PEI Alternative Insight

PRIVATE EQUITY INTERNATIONAL

MARCH 2012 | privateequityinternational.com

FOR THE WORLD'S PRIVATE EQUITY MARKETS

THE LATIN AMERICAN HANDBOOK 2012

A PEI supplement

A region on the rise
The hunt for Latin American LPs
NESst on social enterprises
Rio builds for life after the Games
The hottest new markets

... and more

Sponsors:
Capital Dynamics
Pantheon
Stanwich Advisors

KEYNOTE INTERVIEW **STANWICH ADVISORS**

Getting it right

Institutional investors learned some tough lessons in the late 1990s when Latin America – especially Argentina and Brazil – spiraled into recession. They're keen on the region now once again, but approach it with greater caution, says Stanwich Advisors' managing partner Charles Daugherty

Latin America has become a major destination for limited partners, who are attracted to the region's economic growth in their never-ending search for yield.

LPs pledged a record $8.1 billion to Latin American funds in 2010, a number that could be surpassed by fundraising last year, which had reached a total of $4.9 billion in the first half of 2011, according to the Latin American Venture Capital Association most recently published statistics. Fundraising was focused mostly on Brazil, where several managers raised investment vehicles that topped $1 billion.

This year, even more attention is on countries outside of Brazil, including Colombia, Peru, Chile and Mexico, says Charles Daugherty, managing partner with placement agent Stanwich Advisors. "People are beginning to look at other parts of the region with large and growing middle classes, attractive natural resources, large labour forces … it's the next frontier for LPs."

He adds: "It's a unique opportunity to invest in a place in the world with attractive growth rates, high quality businesses and room for growth."

But Latin America wasn't always looked on with such optimism.

Daugherty: *LPs look beyond Brazil*

> *People are beginning to look at other parts of the region with large and growing middle classes, attractive natural resources, large labour forces … it's the next frontier for LPs*

SERIOUS SETBACK

Private equity in Latin America was hot in the late 1990s, particularly in Argentina and Brazil. Given the region's extraordinary growth rates, foreign funds managers, leveraging their successful track records in the US or Europe, and local managers, often with minimal investment experience, were able to successfully raise funds. As a result, the local private equity industry was largely dominated by foreign players seeking to apply a model that had been successful in the US or Europe, and local investors, primarily wealthy individuals and/or families who had little experience in professionalizing, turning around and/or running companies.

During this period, Buenos Aires-headquartered Exxel Group was for a time considered the top buyout shop in the region; media reports from the 1990s compared head of Exxel Juan Navarro to Kohlberg Kravis Roberts co-founder Henry Kravis. Exxel raised $5.5 billion and invested in more than 65 companies in sectors like power and consumer credit, according to a report from the University of Penn's Wharton School of Business.

But the good times were not to last; by 1998 Brazil was headed for recession, in part caused by global turmoil that was triggered by the Russian debt default that year. Brazil's crisis quickly spread across the region. Argentina defaulted on about $140 billion of debt in 2001 and the political situation in the country deteriorated as a government freeze on bank accounts sparked riots and a succession of political leaders who tried to

KEYNOTE INTERVIEW **STANWICH ADVISORS**

quell the unrest. As the economy shook apart in the chaos, foreign investors were scared away, and many of the firms operating in the area collapsed.

The bulk of Exxel's investments suffered amid the crisis and the firm's LPs – including the California Public Employees' Retirement System and the State of Colorado – subsequently failed to receive the returns they'd hoped for. CalPERS still retains a stake in Exxel's fifth fund, which raised $867 million in 1998 and was producing a .10x investment multiple and a negative 38.6 percent internal rate of return as of 30 June 2011. CalPERS committed about $82 million to the fund and had received back $4.7 million.

> *"People have to be disciplined in terms of making sure they back groups with the right mix of operating and investing experience"*

Exxel wasn't the only firm whose 1998-vintage fund faltered: for example, the Westsphere Latin America PE Growth Fund II, a 1998 vintage that focused on Argentina and Brazil, was a 100 percent loss for the State of Colorado, according to state pension documents.

Daugherty notes that the near meltdown of a region from an economic and political standpoint was perhaps something no one could have fully anticipated. But LPs learned some very hard and clear lessons from the experience, he adds. Most realised the need to remain strategic and cautious in choosing an emerging markets manager with whom to trust their capital.

Particularly in Latin America, investors need to be disciplined in terms of ensuring that they back managers with the ability to be successful across all economic cycles; This requires the right mix of both operating and investing experience coupled with a strong understanding of the intricacies and complexities associated with Latin America's private equity landscape.

Argentina's story is a sad one; talk to veteran investors who were around in the 1990s and they remember the potential of the country that was once a model of modernisation, economic growth and a nation full of natural resources with large and powerful demographics that should have made it an exciting destination for foreign capital. Sadly, the political environment in the country has remained hostile to foreign capital and open markets, meaning private equity investors are likely to remain averse until it changes course.

SECOND LOOK

Over the past decade, as Latin American countries rebuilt their economies and memories of huge losses from '90s-era investments faded, institutional investors and general partners began looking to Latin America again. Especially toward the middle of the decade, when Asia quickly became the 'hot' market for private equity, investors inevitably began looking for the next new emerging market to target.

Brazil was where many investors set their sights. Today, Brazil is mentioned in the same breath as China when LPs discuss the most attractive emerging markets for their capital. Everyone wants exposure to Brazil as they similarly embraced Argentina in the late '90's, Daugherty says. However, Brazil differs from today's Argentina in that it enjoys political stability and a dedication to open markets, he says.

"Brazil remains an exciting and dynamic market that will continue to offer large and attractive investment opportunities across many segments. The large-cap market in Brazil is becoming increasingly competitive," he says. "Some believe more attractive opportunities may exist in the smaller end segments of the market, where people view that segment as less competitive." However, in the smaller parts of the market, you may also be dealing with managers with less experience, Daugherty says.

"There are not many GPs that have deep successful track records on the private equity investing side," Daugherty says. "The challenge for LPs is to find groups that are differentiated in their focus on the market and either have direct or indirect proxies for their ability to create value on the operating side and/or the investment side. That's challenging."

The opportunities in the region go beyond Brazil, however. Colombia, Peru, Chile and Mexico all have come a long way in building the necessary regulatory and financial sector infrastructure that allows for the growth of a private equity industry.

"There are strong positive macro dynamics throughout the region and we think there will be continued strong institutional investor demand," Daugherty says.

These days, outside of a few outliers like Argentina or Venezuela, Latin America is in the best economic shape it has been in over the past 20 years, Daugherty says. Political stability, economic transparency, and a strong system of laws make the environment "very appealing to institutional investors," Daugherty says.

"As a result, you have a lot of investors that were not interested in the region five years ago and are now embracing the region and are actively trying to find groups to back in the private equity asset class," he says. ■

COMPANY PROFILE **STANWICH ADVISORS**

Overview

Stanwich Advisors L.L.C. is a leading independent, boutique investment bank that focuses exclusively on providing advisory and fundraising services to private equity partnerships globally.

Stanwich offers its clients an extensive range of services in preparing, structuring, and placing alternative investment funds, as well as assisting in document negotiation and post-closing support.

Since 1996, the Stanwich Advisors' team has raised in excess of $17 billion for more than 40 funds from leading institutional investors based in North America, Europe, Asia, Australia, and the Middle East.

Stanwich Advisors was recently voted "2011 Placement Agent of the Year in North America" by *Private Equity International*'s readers.

Services

- Provide senior, hands-on execution for a limited number of mandates each year
- Assist in the preparation of all relevant marketing materials, including private placement memorandums, road show presentations, and virtual data rooms
- Offer an informed and objective perspective on the fundraising environment, including feedback on terms and conditions, guidance with respect to strategic positioning, as well as a clear assessment of institutional investor appetite globally
- Deliver access to a broad range of global institutional investors, including endowments, foundations, pension funds, consultants, funds-of-funds, financial institutions, sovereign wealth funds, and large family offices
- Provide detailed information on Limited Partner's investment programs, including overview, exposure to strategy, process, "hot buttons," etc.

Target Mandates

- High quality managers, typically seeking to raise $200 million to $2 billion
- Investment strategies including, but not limited to buyout, growth equity, venture capital, special situations, mezzanine, distressed, secondaries, and real assets
- Established and emerging managers, including first-time institutional funds, spinouts, etc.
- Global investment strategies, with an emphasis on firms that focus on emerging markets, particularly Latin America and Asia
- Firms seeking to establish or transition to a well-diversified institutional investor base
- Managers seeking to develop a long-term partnership with a trusted advisor

Experience in Latin America

Over the past five years, Stanwich Advisors has established itself as one of the leading placement agents in Latin America. The firm's experience includes both single country as well as regional strategies.

In 2010, Stanwich Advisors raised Southern Cross Latin America Private Equity Fund IV, L.P., which at the time, represented the largest Latin American fund raised to date. With aggregate commitments of $1.68 billion, the fund significantly exceeded its target of $1.25 billion. Stanwich was also responsible for raising its predecessor fund, which closed on $750 million of commitments in 2007, substantially exceeding its target of $500 million.

In addition to Southern Cross, Stanwich was responsible for raising Axxon Group's first institutional fund, Axxon Group Brazil Private Equity Fund II, L.P. The fund was capped at $315 million in June 2011, just seven months after its launch. Latin America continues to represent a major strategic growth opportunity for the Firm.

Please visit Stanwich Advisors' website for more information:
www.stanwichadvisors.com

Representative Mandates

MANAGER	DESCRIPTION	MANDATE	FINAL CLOSE	YEAR
Axxon Group	Value-oriented buyout fund focused on control acquisitions of small and midcap companies in Brazil	Fund II	$315 million	2011
Southern Cross Group	Pan-regional buyout fund focused on control investments in Latin America	Fund IV Fund III	$1.68 billion $750 million	2010 2007
J.F. Lehman & Company	Middle market buyout fund focused on defence, aerospace and maritime industries	Fund III Fund II	$575 million $335 million	2011 2006
Tripod Capital	Value-orientated buyout and growth equity fund focused on China	Fund II	$262 million	2009
Artiman Ventures	Early stage venture capital fund focused on the United States and India	Fund III Fund II	$200 million $180 million	2010 2007
Private Equity Investors	Secondary fund focused on small and very mature secondary interests	Fund V Fund IV	$202 million $170 million	2010 2006