

A portrait of Carlos Lavilla, a middle-aged man with dark hair, wearing a dark suit jacket, a white shirt, and a striped tie. He is looking slightly to the right of the camera with a neutral expression.

Corfin Capital managing partner
and Ascri president **Carlos Lavilla**

In rude health

Sentiment is changing in the Spanish private equity industry as international investors set up shop in the local market. But are LPs equally bullish? **Amy King** reports

ONCE THE sick man of Europe, Spanish private equity is experiencing something of a renaissance; though statistics remain depressed, the country has piqued the interest of global heavyweights in the buyout space.

In early February, buyout behemoth KKR opened a Madrid office, joining the growing list of international investors with a local *oficina*. Prominent local hires such as Blackstone's appointment of Inaki Echave as managing director for Iberia have also bolstered the market recently. And the current portfolio held in the \$2.2bn fund raised last year by Trilantic Capital Partners reflects its increasingly bullish take on southern Europe – all are based in the region. After the inevitable retrench of international buyout houses and the demise of several local players during the financial crisis, the return of international GPs reflects warming sentiment.

"International investors realise that the Spanish economy is exporting itself out of recession and that the country is more competitive as a result of structural reforms," says Carlos Lavilla, president of Spanish industry association Ascri and managing partner at Corpfin Capital. "When you combine the status of the Spanish economy, the investment opportunities and the fact that competition is low because there aren't many private equity houses here with dry powder to invest, that results in a very attractive scenario." But are LPs equally convinced?

"We just raised a new fund; it was a very successful fundraising and many of the questions from LPs were on Spain," says one pan-European firm with a Spanish presence. "They were very keen that the fund invests in Spain, because they feel we will have a few difficult months in front of us, but then hopefully we'll have tailwind."

Meanwhile, for Altius consistency is key, regardless of the recent improvement in the country's economic climate. "Not that long ago, American clients used to say they wouldn't touch southern Europe," says Rhonda Ryan, partner and head of EMEA investment at Altius Associates, "but I think that swinging between 'we want it, we don't want it, we love it, we hate it'... that's dangerous. It is not the way to get long-term sustained performance from any portfolio. You have to be very selective when investing in Spain, so I will probably only look to back the top player."

For others, the relatively low numbers of active GPs is a hindrance. "Our approach has always been quite bottom up; we look for the best managers rather than following country allocations," says Paul Newsome, head of private equity investments at Unigestion, previous backer of Mercapital and Portobello. "Around 10-12 years ago we invested in Spain

like we did any other country in Europe. Up until a few years ago, there had always been a good supply of managers... but in the past couple of years, there haven't been any funds to invest in; there has been a lack of opportunity."

The burgeoning Spanish renaissance could, therefore, present opportunities to new players. "We would say it is time for new blood in Spain," says Mounir Guen, CEO of MVision, the placement agent involved in the €1.25bn fundraising of Investindustrial V in 2012 – the largest fundraising of a southern European fund. "The incumbents are set in their ways with just a handful of the smaller groups being popular. You see this every 10 years or so; it happened in the last cycle in Brazil. We are expecting new groups to come into the marketplace."

Perhaps new players would have more luck in convincing LPs to knuckle down and write the cheques. While investors seem wary of putting skin in the game too early, commitments

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do not seem far off, according to local GPs in fundraising mode. Several have said that meetings with LPs are no longer dominated by macroeconomic discussions, leaving time instead to focus on dealflow and strategy. Nevertheless, the shift in sentiment is yet to show in the statistics.

Leading by example

Fundraising reached an all-time low last year; not a single Spanish GP held a final close. Though a handful of venture funds reached a first close, the only private equity players to hit fundraising milestones were Suma Capital for its Catalan vehicle, and N+1 Mercapital, which has since postponed fundraising following the departure of its CEO. But this could be about to change thanks to the Fondo ICO Global.

Managed by Axis, the €1.2bn state fund-of-funds made its first commitments in the closing days of 2013, allocating €190m across three private equity and three venture funds. "We realised that the Spanish market is relatively small as a percentage of GDP. The venture capital segment is particularly

underdeveloped; we estimate that it is at 50% below potential," explains José Abad, chief economist at the Instituto de Crédito Oficial (ICO), Spain's state-owned bank attached to the Ministry of Economic Affairs and Competitiveness.

"We also realised the market is small because the players are small. If you look at the average assets under management of Spanish players, it's half the size of other players in continental Europe. The idea was, therefore, to support the enlargement of private equity and venture capital markets by enlarging the average size of existing players and by attracting new players to the market," he says.

The second tender process began at the end of February, with a third scheduled for July. And recipients do not have to invest solely in Spain. Says Abad: "We want to attract international funds, but we know they have to diversify. What we require is that they have a certain percentage of their investments in Spain, or at least that they invest an amount of at least twice the amount of our commitment to

investors to back. Indeed, the outcome of macroeconomic challenges has played to the advantage of debt funds. Says Lavilla: "Spain has traditionally been a market where banks have accounted for a very high proportion of the debt market; around 85% was provided by banks and *cajas*, with the remaining 15% provided by the capital markets. So there is a real opportunity for debt funds to come to the market and support SMEs."

In fact, a number of credit funds have set their sights on Spain. Local player Oquendo held a €110m first close on its latest debt fund last year. And a number of large buyout firms present in the region are also known for their activity in the credit space, such as HIG's credit arm Bayside. There has even been movement in the venture debt space, pioneered by Inveready, which has completed five investments from its venture debt vehicle.

Hand-picking the best assets

Increased liquidity and financing would give stagnant dealflow a much-needed boost. But which segment is most appealing? General consensus suggests that opportunities are strongest in the lower-mid-market. "The more attractive deals are in that space," says Newsome. "The pan-European or global GPs are clearly more interested in the larger Spanish companies that have already expanded their businesses overseas, considering them as any European deal and pricing them accordingly." Indeed, all deals valued upwards of €500m in the Spanish market last year were completed by GPs without a base in Spain. "It's the more domestic companies, which have the potential to be internationalised, that can still be bought at very low prices. All the large intermediaries that used to be covering Spain went away during the downturn, so there is no competition for these local companies whatsoever. It's the lower-mid-market firms with the network that are able to source these deals," he continues.

As a result, proprietary dealflow is more important than ever. "Spain, more than any other market, is very imperfect in that sense. You really need to be on the ground, turning every stone to make sure you find the odd deal you can work on as a proprietary transaction," says one local player with an international presence.

Though hesitancy may linger among the LP community, the decision of international players to establish a physical presence in Spain has been a smart one. HIG was recently strengthened by the hire of Riverside's former European head of origination Juan Barnechea. Staffing will be crucial as the new kids on the block seek to build that vital network to snare those coveted off-market deals. ■

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the fund." But the gargantuan fund-of-funds is only one part of a dual programme to lure international investors back: the Spanish government is also working on a new regulatory framework to attract foreign fund managers to Spanish soil.

ICO's contribution works on a matching basis, sidestepping any artificial maintenance of the local market. Given that the number of *cajas*, the Spanish savings banks that historically accounted for 30-40% of commitments to domestic GPs, has dropped from 50 to eight and the allocation to private equity has dried up entirely, its role is more crucial than ever.

But in a market otherwise devoid of dry powder, could increased liquidity have a negative effect on pricing? "That is something we've been thinking about," says Abad. "The good thing about how we are managing Fondo ICO Global is that if we find there are negative effects created by capital injections, we could delay and adjust the next bidding process. We could also select different sectors; debt funds for example."

Should the fund-of-funds seek to diversify its commitments, there would certainly be no shortage of debt