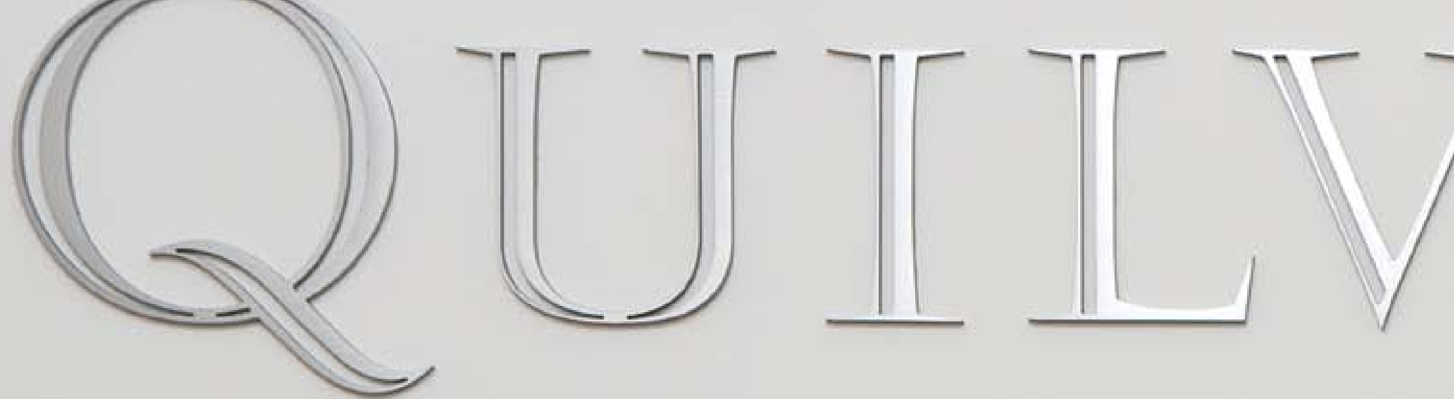

PRIVATELY SPEAKING: MICHEL ABOUCHALACHE, QUILVEST

Family values

Under the leadership of CEO Michel Abouchalache, Quilvest has transformed itself from low-profile family office into serious industry player – with an interesting sideline in direct investing. But how can it hope to compete with the biggest players in its space? In a rare interview, Abouchalache tells James Taylor why he thinks bigger does not necessarily mean better…

PHOTOGRAPHY BY JAMES CLARKE

For a firm that's been involved in private equity for no fewer than forty years, Quilvest has done a pretty good job of flying below the radar. Of the people *Private Equity International* asked about it in advance of this interview, most struggled to describe exactly what it does – and some hadn't even heard of it. This is no accident; Quilvest has deliberately shied away from courting media attention.

Yet this is a firm that in the last decade has increased its private equity assets under management ten-fold, from $400 million to $4 billion ($2.8 billion of which has come from third-parties), while averaging double-digit returns from its annual flagship fund of funds programme (even if you include the crisis years vintages). It now has 13 offices around the world, and raises about $500 million of fresh capital every year. That's quite a transformation for what was once a relatively small family office – and it can all be traced back to the arrival of Michel Abouchalache in 2001…

BEER MONEY

For the uninitiated, the name Quilvest might give you a clue as to the firm's origins – or at least it might if you've spent any time propping up bars in South America. It's a play on Quilmes, the *cerveceria* that was set up by German immigrant Otto Bemberg in Argentina at the end of the last century and went on to become one of the world's most famous beer brands; Quilvest began life as the office tasked with managing the Bemberg family's wealth.

Its interest in private equity is long-standing: it made its first investment in the asset class in 1972, and has remained »

» active ever since. But at the start of the millennium, its activity as a limited partner was... well, limited. Its money was parked with just five GPs, spread around the globe in the interests of diversification. Each of these relationships operated in a different way – maybe Quilvest owned the GP, or maybe it had a veto on investment decisions, or maybe it had no influence whatsoever.

Enter Abouchalache. A French national, he'd been working in the US (originally as a strategy consultant for Bain & Company, and then as the founding partner of a buyout firm called Delta Capital) but was keen to move back to Paris; the Quilvest job gave him an opportunity to do so in a role that was still global in scope. The other big attraction was that he was effectively starting with a blank piece of paper on strategy; although the group had been involved in private equity as an asset class for a long time, they were evidently open to the idea of their new CEO talking them into a change of tack. And there certainly wasn't much in the way of existing infrastructure to muddy the waters: at this point, the private equity team was just Abouchalache and one other person (Jerôme Chevalier, who's still there as head of the group's energy and tech investing).

The first thing Abouchalache wanted to do was to ditch the existing model of relying on five GPs, which was, inevitably, becoming problematic – if they were doing well, they wanted rid of Quilvest; if they were doing badly, Quilvest wanted rid of them. Instead, the firm would move to a more typical fund of funds model of selecting the best GPs around the globe.

He was also keen to boost its co-investment activity and, ultimately, branch out into direct investing – which, he believed, would not only help with fund selection but also generate better returns than plain old fund investing. (His initial promise was that the latter would deliver a performance advantage of 5 percent over listed equities, while direct investing would deliver a 10 percent premium; in practice, the figures have been more like 10 and 15 percent respectively, he says.)

His other big argument was that Quilvest needed to open up its platform to third party investors. He believed (rightly) that private equity would grow much faster than expected; so to invest in the asset class efficiently, managers like Quilvest would need to attain a certain size. And since at the time it was only managing about $400 million of Bemberg family money, relying on organic growth would only get it so far.

OTHER PEOPLE'S MONEY

This, in brief, was Abouchalache's strategy; the board gave it the green-light, and he spent the next four years building up the internal team he needed to deliver it (using advisory group Cambridge Associates to fill in the gaps in the interim). It remains largely unchanged to this day.

The board did have one caveat when they agreed to Abouchalache's new strategy, however. Quilvest, they told him, was a principal investor at heart – and wanted to remain that way. So from day one, the family has always been the biggest single shareholder in every single one of the firm's deals and funds. As far as Abouchalache was concerned, this was good news: at a time when everyone was talking about alignment of interests, this made his pitch to prospective new investors more compelling – because Quilvest would always be putting a substantial amount of money where its mouth was.

There was another related benefit to the deal Abouchalache agreed with his board. Although they would always be the largest shareholder, they wouldn't get any sort of special deal on terms – so to keep them happy, Abouchalache agreed to "be reasonable on fees", as he puts it. For instance, the flagship fund of funds programme only

> *I'm not denying that there are some formidable large platforms – but they're usually the exception rather than the rule*

charges fees on invested, not committed capital; carry doesn't start racking up until the fund has repaid all the invested capital plus a hurdle rate; on direct investments, the deal is 1.5 and 15 rather than 2 and 20. These days, most funds of funds are being forced to introduce more LP-friendly terms; Quilvest went through this process a decade ago.

All of this was clearly useful for the sales pitch. But moving from investing your own money to investing other people's is a big step – particularly when you don't even have a team, let alone a track record. Institutions were effectively a no-go, so Abouchalache began by targeting groups like his own: family offices. And although it finds it much easier to woo institutional investors these days, now it has an established track record, it has largely stayed within that niche: institutions still only make up about 10 percent of Quilvest's 300-strong LP base.

A LONG-TERM VIEW

Today, fund investing continues to be Quilvest's core business, accounting for about two-thirds of overall private equity assets: the firm has invested in about 300 funds to date, and has about 200 currently in the portfolio. QSPEP, its flagship fund of funds programme, raises money on an annual basis (unusual in this space) and aims to put about $300 million to work per year – roughly 15 investments of $20 million. In a slow year it might be nearer $200 million; in a good year more like $350 million. "But you won't see us going to $500 million because we're not doing too many large caps," Abouchalache says.

Instead, Quilvest is predominantly focused on small and midcap funds – and has been throughout the Abouchalache revolution (the Aboucha-lution?). That's because he firmly believes they have a performance advantage. "Everything else being equal, they will outperform large cap funds. We have the data: we took the 40 largest funds, and looked at their last five vintages over a 30-year period. Most are seeing returns decline over vintages. We haven't seen many multi-billion-dollar funds that have delivered more than about 1.9x net to their LPs. I'm not denying that there are some formidable large platforms – but they're usually the exception rather than the rule." So while Quilvest does back some large buyout firms (Bain Capital and Cinven are two of its managers, for example), it has always been overweight on small and mid-cap funds.

Abouchalache is a big believer in diversification – by geography, by strategy, by vintage year and by investment stage. However, he doesn't really believe in set allocations, even geographically. "Our philosophy is usually to avoid that. Every market can have its merits if you have a good team – albeit we believe that tactically, at specific times certain markets will be more attractive than others." So in 2009, it invested heavily in secondaries and leveraged loan funds; today the focus is on distressed funds (although he says it's hard to find good ones, particularly in Europe), and also real estate funds, which it believes will benefit from distressed sales at rock-bottom prices.

Crucially, though, the most important criterion is always the calibre of the GP, he says. Take emerging markets, where his firm was an early mover (Quilvest has been active in Asia since the 1990s). Today, Abouchalache is less bullish than most about the return prospects of the big emerging markets: "Brazil, India and China will still have attractive returns over the next five years – maybe higher than Europe and North America. But not much higher – either because they've become expensive, like India and Brazil, or overcrowded, like China." He's far more interested in "peripheral markets" like Indonesia, Vietnam, Chile and Peru – as long as he can find the right manager. "We always prioritise the quality of the GP. Vietnam's a great market »

» – but if I can't find the right GP for five years, I won't invest." (N.B. Quilvest does actually have a Vietnamese GP now). Currently, emerging markets account for about 20 percent of the portfolio; he'd like to get this up to 30-40 percent, but admits it will take time.

And why would a GP want Quilvest as an LP? Because of its long-term view and thoroughness, says Abouchalache. "We're very friendly, loyal LPs. We've been there through good days and bad. GPs love us. They call and ask us for market intelligence; they invite us to present to other LPs as an example of somebody who's supportive and does due diligence correctly."

One GP who has had Quilvest in a number of its funds told *PEI:* "You get the impression that it's an organisation that knows its role and has some real momentum. They have a point of view, which they're always willing to communicate; they're very thorough and ask all the right questions; they have a long-term perspective, which is vital in private equity; and because of their history they think commercially, not institutionally." This latter point is why they tend to get more right than wrong on the co-investment side, he adds.

CUTTING OUT THE MIDDLEMAN

Fund investing remains Quilvest's bread and butter. But you get the sense that it's the direct investing side of the business that really gets Abouchalache excited; there's visible animation in his eyes when he talks about how this side of the business has developed. It's still fairly small – Quilvest has done about 80 deals so far, about two-thirds of which have been co-investments alongside its fund sponsors. But as far as Abouchalache is concerned, direct investing is a way to boost returns, build relationships and – not insignificantly – have a bit more fun.

"Most of our investors find it more fun to do direct deals rather than funds. QSPEP has had 11 vintages that are all in the money, so they believe now that this is a safe investment vehicle. But what really makes them happy when they meet us is when we talk about direct deals. It creates a very personal relationship, which helps us convince them to re-commit every year." For Quilvest, with its unusual fundraising model that requires fresh capital every year, this is worth its weight in gold. Abouchalache reckons the firm's re-up rate is above 90 percent.

But how can a firm like Quilvest hope to differentiate itself? How does it persuade a management team that it will be a better partner than a rival that does nothing but buyout investing?

To Abouchalache, the answer is partly about focus: again, Quilvest focuses on smaller, growth-style deals. He talks of his ambition to become the Bain Capital of the small to midcap space *(see box),* a key aspect of which is to leverage its global platform. Quilvest has 13 offices worldwide, nine of which are dedicated to private equity (the rest are focused on wealth management). This has helped it to build a diverse portfolio of assets – including microfinance in India, oil exploration in the Ukraine, sushi restaurants in the UK, and dry cleaning in France.

Perhaps the best example of this philosophy is BBB, a Mexican discount retailer that Quilvest first backed in 2007. The firm had originally looked at a hard discount chain in Turkey, but the deal didn't work out. So instead, it decided to try and replicate the model in Mexico, backing a local entrepreneur to launch what was effectively a start-up. Five years later, BBB now has 350 stores and 2,500 staff. Quilvest's original equity cheque? $6 million.

This example also illustrates one advantage Quilvest has in the direct space: the fact that it is not investing from a standard ten-year fund – which means it's not under the same time constraints as a standard

> **We don't want to grow too much, because we believe that size is the enemy of performance in this asset class**

BIG AMBITIONS

"We would love to be the Bain Capital of the small cap world'," smiles Michel Abouchalache. "That's not to say we have the arrogance to compare ourselves to Bain – but in the small cap space, there are not many global platforms that can bring synergies, source from China, and so on."

One example of the kind of deal Quilvest likes is Tortillla, a Mexican fast-food restaurant chain based in London. It only has eight sites at the moment – up from six when Quilvest invested last year – but it has big ambitions. Casual dining is a sector the firm knows well, thanks to its previous involvement with Yo Sushi, the UK-based sushi chain that is about to expand into the US; it now has 80 restaurants, up from about 30 when Quilvest bought it in 2008. The plan for Tortilla is basically the same: build its presence in the UK, and then possibly look to the US. (Quilvest has

also invested recently in Anthony's, a US pizza restaurant chain that's about the same size as Yo Sushi was in 2008).

Abouchalache argues that Quilvest has a competitive advantage on growth capital deals like this. Partly because of its fund structure: it's easy enough for Quilvest to provide further expansion capital three or four years down the line, in a way that can be difficult for a typical buyout firm. But also because it takes a broader view than most firms operating at this level. "There are not many players like us who are global and would be interested in a tortilla chain – and if it's successful in UK, then maybe take it to the US," he says.

buyout firm. "One of the main drivers for selling companies [in this business] is the fundraising cycle," he complains. "It's bad enough having to deal with our own biological clocks – I don't want to have to deal with another one in my professional life too! I think that's the biggest disease in private equity."

Its holding periods have, to date, been broadly similar to the industry average – but importantly, it can make an exception when it makes sense. At the time of the BBB deal, Abouchalache says he told investors that the chances of failure were about 70 percent – and if the deal was a success, they wouldn't reap the rewards for a decade or more. It has now held the business for five years, but has no plans to sell. "I'd be crazy to exit now – we're opening ten stores a month. Why would I sell that company?" asks Abouchalache.

He admits that, like every private equity investor, he wants to get cash out sooner rather than later – but at least he has the luxury of not having to.

Because it doesn't do many of them, Quilvest finances direct investments on a deal-by-deal basis. But rather than having to put financing together to complete a deal, like others who work this way, Quilvest always underwrites the deal itself and then looks to sell down equity to its LPs later (though it will always remain the biggest shareholder, with a stake of at least 20 percent). This obviously gives it a big speed and execution advantage in a competitive process.

Abouchalache admits that he'd like the firm to do more direct investing than it currently does. "I would like to be 50-50 [between funds and directs]. But it's much easier to find good GPs than it is to »

» find good directs!" And while he would love to put more money to work, he doesn't want to take unnecessary risks. "We are always the largest investor in every deal; we think as principals, not as asset managers. So we're as comfortable turning down a deal as we are excited about closing one." Quilvest does have investment targets, but they're not set in stone – something that he believes proved invaluable during the financial crisis. "That's what saved us; that's why we have the track record we do. I think we've made fewer mistakes than others."

WHAT NEXT?

The growth of Quilvest has undeniably been impressive. But it remains a relative minnow compared to some of the big fund of fund groups investing in private equity. And the consensus is that this segment of the market will see a great deal of consolidation in the next few years, with the bigger players (who enjoy the benefits of scale) likely to swallow up the smaller fry. Is there a place for Quilvest in a market like this?

Abouchalache certainly has no plans to take his foot off the gas; if he can keep raising about $500 million a year, as he has done for the last few years, and keeps generating good returns, it's plausible that its private equity asset base could be more like $6 billion in five years' time.

Equally though, he has no inclination to grow any faster. "We don't want to change our strategy; we want to be disciplined. And we don't want to grow too much, because we believe that size is the enemy of performance in this asset class." Raising extra money is not the problem, he says; it's putting it to work. "If we double the size of our dry powder per annum, we'll have to start looking at bigger funds. And I don't want to do that." If the market does get smaller – and he believes it will shrink by a half – that just allows him to be more selective on the deals and funds he backs, he says.

"One of the main drivers for selling companies [in this business] is the fundraising cycle. I think that's the biggest disease in private equity

Will investors keep buying his strategy? As long as returns are good, and its fee structures remain appealing, there's no reason why not. When Abouchalache first made the case to his board for going after third-party capital, he told them it was a good way to let the market judge the calibre of the Quilvest team. Fundraising every year is no easy task, but the firm's recent success – the last four years have been its most productive years ever, despite the macro environment – does suggest that he is winning the argument.

Then again, this approach does have its downsides: "On December 31 every year, I celebrate a good fundraising year. On January 1, I wake up and think 'Damn – I have to raise another $500 million'," he grins.

Still, he says he's more optimistic for private equity than he was this time last year. "It will take a couple of years for Europe to settle down. But when it does, there should be benefits: fewer players, less money chasing deals, more sources of debt financing. So as an industry, we're moving in the right direction because of the crisis. What's missing is the macro picture: if private equity gets better and the economies don't, that's more of a challenge." ■