Quilvest CEO Michel Abouchalache on the journey from family office to global investor

Private equity dragged screaming into the public eye

Sovereign wealth funds flex their muscles in the secondaries market

Funds of funds follow alternative paths to stability

Local knowledge still key to unlocking China

New wave of growth for alternatives - supposedly

US buyouts urged to show courage under fire

Plus: LP perspectives on funds, sectors & regions
The investment strategy of global private equity investor Quilvest can be traced back to its family office roots. Originally launched to manage the assets of Argentina’s Bemberg family - founders back in 1888 of the Quilmes brewery - it continued the family’s focus on investing back into industry. Even before private equity as an asset class was established, it understood the intersection between business and finance, according to Quilvest CEO Michel Abouchalache.

Joining the firm in 2001, his arrival marked a strategic shift for the group as it sought to grow beyond its single-family origins. Now with $18bn of assets under management, it manages capital on behalf of high-net-worth individuals and institutions, across both its wealth management and private equity arms. To date, Quilvest Private Equity has invested around $4bn in over 300 private equity and real estate funds, alongside 150 direct investments.

Abouchalache says, “When the current team joined 11 years ago, the first thing we noticed was that the family had tremendous experience and legitimacy in the asset class. There were very few players with that kind of experience and global exposure. In the early 1980s Quilvest had investment offices in New York, London, Paris, Hong Kong and Buenos Aires.”

The original family office made investments throughout the 1950s and 1960s, within more of a merchant banking template. In time this turned into fund investing, which continued through to the late 1990s. Alongside this it began to develop its wealth management business, opening up the platform to other asset classes, from hedge funds to liquid assets and private banking.

“When I joined, the firm had already invested in 15 GPs in Asia. It had a portfolio of interesting GPs, and a global presence,” he says, “We saw the need to be different. We convinced our shareholders that opening the platform to other asset classes was the way to go. We needed to grow with the industry and to grow our team.”

The response from the market was to be the litmus test for Quilvest’s new direction, with the thinking being that if it could convince other investors to join its platform then it could truly become a multi-family office. It now invests on behalf of more than 400 clients, many of them private individuals and families.

He adds, “We do not see ourselves as asset managers, we are investors. We manage other people’s money as investors alongside our own money. Initially we used the history and the legitimacy of the family, and we were able to convince investors to join us. Now the track record speaks for itself.”

Although the firm’s strategy has remained the same since 2001, it is defined by a flexibility and global reach that enables it to react to an industry still enduring some tough times. “Clearly like everybody else we are facing headwinds, but we feel the strategy is the right one,” says Abouchalache.

“It’s a global strategy. We are diversified, and we feel we are lucky not to be focused on one country, or one continent, for that matter – there you are playing the odds. We focus on both fund investing and direct investing, which includes co-investments, as well as lead investments.”

He adds, “Really it is an opportunistic approach – going where money can be made, without defining parameters or limiting our options. This is reflected in our lead deals, which are as much about start-ups as they are about mature LBOs.”

Alignment of interest
At the heart of the firm’s approach is the familiar watchword of alignment of interest. For Abouchalache, though, the firm pays more than lip service to this often repeated phrase, investing a minimum of 20 per cent of its own capital in all its products.

He says, “Our shareholders, who are not involved in investment decisions, are principal investors in all programmes, which ensures...
The Quilvest team: Axelle Strain (front left) and Nadine Koniski-Ziadé; back row Michel Abouchalache (left) and Elan Schultz
a total alignment of interests for private investors, families and institutions and that management teams adopt an investor-minded approach driven by returns, not fees.

“Our clients trust us, because we put our money along with them. We are also the largest investor in all of our products. By definition we do not accept investors larger than our own commitment. They know that we are not going to do anything that hurts us, and by definition them.

“We are more sensitive to it, because the original family office has been investing in the asset class for 40 years now as an LP.”

One of the features to being a principal investor is that it automatically drives flexibility, says Elan Schultz, managing partner of Quilvest USA, and responsible for the firm’s activities across the Americas.

“We are not structured in a way that we have specific mandates. We are driven by absolute returns,” he says. “If you focus on the principal aspect of our business, when things change we have the capacity to adapt – whether in our fund investments or our direct activity.”

Back in 2009 the firm allocated half its fund investments to secondaries and distressed debt, a move that a ‘normal’ fund would arguably not have been able to do, he points out. And this freedom to adapt quickly to market conditions is a real advantage in today’s investment world, according to managing partner of Quilvest Europe Axelle Strain, who heads the firm’s London and Paris buyout teams.

“Most funds of funds are structured in such a way that they have very narrow mandates,” she says. “We have the flexibility they don’t, and our investors are happy with that, because they know we put our own money on the line. It is a virtuous cycle and one that creates opportunities not available to many other funds.”

Schultz adds, “Not only did we change our strategy, but we downsized our programme that year because we could not find managers we liked. Had we had a normal multi-manager programme, that approach would just not have been possible.

“Because we don’t have a structured fund, as we use so much money from our balance sheet, it gives us a wide selection of opportunities, and it is always on an absolute return basis.”

Without this principal capital, it would simply not be driven to look at these kinds of opportunities, says Abouchalache. “We are wired in such a way as investors that across whatever region we look at we consider fund and direct opportunities, and what the best approaches are within that particular region.”

Over the past decade Abouchalache has witnessed the private equity market’s latest and most radical stage of growth. The number of GPs has tripled to almost 5,000 and the number of funds has also tripled to close to 10,000. And while the industry was initially very US-centric, with Europe alongside, it is now “truly global”, he says.

The industry is continuing to mature, he says. “The dry powder tripled between 2000 and 2011, and there is now a considerable overhang. The size of the industry is now at about $3tn, while 11 years ago it was $1tn.”

Alongside this, so-called ‘emerging’ markets such as China, India and Brazil are already crowded. With these markets now maturing it is even more difficult to generate eye-catching returns, and the strategy must take this into account. “Unless you are flexible and can manoeuvre between strategies and regions, you are not going to gain alpha,” he says. “If you define yourself too rigidly, you certainly have a limited amount of opportunity to make really interesting investments.

“The principle approach creates discipline, and is the way we make investments – it’s the way we react when we go to our investment committees. We see ourselves as investors, not asset managers. This is key, and it’s the discipline that comes with that investor’s mentality.”

Oversized and underpaid
Coupled with a global structure that emphasises locality, Quilvest focuses specifically on the smaller end of the market, whether small-cap funds or direct investments.

Abouchalache says, “It is not that we are smarter or harder working, we just do certain things that others won’t do – often because they have become too large. Sometimes they don’t see it, but flexibility can be a valuable asset.”

Size has become a key determinant in the strategies of private equity investors. And despite Quilvest’s global reach, it is among the few who are interested in making commitments in smaller, emerging managers, according to Schultz.

“A $1bn mid-cap fund is just not interested in writing a $20m ticket. Right now looking at just the AUMs in our portfolio, we...
would compare in size to a US mid-market fund. However, our abilities go significantly beyond that in terms of global reach, expertise and track record. We do it because we have offices all over the world. We are in countries with local partners.”

And while a firm needs to be big enough to scale globally and have diversification by strategy, if it gets too big, it can effectively limit the ability to generate exciting returns, he argues.

“Private equity is one of those businesses where manager selection has a huge impact on performance, and the dispersion of returns around the mean are quite large. We need to be big enough, which is why we are multi-family and global, but not so big that we are relegated to allocating capital to managers across a wide range of strategies.”

Of the $3tn currently under management in global private equity, some $2.2tn is in funds that are larger than $1bn. Tellingly, Abouchalache points to the high, negative correlation between the size of fund and performance. “There are outliers, but looking at the fact that more than two-thirds of the industry is in these mid to large-cap funds, it raises the question about returns and the need to be flexible and to stick with the right size.”

This raises real questions over the strategy of some of the larger institutions that are massively constraining their investment options by only being able to write cheques of $100m-plus. In some cases, size can be more of a limiter, Strain says.

“You could argue that some private equity investors have too much money. For many of them, they have no choice but to invest large amounts, at the risk of diluting their returns.”

Schultz adds, “If you have a $5bn programme, how are you going to do that from the ground up? If you choose one small manager that taps into that area and can create a lot of alpha, it is not going to move the needle because the overall programme is so large.”

And by keeping an eye on scale, Quilvest is able to look at those small and medium-sized managers in local markets that do make a difference. Not everyone shares their opinion, however, with larger institutions continuing to operate within rigid boundaries.

Abouchalache says, “We pitched to a few institutions and quickly realised that the name of the game was a box-ticking exercise. I was quite puzzled by how rigid the process was – but then they are surprised when their returns do not live up to their expectations. Based on our experience over a number of years we have found this approach to be the wrong one, often leading investors into large-cap funds - which deliver lower returns.”

He adds, “I have always said this is not an asset class for the poor, but it is also not an asset class for the very rich, as you are forced into those super-sized funds and you will see your returns affected as a result.

“I haven’t figured out the solution – if you manage a $300bn pension fund and you have a ten per cent allocation to private equity, I don’t know how you would successfully allocate $30bn.”

**Returns don’t lie**

Quilvest’s wealth management business grants it a valuable perspective of larger economies and asset classes, and the message remains that private equity is still a valuable place to invest in. If anything, now is the time to increase exposure in a period of slow to moderate growth in global economies, says Abouchalache.

“We believe the fundamental trend in the industry over the last 40 years is going towards efficiency, and less alpha. There is a need to be more flexible and opportunistic and the medium to short-term trends are very favourable,” he says.

“While over the past 11 years dry powder has tripled, over the past five years it has been pretty flat. The number of companies for sale has been huge, and everything indicates that the supply side is very interesting. Putting the two together, we should be heading towards a good period of activity.”

Clearly obstacles remain, with credit markets slowing down and
a continued risk aversion on the part of many investors. But for those who are patient and for those who are liquid, now could be a prime opportunity to deploy capital. Investors are feeling the pinch, however, with many suffering significant decreases in their asset base due to losses. Private equity as a whole is being asked to justify its presence.

Schultz says, “One of the challenges you have is convincing people that this is a business that can generate compounding returns over long periods of time, but you can’t do it sitting at your desks and picking managers. You have to be out in the field, be systematic, rigorous and do bottom-up research, day in day out. You need on some level to be genuinely diversified – and you find that a lot of organisations are just not doing that.”

It is this diversification that helped the firm weather the financial crisis, says Strain. “We suffered a few losses like everybody else, but because these did not amount to a large portion of the Quilvest portfolio, we were able to recover quickly and should demonstrate a good track record even during the more ‘difficult’ vintages.”

Schultz adds, “I really think that the 2006 vintages for private equity are going to look a lot like the 1999 vintage. People are going to have a hard time returning even single-digit returns.”

And in a tough climate, institutions have no choice but to take a long hard look at their investment practices, according to Nadine Koniski-Ziadé, partner and global head of IR at the firm. And there has been a something of a subtle but significant shift in attitudes in recent years, she says. “Interestingly, we have seen that the behaviour of a number of these institutions is changing, and proving our strategy right. A lot of them want more managed accounts, with dedicated programmes and terms.”

Many of the recent discussions within the industry have centred around the balance of power within the LP-GP relationship, with LPs deemed to be in a better position now that money is scarce. While a familiar conversation, this issue comes second to the simple matter of making returns, says Abouchalache.

“What we have learnt is that while we would always prefer to pay a management fee of 1.5 per cent rather than two per cent, when you are targeting a fund that is going to make 15 to 25 per cent, it’s not going to make much of a difference.”

And the main discussion within the fund industry continues to centre around the double layer of fees for funds of funds. If it is done well, however, cost should not be a primary concern, he says. “If you are deploying $50m a year, a 0.9 per cent management fee is $450,000, and if you want to duplicate the role of a good funds of funds, you will spend that on airline tickets and due diligence costs pretty quickly. The sole focus on the wrong issues still surprises me.”

**Direct investment ‘disaster’**

One consequence of this seeming fee aversion has been the growing trend for institutional investors seeking to make direct investments. The results have been mixed, at best. Schultz says, “For the most part it has been a disaster. Some will do well; they have the pedigree and have built good teams. For others, the returns have been low, and this is not a fair reflection of private equity. They are so focused on not paying two and 20 that they end up with sub-optimal performance.”

Abouchalache adds, “In all frankness, when looking at top-quartile funds, we have not seen much evidence of this shift of power between GP and LP. When you are talking to the best managers you only have limited influence to discuss fees as their track records speak for themselves, and there’s a line of potential investors waiting to replace you.”

Ultimately, Quilvest’s focus continues to be on finding what it calls the “money-makers” in each market, often smaller and emerging managers outside the established private equity regions.

Strain says, “It is not necessarily irrelevant how much you pay in fees, but it is not our main concern. As we are also a direct investor, when it comes to identifying attractive GPs, our focus is on how these managers make money.

“For a lot of institutional investors, these types of funds are simply too risky. Historically, fund managers make their best money in their earlier funds. Of course, there is a higher risk in investing in first-time or emerging managers, but our job is to allocate and price this risk appropriately.”

This focus on breakthrough managers has seen the firm maintain its activity in established emerging markets such as China and Brazil, as well as pushing beyond to the new frontier markets of Vietnam, Turkey, Africa and Indonesia. And with 13 offices across
the globe, the firm is conspicuously local in a number of regions, Schultz says.

“Our philosophy is to try to be genuinely global. We do have geographic allocation targets, but they are not rigid. We go where the opportunities are. Looking at our commitments, some years they are biased towards one country based on the market at that time. It is always bottom up.

“We try to be diversified across the globe, and be a bit more daring towards the peripheral countries.”

This approach is also reflected in Quilvest’s exploration of new sub-asset classes such as energy, and specifically energy efficiency within the established oil and gas space.

Another of these sub-sectors is real estate, which the firm started looking at in 2007 before launching its programme in 2009. Its appeal is that it offers a more manageable universe of firms, Abouchalache says.

“The idea is that contrary to regular private equity where you have 5,000 GPs worldwide, you have only a few hundred [in real estate]. The idea was to take advantage of major structural moves in the industry. We believe we could generate the same returns as private equity in the space. It also has advantages – it is an inflation hedge and it is a little less risky as it offers hard assets.”

Abouchalache also argues that the firm’s strategy also presents a more honest reflection of the industry as it was originally conceived. Many of the investments that fall under the banner of private equity can often be hard to differentiate, he says.

“Private equity used to be an asset class but I think this is no longer true,” he says. “You used to be on the spectrum of capital markets. Private equity was used to financing companies prior to them going public, but in most cases they were either start-ups or growth capital – small-cap companies.”

By investing in ever larger companies, which could just as well be public or gain access to bank finance, he questions whether it actually constitutes a defined asset class. “It is almost the same risk security as you would find in a public equity,” he adds. “You could argue it is an equity asset class no different to listed equities.

“What is the difference and why should you expect alpha? Liquidity? You could stay as long in a listed fund. Because it is a blind pool? You could argue this could be found with a mutual fund.

“The day you are in investments where listed equities or bank financing could be a substitute, I am yet to be convinced it is a different asset class.”

Quilvest’s approach is something of a return to what private equity used to be – investing in smaller, growth assets. Abouchalache adds, “Ultimately, for this to be considered a truly independent asset class again it needs to go back to basics.”

“We do not see ourselves as asset managers, we are investors. We manage other people’s money as investors alongside our own money”