace of many of the region's descendents. Although it is technically "sub-tropical," this mountainous province boasts a predominately cool and damp climate, rendering irrigation unnecessary. Optimal temperature range and natural conditions allow winemakers in these regions to develop several grape varieties. Furthermore, as Ms. Carraro points out

"If we have to compare, we are much closer to European style than New World style, and this is a very important point as nowadays people are looking for more balanced wines ... moderate alcohol, fruity, fresh, and we have this style naturally in our wines due to the conditions of our land," said Ms. Carraro. "It's a new experience for people."

Vale do São Francisco in the northeast of Brazil, along with Planalto Catarinense in Santa Catarina (just north of Rio Grande do Sul) make up the last 2 wine-producing regions.

Lidio Carraro, a family-run boutique winery is said to be creating some of the best wines in Brazil, as testified by a slew of awards and rave reviews in the international press. The winery was born commercially in 1998, and their first wines launched in the market in 2004. However, their family's economy has always been wine-centric, consisting of 5 generations of winemakers originally from Veneto, a popular wine region in Italy. You can note the pride in her voice when Ms. Carraro states, "In the south of Brazil – the wine is in your blood."

Family-run wineries in Brazil are the norm. Aside from the Portuguese company South Dao, and the French mega brand Chandon, Brazilian families run 100% of Brazilian wineries. These families

are primarily descendants of the original Italian immigrants who have worked in viticulture ever since their arrival to the country. The youngest generations of wine growers commonly study at the Technical College of Enology and Viticulture in Bento Gonçalves and many venture abroad, gaining expertise by studying with European producers in France and Italy and even Argentina. In recent years, some wineries have begun to hire foreign consultants from other popular wine-producing countries.

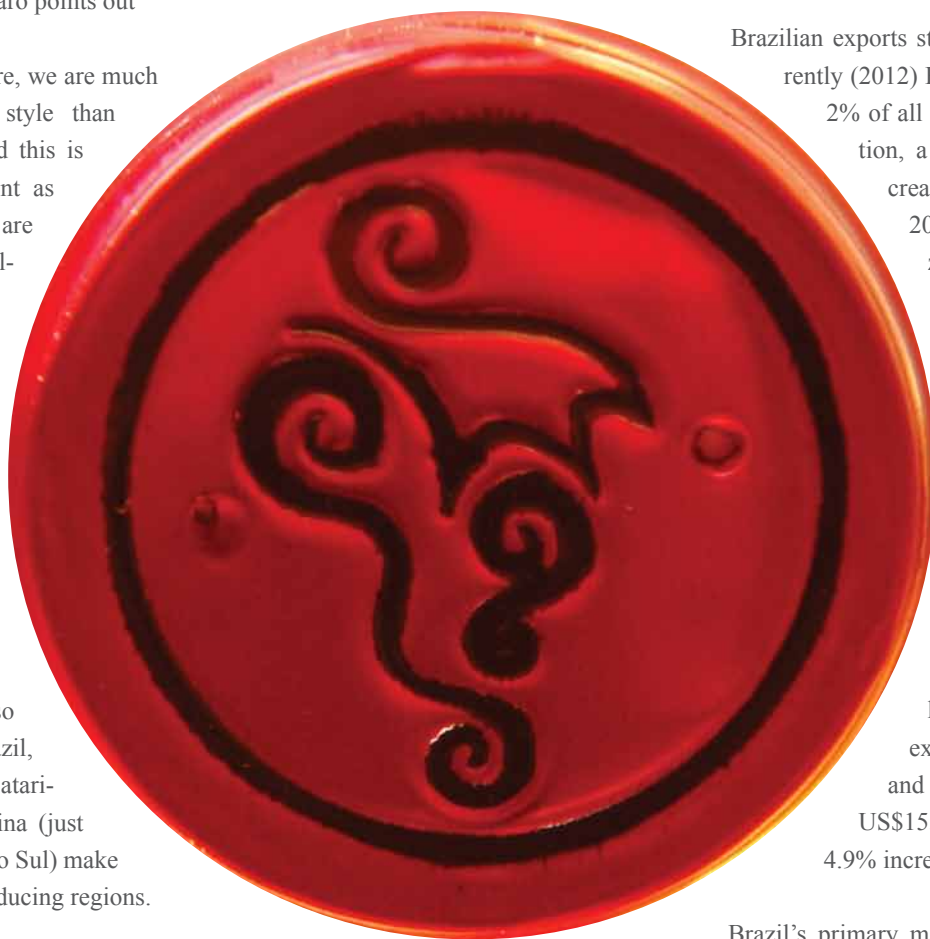
■ Exportation and Growth

Brazilian exports started in 2002 and currently (2012) Brazil is only exporting 2% of all Brazilian wine production, a small yet steadily increasing number. In 2002-2003 the exports were at zero.

The work to build the image of Brazilian wine has been highly targeted over the past few years. The 2011 Overview Performance of Brazil in the International Grape and Wine Market states that Brazilian exports within the grape and wine sector totaled US\$155.70 million in 2011, a 4.9% increase over 2010.

Brazil's primary markets are Europe (the UK and the Netherlands, mostly), North America and China. With a strong pride and identity riding on Chilean and Argentine wines, demand for Brazilian wines hasn't yet developed within the South American market. As far as exports go, the Merlot is the most popular export in the domestic market; in spite of its fame for being quite traditional it is also highly popular on an international level. Sparkling wines, typically a blend of Chardonnay and Pinot are also incredibly popular as well as the Italian Muscatel.

Nowadays, in the domestic market, there is space for all types of wines. A large volume is concentrated in the affordable segment; however, according to the consumption and culture around wine growing, demand in the medium and luxury segments has been in-



creasing. In recent years, it is worth noting that Brazilian professionals from other sectors of the economy have begun investing in vineyards and wineries in the country.

According to the Wines of Brazil institute, the estimated growth of Brazilian wine exports is around 15% by 2016, based on projected growth of wine consumption in the domestic market and the development of promotional and commercial strategies of Brazilian Wineries in the international market.

According to Ms. Milan, the supermarket chains are a driving force. Out of every 3 bottles of wine sold on the market in Brazil, 2 are sold to supermarkets. While restaurants play an important role, it is currently very expensive to buy wine at a restaurant in Brazil, making restaurant wine consumption inaccessible for the majority of Brazilians.

The regulation on domestic wines in Brazil has historically been much stricter than those imposed on foreign-imported wines. The agriculture ministry in Brazil, which controls said regulation, is working to develop strategic trade agreements that might help ease regulatory restrictions as Brazil expands its involvement in the international wine market. Regulation is a bit stricter when it comes to Europe, as they are big producers and are protective of their market. Luckily, Brazil is not yet seen as much of a threat. Softer markets to enter are Germany, US and China, where it is very easy to export.

As growth and production increases it goes without saying there is a lot of potential in the sector. With the World Cup and Olympic Games on the horizon, Brazil is well aware of the unique opportunity it will have to promote the image and awareness of Brazilian wines. Ms. Milan adds, "The World Cup is our chance. ... All attention is going to be on Brazil and we have to take advantage of that"

Alternative Latin Investor would like to thank Patricio Carraro from Lidio Carraro and Andreia Gentilini Milan from Wines of Brasil. For more information visit:

<http://www.lidiocarraro.com/>

<http://www.winesofbrasil.com>



Lidio Carraro Technical Team

Private Aviation *Takes* *Off* in LatAm

The growth of private wealth in LatAm has led to a rise in demand for private aircraft and private aviation services. For the region's mounting numbers of high-net-worth and ultra-high-net-worth individuals, a plane can be purely a luxury item, of course; but for increasingly global and mobile professionals and business owners, it meets a demand unsatisfied by local transportation alternatives, as well.

This demand is reflected in the numbers of individuals obtaining flying licenses, in sales of small aircraft and in the many aviation charter services sprouting up around LatAm, and it has motivated aircraft manufacturers and private aviation providers worldwide to expand their scope in the region.

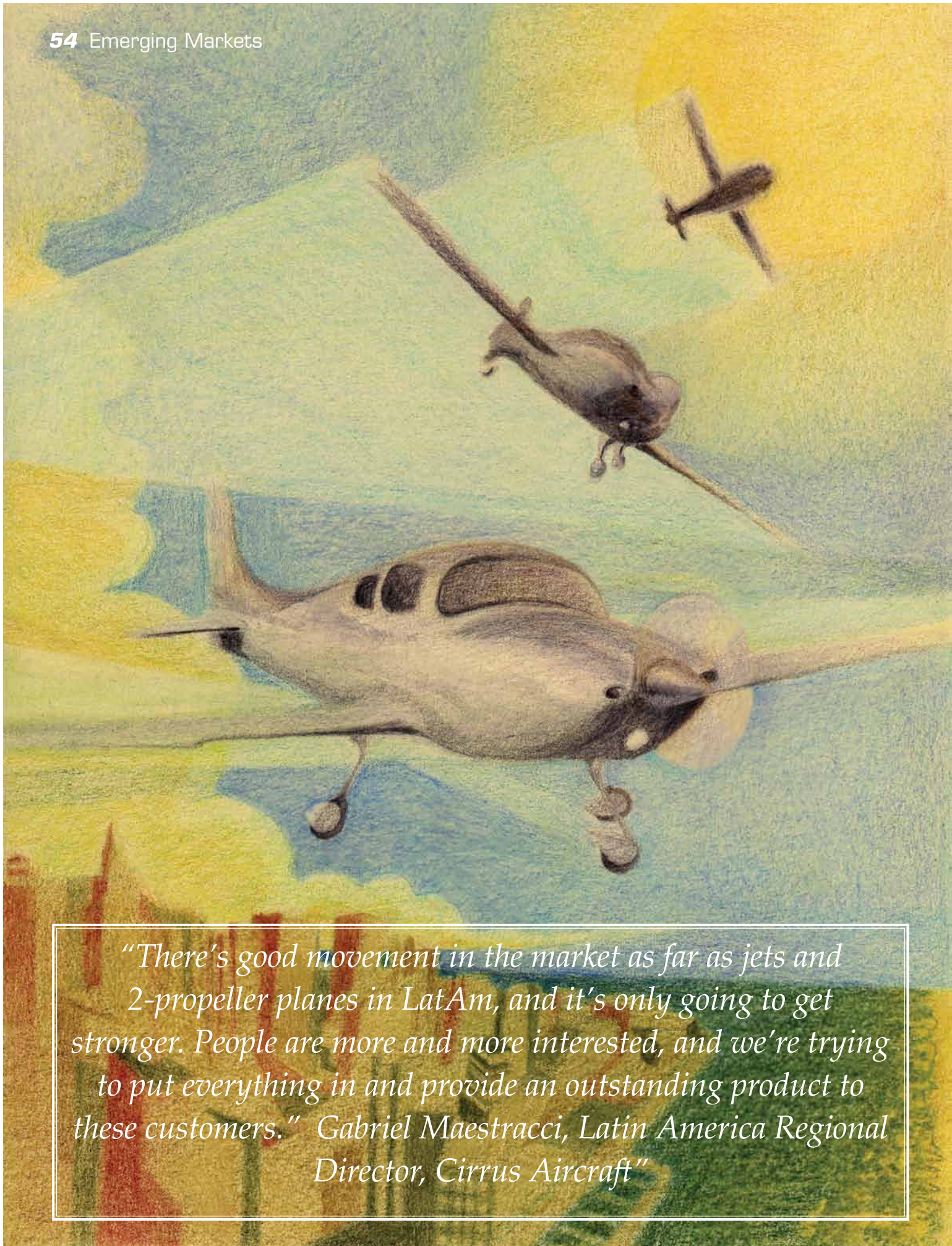
A prominent example is NetJets, a US company affiliated with Warren Buffet and Berkshire Hathaway that is by far the dominant private aviation provider in the US, having pioneered the fractional ownership model of private aircraft ownership and investment. NetJets recently made headlines with what

was reported to be the largest purchase of aircraft for private use in history, valued at US\$9.6 billion, including the Cessna Citation Latitude and the Bombardier Challenger 300 and 605. This year the company also inaugurated its first Bombardier Global 5000 aircraft. According to several industry experts who spoke to ALI, this expansion and improvement of the NetJets fleet will, among other things, allow the company to expand the range of its flying capacity and the scope of its operations into LatAm, meeting the rising demand of clients who need to travel easily between LatAm, the US and Europe.

From the aircraft manufacturing sector, another prime example of a global company

expanding into the region is Cirrus Aircraft, a US-based manufacturer of small propeller planes that have become the cream of the industry's crop in terms of technology, functionality, safety and style over the last decade. The company's SR22 model, for instance, has won the prestigious Robb Report "Best of the Best" award 9 times in a row, more than any aircraft in any category. The 4-seater plane it makes is especially renowned for its safety features, including a full-aircraft parachute system.

Cirrus has clients throughout LatAm and has seen sales grow steadily in the region, both in absolute terms and relative to other regions worldwide. Indeed, Gabriel Mae-



"There's good movement in the market as far as jets and 2-propeller planes in LatAm, and it's only going to get stronger. People are more and more interested, and we're trying to put everything in and provide an outstanding product to these customers." Gabriel Maestracci, Latin America Regional Director, Cirrus Aircraft"

stracci, the company's recently appointed Latin America Regional Director, made a name for himself within the company in 2009, when as the country director for Venezuela, he earned the company's award for most per-sale income among country directors. The following year Colombia was added to his portfolio, and in 2012 he was tapped to oversee all of LatAm.

Mr. Maestracci, a native of Venezuela who has lived the last 18 years in the US, has seen a steady increase in demand for Cirrus propeller planes since he started at the company in 2008. This is due in part, he says, to the rise in wealth in the region and accompanying rise in interest in private aircraft. "There's good movement in the market as far as jets and 2-propeller planes in LatAm, and it's only going to get stronger. People are more and more interested, and we're trying to put everything in and provide an outstanding product to these customers."

The company has done just that, outstripping its rivals in the propeller-plane market and even winning some market share from jet plane manufacturers. "Cirrus sells state-of-the-art aircraft; you barely see this level in private jets," he says, adding that operational costs for Cirrus planes are lower than those of jets and that propeller planes are often ideal for customers traveling relatively short distances, as is the case in many countries in LatAm where prime destinations will be within a few hundred miles of each other.

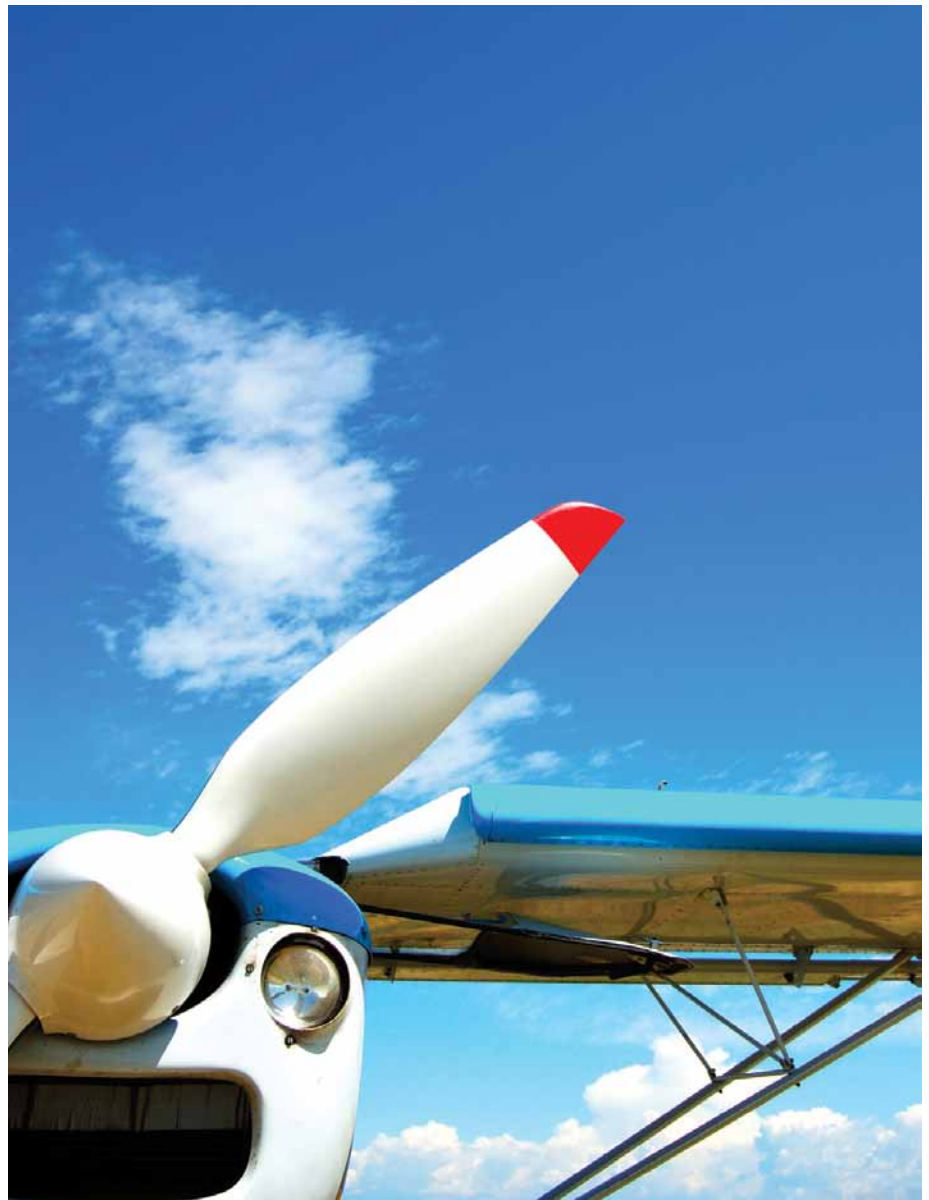
"There are many reasons our customers believe our airplane is superior to the competition," he says. "We welcome side-by-side comparisons to other aircraft in this class. This airplane is super capable and the design and comfort mirror what our customers are used to in their luxury cars. We have been the best-selling piston airplane in the world for almost 10 years."

"At Cirrus shows in Central America," he continues, "I've surveyed potential buyers

and asked them: If you could choose between learning to fly with a Cirrus or with a Cessna – the plane you usually learn to fly on at flight school – even if the cost of training would be double, what would you choose? And most say they would prefer to learn with Cirrus, because of the innovation, the technology and of course the parachute." Though the demand for Cirrus products and other private aircraft options is certainly there regionwide, Mr. Maestracci says that financing remains a challenge in many countries where the financial infrastructure and regulations make purchasing more difficult. The company currently works with the EX-IM Bank, an import-export bank

based in Miami and Washington, to improve the availability of Cirrus planes in terms of financing, and they're trying to launch more international financial aid options. "But each country has its own politics and possibilities," he says. "For instance, Venezuela has had currency control for 8 years, so a regular person who wants to do currency exchange has to go through a complicated political process. The same is happening in Argentina now."

"On other hand, Brazil has strong financing options," he adds, "and Mexico too. I intend to pursue Mexico aggressively, because it's so close to the US and has strong institutions."



Paving the Way

High-Tech Financial Infrastructure Hits LatAm

Foreign market leaders such as Fidessa, Direct Edge and Navatar are challenging local providers in the race to meet the booming region's needs



The growth in size and sophistication of LatAm capital markets has both fueled and been fueled by the implementation of high-tech financial infrastructure in the region, as the hardware and software that have been the foundation of high-frequency e-trading and other tech-heavy investment activities in the U.S., Europe and Asia are quickly gaining ground.

In a recent white paper, Alice Botis, Head of Latin American Business Development and Sales at FIDESSA, a New York-based global multi-asset software leader, discusses these themes, outlining the major current trends among technology providers as well as the region's modernizing equity and derivatives exchanges.

"Throughout Latin America," Ms. Botis writes, "firms are replacing legacy vendor and proprietary systems and investing in customizable, high-throughput, low-latency trading solutions both to achieve greater operating efficiency and to provide a solid basis for competition in a region with diverse regulations and varying stages of electronic market access."

Increased networked connectivity, market fragmentation and the need for access to global liquidity are three of the main driving forces behind the development of financial infrastructure in the region, she says.

Demand is coming from all sides. International brokers, banks, fund managers and investors entering the LatAm market are eager to utilize the same technologies they have relied on increasingly in developed markets over the last decade, while maintaining technological uniformity across their global operations. Local players, too, are adopting the new technologies enthusiastically, in part to compete in the increasingly crowded markets, as well as to better serve international clients with certain technological expectations. The region's exchanges, meanwhile, are revamping their own infrastructure in an effort to appeal to international investors while aiming for greater interconnectivity region-wide.

While local tech providers are meeting this demand to a certain extent, exploiting their on-the-ground knowledge of individual markets in the region, there has been an influx of international tech companies who have brought in well established technologies and begun tailoring them to specific LatAm markets. Recently, ALI spoke to representatives from three exemplary companies about the challenges and opportunities of the evolving financial technology space in LatAm.



In her aforementioned white paper, Ms. Botis says that “the dominating global trend is fragmentation of the markets,” adding that, in the LatAm region, “Brazil seems likely to take the first steps towards fragmentation.” The process is being driven, on one side, by Brazilian regulators eager for their market to reach the next level and, on the other, international companies specializing in high-performance stock exchange infrastructure.

One of these companies is Direct Edge, a stock exchange specialist based out of Jer-

sey City, NJ, that currently runs 2 platforms in the U.S., across which US\$20-25 billion are traded every day, making it the country’s 4th largest exchange. Founded by Knight Capital in 2007, Direct Edge has grown quickly from about 2% market share in the U.S. to about 12% market share today.

In recent years, the company has been investigating the possibility of establishing an exchange in Brazil, attracted by the size and maturity of the market and encouraged by Brazilian regulators who are actively seeking to foster competition in part to address the high trading and post-

trading fees in the country’s dominant stock exchange, the BM&F Bovespa.

Anthony Barchetto, Head of Strategy at Direct Edge, says there is strong demand in Brazil for the high-performance technology and customer-centered mentality that have been Direct Edge’s hallmark in the U.S.

“In the U.S., we’ve had to compete with incumbent exchanges, some that have been around for decades and one whose origin goes back more than two centuries,” he says, “and to do so we’ve had to bring high functionality and technology, lower costs, and a customer-centered mindset. Now we’re bringing that to Brazil.”

■ High-Tech Financial Infrastructure Hits LatAm

In spite of some early skepticism, both the Brazilian regulators and local firms have welcomed



Direct Edge into the market. “These firms are trying to reinvent their businesses, and competition between exchanges is one way they can get a little leverage,” he says. He has been particularly impressed with the CVM, Brazil’s equivalent of the U.S. SEC, he said, which has been proactively fostering competition via the Instruction 461 framework, while being attentive to outsider recommendations from Direct Edge and other concerned parties.

But Mr. Barchetto stresses that it took time to convince local parties that Direct Edge was serious about, and capable of, giving the market what it needed.

“Familiarity is important when building meaningful relationships,” he says. “The more times we come to Brazil to meet brokers in person, the more they realize your commitment is real. They talk to their friends in the brokerage community, which is relatively small and close-knit in Brazil. And now we’ve gotten to the point where we really know these firms.”

At the same time, Direct Edge has understood from the beginning that it was essential to tailor its service to the local market and rely on local expertise that U.S. companies simply do not have. And even as they are attempting to bring something new and competitive to market, it was important to respect the incumbent exchange as well as local brokers’ current relationship to it.

“We’ve been careful to be respectful while competing with Bovespa and acknowledge that some things work different in Brazil, and some things are better. Their clearing regime, for instance, identifies the investor at the final beneficiary owner level, which can provide both regulators and the exchange with more transparency and safety in the market in terms of clearing.”

“But more than that,” he adds, “we’ve also been careful to push forward a vision of our exchange as coming from the local market.”

This has meant working closely with local regulators, brokers and the city of Rio de Janeiro. Direct Edge is also targeting local investors primarily in this early stage, even though they will be able to add great value to the Brazilian market with their network of established international clients. As they have in the U.S., Direct Edge is aiming to serve a variety of clients, including retail, institutional and high-frequency investors. “The fact that it’s foreign doesn’t really make a difference,” he says. “It’s going to be as Brazilian an initiative as possible, with support from us up here. We’re bringing our expertise and leaving local expertise to the people we bring in, without pretending we know everything just because we’ve been successful in the U.S.”

Aside from BM&F Bovespa, Direct Edge faces competition from another U.S. stock

*The
exchanges
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*Head of Latin American
Business Development and
Sales at FIDESSA*

exchange firm, BATS Global Markets. Both firms are keen on entering the Brazilian market, though they are following different models. “We have different strategies. We’ve been clear from the beginning that the best way to introduce competition to Brazil with the least systemic risk to the marketplace, is to



Anthony Barchetto, Head of Corporate Strategy at Direct Edge

use the existing clearing facility provided and owned by Bovespa. BATS has talked about building their own clearing facility. They are two distinct visions.”

He adds that Direct Edge will not open two platforms in Brazil, a model it has pioneered to great success in the U.S. “We did that to create distinctive pricing and technology options in a very crowded marketplace,” he explains. “In Brazil, we can provide compelling pricing and technology with just one exchange supported by superior customer service.”

Direct Edge’s decision to go international via the Brazilian market, as opposed to, say, London or Hong Kong, was based on where they felt they could have the greatest effect, he says. “Unlike in London, in Brazil we have a shot to be first to market and offer something truly compelling.” He adds that Direct Edge has no concrete plans to expand elsewhere in the region, though he concedes that there are opportunities. “It isn’t in the business plan now, but we are definitely giving it thought. It’s going to take a lot of work to get our cash equities exchange going in Brazil. But once we have our base operation in the region’s largest market, it would be foolish not to consider other countries or asset classes.”

Fidessa

Trade / Invest / Inform

Ms. Botis's firm, FIDESSA, which providing trading systems, connectivity and market data to brokers and banks worldwide, is leading the way among multi-national software providers entering LatAm. The global leader in the space, FIDESSA has focused on LatAm over the last 4 years, recently opening an office in Sao Paulo and with plans to co-locate at the Santiago, Chile, exchange.

The original impetus for the firm's entry into LatAm, Ms. Botis explains, was to better serve international clients in the U.S., Europe and Asia who were entering the LatAm market and wanted to have consistent technology across their global businesses. But more recently, a converse trend has developed as well, as local players have begun adapting the newest technologies to better interact with international markets.

"A lot of these brokers have been working in their own markets for a long time and have been doing well, and it's really when they start looking out of their country to attract foreign flow that they want to increase their technology," she says.

Regional exchanges are proactively modernizing their technology. For instance, in her white paper, Ms. Botis mentions the Bovespa Exchange's adoption of a new trading platform, called Puma, which launched for derivatives in 2011 and will launch for

equities in 2013, and a region-wide adoption of FIX messaging by most of the major exchanges, including the three that constitute MILA: Colombia, Peru and Chile.

"The exchanges themselves are driving the brokers and banks to increase their technology as they upgrade matching engines and increase throughput, and the old systems aren't enough," she told ALI. "So local players are implementing solutions like FIDESSA's to help them compete."

Though FIDESSA is the global leader and has had great success so far in LatAm, local solutions have been in place in the region



for several years, which have the advantage of knowing the local market. Indeed, understanding local nuances is crucial to success, Ms. Botis says.

"We found out very quickly that you can't just import software into a region wholesale. You really need to look at the

specifics of each country and adapt your solution. That means your solution has to be expandable and flexible enough to offer broad functionalities available in other parts of the world – such as basic order management, order routing, algorithms and basket trading – but also have the ability to accommodate the local market structure and requirements."

That LatAm is adopting these technologies slightly later than other markets provides an interesting advantage, she adds.

"In the U.S., when these technologies began to develop, no single firm offered everything, so there was a lot of cobbling together of different software and services. Now, in LatAm, they can look to a single firm like FIDESSA and get everything – a global, multi-regional, multi-asset provider with the connectivity and market data they need."

"We can start with companies in the growth stage," she adds, "and they can grow into us. They won't grow out of us."

The rapid growth of these markets and their increasing dependence on technology presents a continuous challenge to firms like FIDESSA, who must stay ahead of curve or else lose their market share.

"These markets are growing fast and technology is changing on a regular basis, so we have a commitment to continually support the region and the technology at the exchanges and their members. That's a challenge, but it's also a selling proposition. A lot of firms have been doing things themselves onsite, or they have vendors who are facing challenges making the changes. It's difficult to make the changes, but once we do so, we are able to distribute it to our clients, hitting all the targets at the same time."

NAVATAR GROUP

One subsector of the industry in particular is pioneering a new paradigm of easy distribution: cloud computing. Cloud computing services are those where customers' hardware, software and data are hosted off-site, thus freeing customers from the demands of in-house IT development, support and maintenance.

One of the leaders in cloud computing for global investment is Navatar, a New York-based firm. Currently Navatar has over 300 clients in over 30 countries, with a second headquarters in New Dehli. Their first prod-

uct line came out 3 years ago, and in the last year sales have more than doubled, giving the company a name recognition that has attracted major international financial firms. The hardware and software with which they serve their clients is hosted by the cloud computing host Salesforce.com.

According to Alok Misra, Navatar's Co-Founder and Principal, his firm's cloud computing products and services provide an essential solution for its clients. "Everyone is looking for smarter tech solutions," he says, "which are only available in the cloud." His firm provides high-per-

formance solutions for every asset class's needs: depending on whether a client is a PE fund, a venture fund, an M&A boutique, etc., Navatar will tailor its product and services, covering everything from customer outreach to investors, locating deals, interacting with LP's, producing reports, etc.

"Our products are very tailored to the type of asset class," he explains, "But they are also out-of-the-box, so companies don't have to spend so much on IT and maintenance – it's all included at no additional cost."





Having the technology to perform all these tasks, he says, can make or break a broker or manager. “What most of these funds do is knowledge-intensive and analytical, and technology is becoming more of a differentiator. If you don’t have the technology, knowledge and data you need, you won’t find the deals you need.”

And yet it is costly and difficult for most if not all firms to provide top-notch IT services in-house. “Very few people have nothing better to do than sit around and reinvent the wheel. If you have something that can be built for you at a low cost, why do it yourself?”

This is especially true in emerging markets, where local brokers and investors are increasingly competing with large and well-financed multi-nationals. “If you take a financial firm in LatAm with 100 employees and an IT team of 2 or 3 people, I don’t think they can build the type of data security in-house that Salesforce.com and Navatar can provide.”

Navatar’s sales model is mostly indirect, using resellers and distributors in Europe and Asia to reach global clients. These resellers, Mr. Alok explains, in addition to providing Navatar products, also provide support. When serving a foreign market, it is essential not only that the language and details of the product be localized, but that support be provided in the local

language, he says. Though Navatar has clients in LatAm, one of the company’s mid-term goals is to enter the market more aggressively.

Mr. Misra stresses that the new cloud computing paradigm is still not widely understood. There are concerns about security,

The one thing about cloud computing that a lot of people still don’t appreciate is that if you do things right, you can service multiple customers with the same core base – it’s called multitenancy.

Alok Misra, co-founder and principal, Navatar

for instance, even though, as Mr. Misra points out, the high-profile security-breach issues in global finance in recent years have been courtesy of large players with in-house IT operations, while Salesforce.com and the cloud computing providers who use its plat-

form have an impeccable security record.

Many potential customers also underestimate the advantages of the cloud computing distribution model. “The one thing about cloud computing that a lot of people still don’t appreciate,” Mr. Misra says, “is that if you do things right, you can service multiple customers with the same core base – it’s called multitenancy. Unlike with traditional software, you don’t have to deploy the same number of resources as customers. And the good news for the customer is that the vendor is spending less time on deployment and support and more time on innovation.”

Investment is where Navatar’s focus is in the near term, he says. “As the landscape keeps changing, we have to be agile and constantly provide value and react to the market and regulations. As our software picks up steam, larger organizations will start deploying it, and they have distinct needs. So we need to invest and constantly reinvent ourselves. Our goal is to be the dominant player in the private market in financial services. We’re in a good position in the cloud computing space but not in the overall market. So we need to make a lot of investments in technology, marketing, sales and partnerships.”



Alok Misra, Navatar’s Co- Founder and Principal

Reducing Barriers to Entry:

Catalyzing Early-Stage Impact Investing in Latin America

When it comes to impact investing, Latin America is somewhat of a paradox. Despite its robust economic performance in recent years, early-stage impact investing — funds that invest less than \$500,000 and support social enterprises on the ground — is just beginning. Although major players such as Acumen Fund and Invested Development intend to expand their portfolios to Latin America within the next 3 years, most funds tend to focus on Africa and Asia. Yet, as traditional philanthropy and international aid decline, there is no time like the present for impact investing to take center stage in Latin America.

To understand the challenges to impact investing in Latin America, NESsT interviewed 17 early-stage impact investors about their business experiences in the region. According to interviewees, the lack of knowledge regarding exit opportunities and alternative investment vehicles impede progress. Furthermore, complex policy en-

vironments increase the transaction costs of early-stage impact investing across the continent. Compared with more developed countries, there is also a greater need for additional funds to be invested in building local organizational capacity. Based on these findings, NESsT recommends prioritizing the following lines of action to promote impact investing in Latin America:

■ Establish a culture of knowledge management.

Building a culture of knowledge management is essential to the development of impact investing in Latin America, where there are few early-stage funds. Since examples of successful exits for impact investors are scarce in the region, monitoring and highlighting the



NESsT leading a financial sustainability workshop in Latin America - working with one of the 3,500 organizations they have supported in 15 years.



Eva Varga, NESsT's Director of Portfolio Performance, leading a panel at one of NESsT's global Social Enterprise Days.

progress of exits is a top priority. Documenting cases like Runa, an Ecuadorian social enterprise that is experimenting with an exit strategy which it hopes will preserve its social mission, could raise Latin America's profile as an attractive investment destination.

Equally, documenting and sharing information on alternative investment vehicles would help to develop Latin America's relatively underdeveloped capital markets. Currently, little is known about the success or failure of investment innovations such as Invested Development's Impact Factoring Fund, which aims to deliver working capital to businesses in their portfolio without follow-on investment (NESsT, 265). Publicizing such approaches and other similar case studies would help current impact investors build a track record of success, further drawing international attention to the region. Moreover, such case studies can serve as resources to share best practices and industry knowledge among diverse sectors, as well as call attention to unexplored investment and business development opportunities.

■ Expand and multiply incubators/accelerators.

According to NESsT's research, Latin American impact investors heavily rely on incubators and accelerators such as New Ventures, Artemisia and NESsT to develop their pipelines of social enterprises. These organizations also play important roles in building social enterprise capacity, thus absorbing some of the costs incurred by funds. NESsT, for example, provides strategic tailored financial capital, training and mentoring to social enterprises in 10 countries from idea to scaling stage. As noted in ALI coverage this past year, with this support, NESsT Enterprises can address critical issues in the region including high rates of youth unemployment and small producer access to markets. Likewise, Village Capital partners, with local incubators/accelerators, execute training programs for early-stage entrepreneurs.

Given these gains, more efforts must be made to grow and replicate incubators and accelerators in Latin America. In a continent of almost 600 million people, there are far too few of them that support early-stage enterprises. Impact investors should have access to a greater network of such organizations, as they would significantly improve the performance of funds and hence attract new investment. Resources should also be channeled to increase the collaboration among networks of incubators and further strengthen their collective impact in the industry.

■ Reduce transactional barriers through informational guides.

Given the complex and diverse regulatory environments in Latin America, there is an immediate need for comprehensive legal and investment guides that reduce transaction costs for businesses and investors alike. While NESsT offers comprehensive legal guides and country assessments to social enterprises in its portfolio, similar resources should be developed for potential and current early-stage impact investors in Latin America. These guides could provide valuable information on tax environments for each country, the benefits and drawbacks of incorporating a fund, term sheet templates, legal guidance and even benchmarks for valuating impact enterprises. Such resources would greatly facilitate the entrance of new players into the field.

■ Conclusion

Catalyzing impact investment in Latin America requires high levels of cooperation and exchange — not just among impact investors, enterprises and incubators/accelerators, but also among governments, foundations and civil society organizations. For the first time in Latin America, the Social Enterprise World Forum 2012 (SEWF2012), hosted by NESsT in Brazil, is a unique step in this cooperative direction. SEWF2012 aims to expedite the pro-

cess of collaboration among these diverse actors and to address impact investing and social enterprise together. Among the crucial conversations that will take place, these key players must strive to create, as NESsT co-founder Nicole Etchart puts it, “an enabling environment that helps businesses to grow — regulations that recognize the government cost savings of social enterprises, procurement opportunities, tax incentives to attract capital and low levels of bureaucracy.” Only then will Latin America be able to fulfill its true potential as the next impact-investing destination.



AUTHOR BIO

NESsT is a catalyst for social enterprises in emerging markets and worldwide. We achieve our mission by providing financial capital, training and mentoring, and access to markets for a high-impact portfolio of social enterprises. We combine the tools and strategies of entrepreneurship and investment with the mission and values of the social sector to enable our portfolio to: better plan, improve management capacity, grow, and increase their social impact.

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Order from Chaos:

Family Office Metrics Helps Navigate an Unruly Market

As wealth management has grown more complex in the last decade, particularly with the advent of high-tech solutions and vaster networks of relationships, there has been a proliferation of technology and service providers in the market. Quality is out there, of course, but the mere quantity is a double-edged sword, generating both healthy competition and confusing chaos, or worse. As Paul McKibbin, Managing Partner of Family Office Metrics, puts it, “If you search ‘family office services’ on Google, you’ll get a million hits, but the ways people market make it difficult to determine what they actually do.”

Mr. McKibbin views his firm as the solution to precisely this problem. As a consultant to family offices, multifamily offices and private banks in LatAm and the Caribbean, Family Office Metrics

helps its clients implement operations-related technology and strategy. “As family offices adapt to alternative asset classes, there are challenges for their current systems and processes from an operational and technological standpoint,” he explains. “We work with them to overcome those challenges.”

Overcoming those challenges means, to a large extent, navigating the teeming market of tech and service providers, and a big part of its method is to constantly measure and evaluate both the supply and demand sides of the market. “We think of ourselves as an intermediary between the market and the family offices. We have the experience to help vendors understand what it means to make a commitment to this marketplace and succeed in terms of product design and messaging, and on the family side we have deep knowledge of

how the marketplace is organized and how it can meet their needs.” Consultants such as Family Office Metrics are increasingly indispensable to families and private banks as they navigate the new paradigm of high-tech solutions and the post-crisis imperative of eliminating conflicts of interest and counter-party relationships. Many LatAm families used to manage their wealth with a small handful of trusted contacts, mostly in private banking, but for many, now, the game has changed.

“It’s not just relationships anymore, it’s relationships and technology. The events in the market in 2008 confirmed that counter-party relationships are risky: If you are going to have banking relationships, they should be diversified. I’ve never worked with anyone in LatAm who didn’t have relationships in Switzerland, offshore, and the US – and you need technology to do that.”

Indeed, he says, the need to diversify with offshore accounts and utilize sophisticated cash management strategies has meant that many family offices in emerging markets have become pioneers of innova-

tive technologies and strategies. “In our view, the global family offices are driving innovation more than the US offices,” he says.

*“In our view,
the global family
offices are driving
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the US offices.”*

*Paul McKibbin, Managing Partner,
Family Office Metrics*

Mr. McKibbin believes the kind of knowledge his company has garnered is ultimately just as important as its technical savvy, and one of his firm’s near-term objectives is to bring that knowledge to market, as well as escape the pigeonhole of being mere tech experts. “We’re known as a tech firm, but our reach is actually much broader: We specialize in control processes, operational processes, and not only back-office but front-office technology. One of our goals is to show the market that we have that broader reach. Another

goal is to increase our transparency and show the market the insights we’ve been gathering. We’ve been keeping our secret sauce in-house, but now we want to go out there, raise the bar, and correct a lot of misconceptions about the market.”

“Our edge is our objectivity,” he adds. “We don’t have a product or agenda and we never will, and we think we do what we do better than anyone in the world. No one else is positioned exactly like we are.”



OGX

Beyond the Hype

■ Mark McHugh

Eike Batista has turned into an enigmatic figure over the last few years, riding the crest of the Brazilian economic wave and the country's oil and gas boom. He has become a symbol of entrepreneurial success in the vast new emerging markets, acclaimed for his shrewdness in operating within Brazil's aggressive new form of capitalism and publicly aspiring to become the world's wealthiest man. Yet, since February, the value of EBX Group, his holding company, has fallen by more than 60%. Thus he is now languishing, unable even to support the claim that he tops Brazil's rich list.

The explanation for this sudden change of fortune has its roots in the performance of Eike's flagship oil-and-gas company, OGX, which went public in July 2008, at the height of the oil price bubble and represents the major proportion of EBX's value. Severely overhyped, OGX soared to a market capitalization of roughly US\$41 billion by the end of 2010—a valuation that was very difficult to justify for an exploration company with no producing assets. OGX missed production targets for the company's first producing wells in the Campos basin and triggered a rapid decline in OGX's

share price in June. This in turn has created a credibility gap in company management and guidance estimates. For investors it inevitably boils down to the perception of risk. However, to assess underlying risk and whether such events justify a complete re-evaluation of OGX, we need to go back to the fundamentals.

The formula for success in the oil and gas business is: Get the right people with the right developments coming together at the same time. Exploration companies like OGX are notoriously high-risk, volatile and will have erratic earnings, particularly

in their early stages of development. All the same, OGX's exploration record has been outstanding. Even as the focus is now shifting to development and initial production, the present emphasis by analysts on early production outcomes is misguided. Extrapolating the results of the first 2 or 3 producing wells is a tenuous process. OGX does not become a significant producer until 2016, according to current plans and so it is too early to make realistic judgments about true production capability. Notably, in the wake of the share price collapse, the OGX team has been reorganized to focus more strongly on production and delivery—an



important transition step in the evolution of a very young company. Astute investors should now be trying to get things in perspective and asking whether OGX continues to possess the combination of the best team and prospects to consistently find and produce oil and gas in profitable, commercial quantities in Brazil over the long term. If this is indeed the case, OGX along with the rest of EBX's holdings are significantly undervalued at this time, and perhaps this is why the savvy Mr. Batista is currently buying back shares in OGX's closely linked sister company, LLX.

■ The OGX Story

In reviewing the outlook for OGX it is important to recognize the reasons behind OGX's spectacular success in recent years and in particular the earlier confidence placed in it by the market, whether founded or unfounded. It is a new company established only in 2007 that has rapidly become the largest privately owned oil-and-gas company in Brazil and among the top 10 by market capitalization on the BOVESPA. It has a leading position in the Brazilian exploration and production sector, based upon a highly successful exploration program drilling over 100 wells—second only to Petrobras in terms of its scope, and first in terms of its success rate in finding oil.

At the same time Eike Batista formed OGX in 2007, Paulo Mendonça, who was the previous head of E&P at Petrobras, joined as Chief Executive Officer. He was accompanied by many other members of his former team, the same team that had been instrumental in Petrobras' success in the central portion of the Campos basin and in the most important pre-salt discoveries. Moreover, the team had already discovered over 9 billion barrels of oil equivalent (boe) and had know-how on a lot of other basins that had yet to be exploited.

Inspired by the team's in-depth understanding of the geology, in November 2007,

Eike Batista raised US\$1.3 billion in an equity private placement, generating capital to purchase concession rights in the Ninth Bidding Round held by the ANP (Brazilian National Petroleum Agency). In this round, OGX selectively acquired concession rights to 21 exploratory blocks in the Campos, Santos, Espírito Santo and Pará-Maranhão basins, comprising a total area of 6,400 km².

■ OGX Blocks

Campos Basin
Santos Basin
Espírito Santo Basin
Parnaíba Basin

Timing can make a big difference. Eike Batista founded OGX at what became a turning

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point in the oil and gas industry in Brazil. Armed only with the concession rights and a growing team of former Petrobras specialists, the flotation in June 2008 was shortly

after the major Petrobras discovery of the Tupi field in the Santos basin, when oil prices were at their all-time peak and interest in Brazil and the pre-salt as the new oil province was at its height. Arguably there was little basis for the US\$4.1 billion IPO, as OGX had yet to produce a drop of oil; in what could be only regarded as betting on as yet undetermined potential. Nonetheless, it must be highlighted that OGX, with an aggressive exploration campaign, was able to sustain a high level of investor confidence and a rising stock price through the end of 2010. It held a market capitalization of over US\$30 billion until February 2012. Remarkably, the first oil was only produced by OGX in January 2012. A former head of the ANP explained this phenomenon: Eike understands Brazil. You gringos who try to apply too much of your own logic will never understand Brazil.

From the outset OGX was in a privileged position, with a geoscience team that had intimate knowledge of the geological region and potential prospects. They were exposed to a very different corporate culture at OGX. Gone was the overriding bureaucracy of the quasi-state-company. They were heavily incentivized to work hard and this paid off in terms of OGX's exploration results. From the 67 exploration wells drilled in the Campos basin, OGX now claims a 90% success rate; and from 12 wells drilled in the Santos basin, OGX has a 70% success rate in finding oil and gas. These strike rates are almost unparalleled in oil and gas exploration even in Brazil, which is already known for much higher discovery rates than world norms. Unquestionably, OGX's achievements in exploration are a tangible answer to the critics and a clear indication of the team's ability to outperform the industry in discovering oil.

Eike Batista and OGX's management team were supremely confident. Spurred on by their exploration success, they talked-up production targets, publicizing a goal of 1.4

million barrels per day (bpd) of oil and gas by 2020. Debatably, had they taken a more conservative approach, maybe the company's share price wouldn't have rocketed skyward the way it did, only to plunge when early expectations on production were not met. In some senses it was a disaster waiting to happen. In June, OGX was forced to slash its initial production guidance in half. The market responded in kind, by cutting OGX's value in half. Yet, before writing it off as another example of overpromising and underdelivery, it is worth examining the bigger picture to understand the true underlying potential of OGX.

The bottom line is now whether OGX has the capability to turn exploration success into commercial success, developing and producing oil and gas from the fields already discovered at a profitable level. It is too early to forecast with any accuracy the level of results that can be achieved in 5 years' time, as we are at the very beginning of this transition at the start of the development and production phase. Based upon current plans, it will take until 2014 before the company is producing sufficient oil (60,000 to 80,000 bpd) from its key Campos resources to become cash positive. Even then it will only represent approximately 2% of Brazilian total production, rising to 10% by 2016-17.

Meanwhile, large field development is a complex endeavor and suffering some setbacks will be unavoidable. OGX's newfound realism leaves some margin for error—an important realignment for the company. While management were caught in a clumsy attempt to build excitement around the share price, the true long-term value of OGX should not only be judged on this basis—just as it should not be based upon the output of the first one or two wells.

■ OGX's Niche

In assessing OGX's delivery capability it is important to take account of the quality

and complexity of the resource base, as well as the development plans. In many senses OGX is a niche player, with a superior portfolio that is more accessible for development than the rest of the industry in Brazil.

■ Operations in the Campos Basin

There is a common misconception that all the major discoveries in recent years are in the pre-salt, deep-water, offshore Brazil's southeast coast at water depths of over 2,000 meters. OGX's discoveries are not in deep water at all and much less complex to

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develop. The first and most significant part of this portfolio is the 400 million barrels of reserves recently declared to be commercial in the shallow waters of the Campos basin—at an average water depth of 120

meters. This development has a number of key advantages in terms of cost and the use of conventional technology, when equated with the deep-water pre-salt fields, mainly operated by Petrobras, which represent an enormous technical challenge at the frontiers of today's oil and gas industry expertise.

Moreover, OGX's next most important development asset is not offshore at all—it is an integrated gas and power project onshore in Parnaíba, northeast Brazil, with the Thermal Power Plant ready to enter into commercial production in early 2013. OGX began its drilling campaign in this basin only in July 2010, and since then the company has identified more than 20 prospects and drilled more than 10 wildcat wells. This natural gas project at the Gavião Real Field has been executed in record time. It will begin production in the 4th quarter of this year, together with the commissioning of the GTU and the turbines of OGX's sister company's MPX Parnaíba Power Plant Complex. This is a clear demonstration of OGX's project delivery capability, albeit in a midsize field development onshore.

The remaining blocks in the portfolio are still part of the exploration campaign, with a longer-term time horizon likely to be in production beyond 2016-17.

First, there are 5 blocks operated by OGX (100% owned) in the Santos basin also in shallow water at an average depth of 150 meters. Thirteen wells have been drilled with some high-potential discoveries of gas and condensate and some light oil. Uncertainty remains about the development of these blocks, which will need substantial additional capital and operational capabilities to produce the gas and pipe it ashore. Timing is also a factor as in many cases it will be necessary to seek an extension of the Exploration Phase prior to development with ANP or the blocks must be relinquished.

72 Emerging Markets

The 2 other main OGX areas in Brazil are new frontier exploration in the Espírito Santo basin with 5 blocks operated by Perenco (50% owned) in deep water at an average water depth of 1,000 meters and in the Pará-Maranhão basin, 5 blocks operated by OGX (100% owned) at an average water depth of 60 meters.

In addition OGX has 4 onshore blocks in Colombia: Cesar-Ranchería and Lower Magdalena Valley, close to the Venezuelan border. This can be seen as an attempt to diversify their portfolio away from Brazil. The seismic campaign is currently just beginning here, and so it is too early to make any judgment about this resource.

In general, OGX's resource base provides excellent reserves and production growth potential, but the data is still only indicative. As of December 31, 2010, based on volumetric reservoir estimates, 3rd-party engineering firm DeGolyer and MacNaughton had estimated net 2C (best estimate) contingent resources of approximately 0.7 billion barrels of oil equivalent (and a high estimate of 3.0 billion). The 2C resources are primarily oil resources located in the Campos Basin, of which 400 million barrels of oil equivalent have been recently declared commercial and thus effectively converted to 2P or "probable" reserves. There is also a relatively smaller amount of natural gas resources in the Parnaíba Basin included. Unfortunately, none of these barrels are classified as proven reserves under the SEC definition, thus giving the company little theoretical value based upon reserves potential.

■ When Exploration Risk Turns into Development Risk

Eike Batista declared in his recent book, "Eike Batista's X Factor": "Luck is important, as it is part of any project. But luck will only be present when the project is well designed." However, luck was not present

in drilling the first 2 production wells in the Tubarão Azul field in the Campos Basin and execution risk was playing its part. One of wells had to be shut-in to replace equipment and there was an unforeseen connection between 2 parts of the same reservoir. Essentially they drilled into the same fault block.

"A little like 2 straws drinking out of the same cup," an OGX spokesperson stated.

The consequences of what could be considered as normal technical problems encountered by OGX in drilling the first production wells and the subsequent failure to meet targets has had wide-ranging repercussions

OGX were caught-out by bullish earlier predictions to the market. Anyone who understands the true nature of oil and gas development risk would have accepted that such estimates are far from an exact science—prior to drilling a production well, it is very difficult to predict the outcome.

for the share price. OGX were caught-out by bullish earlier predictions to the market. Anyone who understands the true nature of oil and gas development risk would have accepted that such estimates are far from an exact science; prior to drilling a produc-

tion well, it is very difficult to predict the outcome. There are too many variables, in particular the reservoir pressures and depletion rates. Complexity of the reservoir in the Tubarão Azul Field is greater than originally anticipated. The company is choking back production levels in order to preserve reservoir pressure, consistent with reservoir management best practices. Yet, OGX is now paying the price for having oversold the case, as production is well below the company's original estimated range of 10,000-20,000 barrels per day per well and has been duly punished by the analyst community. Understandably, OGX is declining to give any further public production forecasts.

Meanwhile, production at the shut-in well was restarted in the second week of August and has boosted output from the field to between 10,500 and 11,000 barrels per day, according to OGX Chief Financial Officer Roberto Monteiro. The share price ticked-up a bit on the news. OGX are now pinning their hopes on the neighboring Tubarão Martelo field, where they have initiated drilling of the first 2 production wells. OGX believe that this field has more homogeneous reservoir characteristics and will produce at a higher rate. Although, good news here will have to wait until the end of 2013, when production is due to be brought on stream.

■ First Crude Delivery to Shell Q2, 2012

Initial production from their first operational FPSO—OSX 1, with 60,000 bpd capacity is somewhat limited, as OSX have the ability to connect only 3 or 4 subsea wellheads to the vessel. With a current average output of 5,500 bpd per well in the Tubarão Azul field, it is unlikely to achieve full capacity and will continue to disappoint. Output from the field is now expected to average just 15,000 bpd by the end of the year, well below initial forecasts of nearly 40,000 bpd.

The new FPSOs, OSX 2 and 3 are currently under construction in Singapore shipyards, each with 100,000 bpd capacity—expected for delivery and to be in production by the end of 2013. These should allow OGX to achieve the 60,000-80,000 barrels per day production goal by mid-2014 and become cash positive in the process. The final investment decisions have still to be made on OSX 4 and 5, with similar capacity. These units will not be in production until 2015 at the earliest.

The main ramp-up in production is anticipated in 2014, as the new Well Head Platforms destined for the Campos Basin—WHP 1 and WHP 2, are bought on stream during the year. OGX will initially connect one producing well a month to each WHP for the first 4 months and then one well each 90 days, until about 15 production wells are connected per platform. Although development of reserves potential undeniably will take longer than originally thought; the critical issue is to decide if the current more realistic approach will deliver. OGX continues to modify its development plan, due to material delays in the construction of these 2 wellhead platforms, which are being constructed in Brazil by Techint. As a result of these delays, OGX expects to solely utilize the 3 FPSOs through the end 2013, which will require more costly subsea completions (around \$50 million per well), as opposed to cheaper dry completions on the wellhead platform (which cost around \$20 million per well). We note that the modified development plan should only enable OGX to ramp up production starting in mid-2014, up to 6 months behind the previous plan.

The company's operating costs and capital spending trajectory has also risen above original expectations, due to the revised development plan, increased exploration spending, including spending in the pre-salt in the Santos Basin, higher than projected operating lease costs on its FPSOs, and costs incurred to buy out a 20% stake from

Maersk's in blocks BM-C-37 and BM-C-38 in the Campos Basin, and become operator of the 2 blocks. As a result, greater cash flow deficits can be anticipated, even with a supportive oil price outlook benefiting operating cash flows.

■ The Inca Sun Symbol of EBX Group

In response, OGX has recently revised its business plan, but have not released any updated plan to the market. It has disclosed

OGX needs to prove to the market that they are not only the best at finding oil, but also can develop and execute on the strategies for producing oil and gas in profitable, commercial quantities over the long term.

some elements of the plan, including new figures on exploration capital spending targets in 2013 and 2014, which are reduced by about \$2 billion. This is based upon cuts in

drilling rig commitments from 6 currently to 3 rigs and cuts in seismic spending. It is now concentrating on achieving operational targets. In the meantime there is a solid cash position of R\$5.9 billion, or US\$2.9 billion, to support exploration commitments, development and initial production into 2013, including US\$1.8 billion invested in offshore deposits and US\$1.1 billion raised through a bond issue in March 2012. The new plans shrink capital expenditures to about \$1.2 billion in 2013 from an expected \$2 billion this year. As part of the transition to the development phase, exploration expenditures are expected to decline further, as a proportion of the total until 2014, when the planned capital expenditures of US\$0.8 billion is largely focused on production.

OGX's current B1 Moody's Corporate Family Rating is in general supported by the company's large, world-scale resource base, which provides excellent reserves and production growth potential, energy-sector experienced management team and board, and good liquidity position. Although, the rating is restrained by the company's still early-stage development status, with only 2 wells producing and no proven reserves, large up-front capital spending, with high staging and execution risk, early-stage small-scale and concentrated production operations through the fourth quarter of 2013, and high front-end leverage, with lack of free cash flow until 2014. Moody's warned recently that OGX's B1 rating could be downgraded if "production levels decline, liquidity becomes constrained or debt levels materially rise in order to fund cash flow shortfalls."

After a highly successful exploration program we believe that substantial recoverable oil is in place, taking longer to develop does not necessarily reduce the value of the reserves. Besides, there is always an option to create greater shareholder value by accelerating the program—assuming there is plenty more oil, as Eike Batista has publicly stated. In essence, OGX needs to prove to

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the market that they are not only the best at finding oil, but also can develop and execute on the strategies for producing oil and gas in profitable, commercial quantities over the long term. At this stage many companies would consider farm-ins in order to obtain additional capital, operational capability and more importantly to offset some of the execution risk. This is beginning to feature in OGX's thinking. If they are to participate in further ANP bidding rounds then they would probably seek international partners, a spokesperson said.

■ All Change at the Top

In April 2012, OGX announced a new corporate structure and composition of its executive management, in line with the transition towards production of oil and gas in combination with their hereto highly successful exploration campaign.

Then days after the plunge in shares in June 2012, OGX announced that Luiz Carneiro would replace Paulo Mendonça as CEO. Mendonça who had led OGX from its inception, stays on as special adviser to Eike Batista, but has clearly been sidelined. Even so, it is almost certainly the right timing for a change in leadership, as OGX enters this new phase. Carneiro previously served as OSX's operations director, worked for more than 30 years at Petrobras and clearly has a strong production focus.

Further management changes at the end of August have been badly received by the market, as it is perceived that additional departures of senior management within 2 months do not necessarily address the fundamental issues and are undermining OGX's management strength, until now a key advantage.

■ Where to Now?

A curious aspect of OGX's strategy to date is the fact that they are nearly 100% operator of all their fields and have recently

bought-out a 20% stake from Maersk's in some of the blocks in the Campos Basin. Paulo Mendonça, the former CEO, described the reasoning behind this approach: "OGX is the first company that started in Brazil on its own, the majors entered Brazil with Petrobras. Brazil is not understood well by foreigners, and they do not understand the rules we work with, which is why most of the companies entered the market with Petrobras."

Apart from pride in ownership there is little business logic in this stance, given the current development and production challenges that OGX face. While it may have made sense during the exploration campaign to go it alone, now in order to monetize the discoveries already made, OGX will require capital and operating partners to achieve anything like its previously published (and almost certainly overoptimistic) production target of 1.4 million barrels per day of oil and gas by 2020.

In addition to operating partners, Eike Batista appears to be focused on obtaining equity from strategic investment partners. In March, ahead of the share price slide, he received an investment of \$2 billion from Mubadala, the Abu Dhabi sovereign fund, into the EBX Group.

While OGX has a solid potential resource base and a strong foundation for growth, it appears to lack a clear strategy to turn many of these numerous discoveries into commercial production. It would seem logical that OGX seek alliances to develop the full potential. The recent plunge in the share price should help make this more accessible in terms of price for potential partners farming-in to projects. It should also overcome the concerns of existing shareholders about an impact on share dilution. If OGX are going to develop anything like the 10.8 billion barrels of oil equivalent of prospective resources it has identified over the coming decade, it is going to need to attract a lot

of partners and a lot of new investment will need to be raised. Moreover, strong operating partners can help accelerate the program and ensure that targets get met. OGX may well have discovered a lot of oil and gas, but in time a good portion of the profits to be realized from development will probably accrue to bigger, more experienced partners.

Accordingly, prior to his departure, Paulo Mendonça reportedly was seeking a partner to buy a minority stake in its most promising projects and claimed to be receiving plenty of interest from major oil companies.

■ Beyond the Hype...

It was naive to expect that OGX was somehow going to remain immune from market scrutiny forever. There are undoubtedly huge potential and strong indications that OGX will be successful—a world-scale resource base, energy-sector experienced management team and board, and a good liquidity position. However, there is still little tangible on which to base a full evaluation at this time—hence investors in some senses are placing bets on the upside. Early results have been seized upon and have taken on disproportionate significance. Moreover, exploration companies like OGX are notoriously high-risk, volatile and will have erratic earnings during the early stages of development. OGX can only be properly assessed in the future, based on its long-term performance in consistently finding and producing oil and gas in profitable, commercial quantities.

Meanwhile, Eike Batista and OGX's management must accept the blame for their current predicament. It is an inevitable consequence of their hard-sell, raising unrealistic expectations in the market with little substance to back it up. Even so, the share price debacle has had a positive side; it appears to have created a realignment of company objectives as part of the natural transition towards development and production.

Consistent with this, there appears to be greater realism in target setting.

Valuing OGX without hard data is a complex task and should take into account:

OGX, until recently was a pure play exploration company that has demonstrated its ability to outperform the industry in discovering oil. OGX is a niche player, with a superior portfolio of development assets that is more accessible for development than its competitors in Brazil.

However, most discoveries of oil and gas to date cannot yet be classified as commercial. It remains unclear what the strategy is to develop all of the finds.

- OGX does not become a substantial producer until 2016-17 based upon its current go-it-alone strategy.

- And in terms of strategy OGX can be considered at the crossroads, so it must decide between:
- A measured approach: selectively developing parts of its resource base organically, based upon its new production focus and more realistic strategies; or
- Aggressively seeking capital and operating partners to develop the full potential of the discoveries made, while diluting ownership.
- These 2 scenarios are likely to play out over the coming months as OGX revisits its strategic direction.

Investment in oil and gas has always carried with it a high degree of risk, and volatility. OGX is proving no exception to the rule. Steady nerves and a well-informed industry perspective are crucial to potential inves-

tor success. It is too early to write off Eike Batista and OGX. In due course, as results become more concrete and strategies better defined, OGX should continue to outperform the market—with its strong management team and attractive growth profile. Therefore buying and holding OGX while the stock is low makes sense, assuming they continue to demonstrate the ability to bridge the gap between spending and cash flow or to raise the additional capital necessary for an expanded program.



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