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Power brokers, south of the border

How did 14 financiers in New York earn an impressive reputation for betting on Latin American power assets?

By Matt Levin

Conduit Capital chairman Scott Swensen points an emphatic index finger on the architectural blueprints sprawled before him.

“We’re going to have a lot more space across the street,” he says, gesturing across Madison Avenue through his office window.

Five thousand, six hundred more square feet of space, to be exact: Conduit is planning a move this autumn to a 10,400 square foot office visible from the firm’s current headquarters in Midtown, Manhattan. Considering Swensen’s aspirations for Conduit over the next few years, the firm, which specializes in the Latin American energy sector, is going to need the extra breathing room.

Although Swensen and his partners say they are still in the earliest stages of preparation, the firm is aiming to launch an \$800 million fund sometime in the next two years, a goal which would more than double the firm’s largest fund to date, the \$393 million Latin Power III. Conduit is also seeking to broaden the new fund’s investment focus beyond the firm’s historic specialty – independent power plants and pipelines in market-friendly Latin American countries. Latin Power IV will include investments in other forms of Latin American infrastructure, including transportation. Eventually, Swensen says, the firm also hopes to open local offices in several of the Latin American countries in which it regularly conducts business, including Brazil, Chile and Peru.

Swensen is betting that Conduit’s cross-border reputation as a pioneer in the Latin American energy sector will help springboard the firm towards its lofty goals.

“Lawyers know who we are, governments know who we are,” he says. “We’ve been in the business longer than anybody so the deal flow is pretty intense and our local partners are great sources for us.”

Conduit has weathered enough to earn the reputation. The Conduit team began investing in the region in 1993 with the \$100 million Latin Power Fund I. Back then the team was part of Scudder, Stevens & Clark, managing the firm’s Latin American Power Funds. Scudder merged with Zurich Financial Services in 1998, and was then sold to Deutsche Bank in 2002. Deutsche Bank shortly thereafter decided to stop sponsoring new private equity funds, and in 2003 Scudder’s Latin America Power Funds were spun out as an independent entity, Conduit.

During that first fund’s tumultuous 14-year investment period, several regional economies, notably Argentina, Mexico and Uruguay, experienced severe economic crises. As a result of this type of instability throughout the region, private equity capital deployed for deals in Latin America dropped from \$5 billion in 1998 to \$630 million in

2004, according to data from the Latin America Venture Capital Association. Economic conditions sent asset prices tumbling and forced Conduit to hold onto some assets longer than it intended.

But Conduit bided its time, and late last year finally sold off the last assets of the fund to return 2.2x committed capital and \$215 million in distributions to limited partners. The \$157 million Latin Power Fund II, which closed in 1998, is close to winding down as well. It has yielded a 2.1x return for its investors so far, resulting in a \$343 million waterfall.

Most recently, in June Conduit exited its first energy infrastructure deal from its third fund, a \$31 million investment in Mexican natural gas compression station and pipeline Libramiento. That exit generated an expected internal rate of return of 38 percent.

An ‘operating firm’

Aside from the strength of its human capital, Swenson credits the firm’s success to its operations-focused approach to energy investing.

When the Conduit team was operating early on within Scudder, they only made minority investments alongside major US strategic players sponsoring energy projects across Latin America. But starting with the second fund and continuing after Conduit’s 2003 spin-out, Swensen transformed Conduit into a majority investor with a strong emphasis on taking control of a project’s operational nuts and bolts.

“When we started we were a minority partner alongside strategics,” he says. “Today we are a control investor and there are four engineers in the company. We are effectively an operating company; we take control.”

Up to this point, Conduit has invested primarily in medium-sized independent electric power plants and pipeline projects that require total investment of between \$60 million and \$1 billion. The firm also makes acquisitions of completed energy assets with purchase prices of between \$20 million and \$200 million.

Conduit typically partners with local developers who have earned a government concession to build a power plant but lack the skill set or money to complete its financing.

The firm grants minority ownership in the completed power plant to the local partner who brought its attention to the deal.

Conduit also installs a hand-picked chief financial officer to oversee the project’s daily operations. As part of the bylaws on every deal, that CFO is required to sign everything relating to the business. Because the CFO reports to the Conduit-controlled board, he or she is effectively a Conduit employee. Along with the CFOs, Conduit

Conduit Capital Partners

Year founded:

2003 (spinout from DB Capital Partners)

Headquarters:

New York

Total number of employees:

14

Key personnel:

Scott Swensen, chairman

George Osorio, managing partner

Liliana Rauch, chief administrative officer

Eyob Easwaran, lead asset manager

Ana Calderon, client services & administration

Market sector: Greenfield and acquisition of power generation facilities

Investment size: \$60 million to \$1 billion

Selected limited partners:

ABN AMRO Bank, BNP Paribas, Baylor University, Corporacion Andina de Fomento, Deutsche Bank AG, Kuwait Investment Authority, Teachers Insurance and Annuity Association of America, The Netherlands Development Finance Company, International Finance Corporation, Australia Post-Superannuation Scheme

FUNDS:

NAME	TOTAL CAPITAL	DATE	MULTIPLE	IRR	REALIZED EXITS	STATUS
Latin Power I	\$100 million	1993	2.2x	10.3 percent	7	Fully exited
Latin Power II	\$157 million	1998	2.1 x	15.5 percent	10	Fully invested, partially exited
Latin Power III	\$393 million	2005	n/a	n/a	1	Partially invested

also sends out an internal asset manager to check up on an energy project's progress at least twice a month.

As Spanish-speaking accounting executives are in relatively short supply, the firm uses executive search service Heidrick and Struggles to find the right match for its portfolio companies. Conduit now has access to a stable of Latin American executives with which it routinely works.

Spanish at the water cooler

Conduit's record is even more impressive once Swenson reveals that Conduit's entire full-time staff numbers just 14 – including its receptionist – all of whom operate out of New York. Swensen and Conduit co-founder George Osorio put a tremendous amount of faith in the firm's small, close-knit and remarkably diverse stable of partners, financial analysts, and asset managers.

Conduit deals are traditionally sourced, scouted, and ultimately executed (after investment committee approval) by two-member teams that fly back and forth between the asset's location in Latin America and New York. Entrusting his lean staff with this kind of responsibility, Swensen puts a premium on recruiting talent with an intensive linguistic and cultural knowledge of Central and South America.

"It's one of the reasons we've done so well," he says. "The [US] utilities went down there and by and large used personnel that did not speak the language and were not culturally knowledgeable. They did some deals that maybe they wish they hadn't done and we've been able to avoid that."

Conduit only hires investment professionals fluent in either Spanish or Portuguese; if candidates are lacking proficiency in one dialect, they must take language classes while working for the firm. Staff members must also hold an MBA from a respected business school in the US or Latin America.

Spanish is the casual operating language within the office, and Swensen himself has acquired near fluency in both languages, a skill that still surprises many of his Latin business colleagues.

"They don't expect the 56-year old gringo to be able to speak,

never mind know two languages for business," he jokes.

The emphasis on attracting personnel with a background in Latin American business has resulted in a remarkably diverse office. Five of the firm's employees were born in Latin America, and nearly all of its US-born staff has spent considerable time in the region. The firm also boasts a Bulgarian asset manager and an Ethiopian partner.

Swensen cites his relatively sparse staff as one of the key factors underlying Conduit's success in the region. The firm's primary competition in terms of sourcing and executing deals remains strategic investors, usually US or other global utilities attempting to create a foothold in the Latin American energy market. In large part because of its small size, Conduit is much more nimble when it comes to meeting the financing and regulatory hurdles involved in building a power generator or pipeline.

The Mexican Libramiento deal is an illustrative example. German bank NORD/LB's Mexican energy practice informed Conduit of a Mexican greenhouse developer seeking financing and operational expertise for the construction of a 65-kilometer natural gas pipeline in northern Mexico. The developer had already secured a contract for a related natural gas compression facility with PEMEX, Mexico's state-owned petroleum company. Conduit placed an early bid on the project but lost out, first to a Japanese investment firm who eventually walked away from the deal and then to a firm Swensen declined to name.

Just when Conduit had about given up on participating in the project, the firm was tipped that the unnamed investor was still "asking questions" about the deal just weeks before an important financing deadline. Conduit partners returned to Mexico and lobbied both the local developer and PEMEX, arguing that Conduit was the only firm nimble enough to provide the necessary financing in such a short time-frame.

The local project developer agreed and Conduit plucked the deal, committing \$31 million in equity to the pipeline and the gas compression facility. In June, Conduit sold its stake in the project to InterGen, a global power generation firm jointly owned by the Ontario Teachers' Pension Plan and AIG Highstar Capital.



Swensen: Latin America veteran



Rauch: back office leader

Back office challenges

Although Conduit's small and agile staff remains one of the firm's strongest assets, it nevertheless poses unique challenges for the firm's back office operations – especially as several of the firm's partners and junior analysts are regularly overseas.

The constant flow of personnel in and out of the country can be especially problematic to Conduit partner and chief administrative officer Liliana Rauch when she's attempting to answer the concerns of limited partners.

"The difficulties are getting information to investors that you haven't compiled because you're waiting for other Conduit employees to obtain the information from portfolio companies to give you that feedback," says Rauch, who was born in Barranquilla, Colombia before moving to the US when she was four.

Conduit has instituted a series of internal practices to ensure everyone is on the same page, no matter on which side of the border staff members are working. Unless they are in transit, every Conduit employee participates in Monday meetings at 1:30 pm to catch up on anything and everything happening within the firm. Staff members out of the country are required to call in. The meetings typically last an hour to an hour and a half, and focus primarily on possible deals in the pipeline and progress reports on portfolio companies. Rauch also uses the meeting as a venue to convey what the firm's limited partners want to know, as well as what other back office issues require attention.

"Everybody gets an update as to the status of their project and what we're working on," she says. "It keeps us all in the loop of what's going on. It's rare that people don't call in to participate if they are out of the office."

Occasionally, however, Rauch is forced to play the role of human resource wrangler, tracking down the appropriate partner to get feedback on an investor question.

"It's a lot easier than it used to be," she says. "You can usually get a response within hours, if not immediately."

Outsourcing Is key

With such a light back office team, Conduit relies heavily on outsourcing. The firm uses RGM Financial in North America and Prin-

ciple Advisory Services in Australia as placement agents, and entrusts New York-based Vastardis Capital Services for administration of its only independently raised fund, Latin Power III. For the two Scudder funds, Conduit conducted all of its reporting in-house.

Year-end audits continue to be a difficult task for Conduit, as many Latin American companies do not have their financial statements professionally audited. Creating tax efficient structures for different regions also complicates the process: Rauch says her biggest headaches often stem from the flow-through entity Conduit set up for its Mexican portfolio, for example.

The geographic diversity of Conduit's investor base also makes tax planning and reporting a complicated process. Prominent limited partners in the firm's first three funds have included Australia Post-Superannuation Scheme, the World Bank's International Finance

Corporation, Deutsche Bank, Kuwait Investment Authority, Netherlands Development Finance Company and Zurich Financial Services. Only one limited partner is headquartered in Latin America: the Corporacion Andina de Fomento (CAF), a Venezuela-based multi-lateral whom Swensen compares to the IFC.

In order to bring its geographically diverse investor base closer to the sites of Conduit's investments, and as a favor to CAF, every other year Conduit holds its annual investor meeting in a major Latin American city.

New LPs, new investments

Although Conduit's model seems to have worked well in the past, the firm is now planning for aggressive expansion. The firm wants to position itself to take advantage of several interesting trends, Swensen says.

Conduit expects its plan to open local offices in South and Central America to enhance deal flow and local asset management, as well as tap into a relatively uncharted investor base for private equity – Latin American pension funds.

Because many Latin American pensions' foreign investment allocations are capped by local governments, Conduit is planning on establishing local co-investment pools dedicated solely to projects within specific nations. That way, Latin pensions can commit capital for Conduit to invest alongside its primary fund.

The firm's transition into transportation infrastructure is based on Conduit's belief that Latin American currencies have stabilized over the long-term, making investments pegged to inflation, such as toll roads, a much more tenable outlet for private equity capital.

Finally, as Swensen is quick to point out, Latin America is in desperate need of infrastructure financing. A recent World Bank study estimated that the region would have to invest \$100 billion a year for 20 years for its infrastructure to reach a standard similar to South Korea's.

"There is an increasing awareness among Latin American governments that they need to increase the flow of dollars into infrastructure," says Swensen. "And part of that is liberalizing their local pension funds to invest, and part of it is facilitating international capital coming in." ■