EXECUTIVE PAPERS

ECONOMIC CONTEXT FOR VENTURE CAPITAL ACTIVITY

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In its report for the third quarter of 2009, Cambridge Associates LLC, an investment consultant company, referred, for the first time, that the U.S. Venture Capital Index[1] performance during this period was bellow the performance of other indexes, like NASDAQ and S&P 500, indicating a lower performance from this class of assets.

Albeit venture capital (VC) funds are closed funds with reduced liquidity, whose portfolio value can only be accurately stated on exit, there are in fact real economic reasons that are affecting the companies of VC fund's portfolio. One of those reasons is the slowdown of economic activity, which is delaying sales and making harder for companies to penetrate in their markets and get traction to grow. Another reason is related to a more difficult access to capital (badly needed by the companies to support their growth), due to the inaccessibility to bank credit, and to the scarcity of capital, from VC sources.

A third aspect that negatively contributes to the VC funds performance is the absence of liquidity to transact their portfolio companies, due to the freeze in the IPO and M&A markets, turning exits more difficult, and preventing VC funds to reveal the potential value that exits in some of their portfolio companies.

But behind this negative performance, there is also a positive aspect for venture capital funds and investors. In fact, due to the lack of available capital to young companies, it has been possible, for the majority of VC funds, to negotiate further investments in those companies in conditions bellow their real economic value - albeit with negative impact in the funds accounts, because all the funds stakes in the companies are re-evaluated by this new lower price.

The growing difficulty in getting capital through bank credit or stock market is pushing more companies to venture capital sources. In fact, we have had the chance to look into high quality opportunities, of companies that would normally look for financing through IPO.

These two factors – more and better investment opportunities, dealt in better conditions for venture funds and investors, make these times especially attractive for venture capital investments.

Espírito Santo Ventures activity

Espírito Santo Ventures is a venture capital funds management company, part of Banco Espírito Santo group, with more than 200 million euro of assets under management.

The companies in which Espírito Santo Ventures invest must meet simultaneously three conditions:

1. Be the best in its field, with a unique and disruptive business model or technology. If a company can only deliver incremental changes, it will not be able to create significant value.
2. Have a global addressable market of at least USD $ 1.000 million. Companies addressing a local or a small niche market will remain local or small in their impact.
3. Have knowledgeable, honest and resilient managers. An outstanding technology is not sufficient to drive a company's success if it isn't led by the right people.

Our funds invest in companies operating in areas that are closely related with what we believe to be the XXIst century global challenges.

The first challenge is related with the environment. Global warming is raising awareness about the need to preserve and recover air, water and soil quality. We invest in technologies that can support a sustainable and environment-friendly development. These technologies, broadly grouped in an area called "Cleantech", includes new / renewable energy sources, new industrial and agricultural processes that are more efficient and non polluting, and new ways to obtain drinkable water.

The second challenge is related with demography. The increase in lifespan and the aging of the population are creating new healthcare needs. We invest in technolo-

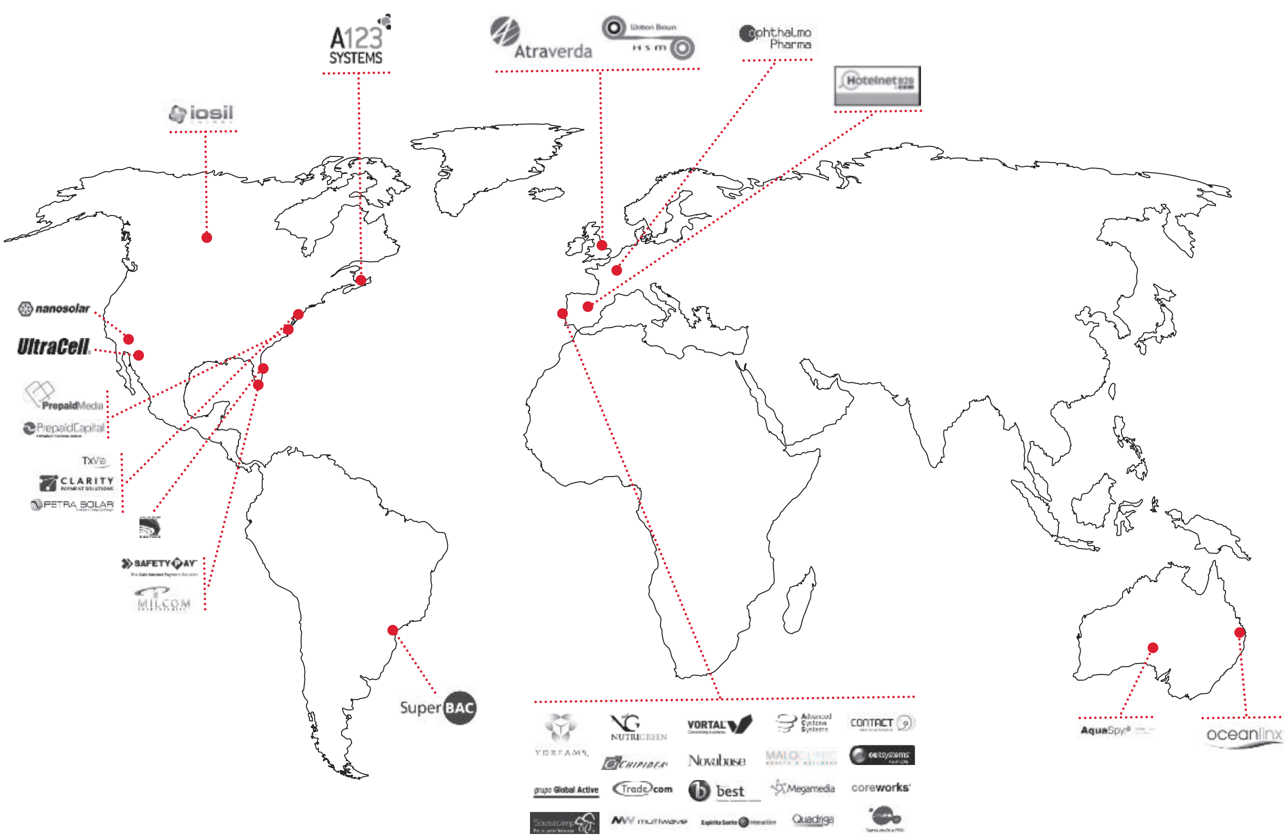
[1] Index based on cash-on-cash returns over equal periods, modified for the residual value of the partnership's equity or portfolio company's net asset value, for 1.287 U.S. venture capital funds

gies to solve these problems and increase the well-being and quality of this extended life. These technologies include diagnosis and therapeutic procedures, as well as healthy food and beverages, perceived as important elements to preserve the quality of life.

The third challenge has to do with global development, made possible through a more fluid communication between individuals and organizations, using technologies to facilitate this communication and optimize the business relations and processes. We invest in technologies and processes that can create significant value in bridging individuals and organizations, such as information technologies, communication technologies, new payment solutions, semiconductors and electronics.

Venture Capital is not a local business. We look for investment opportunities that are the world-best in their fields, wherever they appear.

FIGURE: ESPÍRITO SANTO VENTURES' INVESTMENTS



We invest alongside other international venture capitalists, with local presence and knowledge in the portfolio company business area.

Espírito Santo Ventures is the manager company of the fund "Espírito Santo Ventures II", an 88 million euro venture capital fund, that had its investment period from 2006 to 2008, having invested in 18 companies and performed one exit, with a multiplier of 2.4 in a 6 months period.

Espírito Santo ventures is also managing a new venture fund, "Espírito Santo Ventures III", currently with a committed capital of near 70 million euro, and aiming to reach 120 million euro by the end of the second quarter of 2010. Already with 8 portfolio companies, this fund has been leveraging the above mentioned exceptional investment opportunities, in terms of the quality of the companies seeking capital and the investment conditions.

One of those companies is Petra Solar, a company headquartered in New Jersey, USA, specialist in the design of power electronics and assembly of integrated utility-grade photovoltaic systems for large scale installation in utility poles. The company's offering combines distributed grid-connected solar energy generation with smart grid and reactive power functionalities into a shovel-ready system, ruggedized, modular and flexible for a quick, scalable deployment, with low set-up and maintenance costs.

Why have we invested in PetraSolar ? For three main reasons:

- PetraSolar tackles a market of very large dimensions: in the US, as elsewhere, ambitious targets for renewable energy are being set, some of which explicitly including solar energy. Pole-mounted PV presents a viable, advantageous solution for utilities to comply with those targets, while reducing need for capital by making use of existing assets, addressing efficiency issues and at the same time offering additional functionalities in grid information (smart grid) and in grid stability (reactive power). In the US alone, out of around 300 million utility poles, of which only a portion is serviceable, constitutes a potential market of about US$ 25 billion. While dependent on regulatory constraints, the company's offering can be applied to other geographies around the globe.
- PetraSolar also holds an important first-mover advantage: the company has signed its first large (US$ 200 million) contract to supply a grid of 40MW in New Jersey, and has several others in the pipeline. Having started to develop the utility-grade systems early on, it holds a 12-18 months advantage over potential competitors, which can allow the company to quickly penetrate this new market and establish an important position in it.
- And third, PetraSolar has managed to put together a management team with extensive technical experience and credentials, not only from a technical perspective, but also with deep knowledge of the utilities' business and of the regulatory environment.

Economic impact of venture capital activity

We always tell investors in Espírito Santo Ventures' funds that our objective is to maximize their return on investment. Clearly this is the only metric that really matters.

Nevertheless, it is important to understand the "side effects" of Venture Capital investing, especially in the current context of slow economic growth and high unemployment.

One of the most pertinent studies on this issue is "The Economic Impact of Venture Capital-Backed Companies to the U. S. Economy" – unfortunately there is no comparable study for the European economy. From the analysis of many thousands of American VC funds, the study evaluates the economic impact, measured in terms of job creation and revenue generation, from companies that had venture capital in their early phases of development.

The latest study, released in 2009 (based on data for 2008), shows that from a yearly investment in venture capital representing no more than 0,2% of the US GDP, in 2008, venture capital-backed companies employed 12.1 million people, close to 11% of the private sector employment, and generated sales of $2.9 trillion. These sales represent 20,5% of the US GDP!

Besides the sheer scale of these numbers, it is also interesting to observe that they have been increasing each year. As an example, the sales of venture capital-backed companies have grown from “only” 15,6% of the US GDP in 2003 – an almost 5 percentage point increase in just 5 years, and employed an additional 2.7 million people.

Although venture capital over the years has provided some of the highest returns amongst all asset classes – and not forgetting that this is the only really relevant measure of performance – we also feel it is important, to all parties, to be aware of the enormous contribution that this form of investment has made towards economic development over the years.