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Context for Private Capital Investment

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Colombia's Private Equity Transformation

An Executive Summary of the Privcap Thought Leadership Series
Private Equity In Colombia

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Colombia's Private Equity Transformation

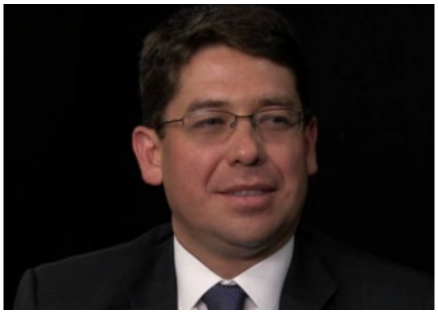
Key Findings

1. Investor confidence in Colombia has grown as the country has stabilized
2. The PE market is similar to Brazil's 10 years ago: Colombians are getting familiar with PE and beginning to trust investors
3. Private equity is increasingly an alternative source of funding for medium-size enterprises
4. Healthcare reform presents investment opportunities in many areas
5. PE firms are increasingly investing in Colombia's booming oil and gas sector

The Panelists

Eva Garcia de la Fuente
Executive Director
EY Colombia

Felipe Iragorri
Partner, Investment Director
Tribeca Asset Management



Mauricio Salgar
Managing Director
Advent International Colombia

1. Investor confidence in Colombia has grown as the country has stabilized.

Any understanding of the private equity opportunity in Colombia begins with an understanding of the changes that have taken place in the country's economy and society over the past decade. Ten years ago, drugs were pervasive, security was questionable, and guerrillas wielded power over broad swaths of the country.

"The private equity market in Colombia 10 years ago was nonexistent," said Mauricio Salgar of Advent International Colombia. "But Colombia has faced an incredible transformation. We had problems with the guerrillas, with the drug dealers, and that's no longer the case. Not to say that the problems are resolved fully, but it's no longer the number one topic on the agenda."

Consistent and stable governments with positive policies have boosted investor confidence and attracted foreign investment over the past 10 years, and that has opened the country for private investment.

"Colombia has always had a business-friendly government, but recently much more so," said Felipe Iragorri of Tribeca Asset Management. "That has been seen with new regulation in private equity, and that's why a lot of investors have come in. GPs are tapping the LP market due to this regulation, and that has opened the space for private equity, local and foreign."

Eva Garcia de la Fuente of EY Colombia spent a good deal of her early career in the European PE sec


Felipe Iragorr, Tribeca Asset Management

Many Happy Returns

One of Iragorri's favorite recent investments is Grupo Emi. In fact, he likes it so much that he invested in it again—after selling 100 percent of the company.

Grupo Emi provides pre-hospital medical care, making it easy, convenient, and cost-effective for middle-class people to see a doctor. The company had 100,000 members and $12 million in revenue when Tribeca first invested, in 2007.

Over the next four years, it embarked on a roll-up strategy, acquiring a number of smaller medical-services companies, integrating them under the Grupo Emi brand, and expanding across eight different countries in Latin America. Tribeca grew the company to one million subscribers and $120 million revenue before selling it in 2011 to Dutch healthcare group Falck.

"Falck invited us to join and continue the growth path in Latin America," Iragorri said. "We had more acquisitions in the pipeline, so we reacquired a minority stake in Grupo Emi with some nice terms. Today the company is growing at 20 percent."

tor. She said that if private equity there is, say, fourth-generation, then PE in Colombia—in Latin America as a whole—should be considered first-generation.

"The European private equity industry is very mature," she pointed out. "Exits are in the hundreds. Whereas in Colombia—in Latin America—it's in the region of 70. The Latin American private equity industry is still emerging."

2. The PE market is similar to Brazil's 10 years ago: Colombians are getting familiar with PE and beginning to trust investors.

A primary requisite of a thriving PE sector is trust. It's one thing for a country to have a growing economy and growing middle class; it's another thing for the managers of local companies—many of them family-owned—to trust private equity investors and partner with them.

Advent International has been in Latin America for 17 years and opened an office in Colombia three years ago. Salgar said the level of trust in Colombia is about where it was in Brazil a decade ago, when locals began to understand the language of private equity and develop fluency.

"It's very tough for the entrepreneur who grew his family business to have a young group of people come and say that they're going to fix his life and give him a big fat check and continue growing the company," he noted. "That's a tough conversation to have, but it's starting."

"When we closed our first fund and did our first investments, the investments were done basically with cash out," Iragorri added. "Entrepreneurs and family businesses weren't prepared to partner with us in a growing company. It was more 'Let's cash out.' Now we're seeing people who want to partner with private equity, who see private equity as an option for growth, not only financially but strategically and through corporate governance and so on."

3. Private equity is increasingly an alternative source of funding for medium-size enterprises.

Small and medium-size companies, particularly those that are seeing rapid growth, need expertise to manage their evolution. Private equity is providing it in Colombia.

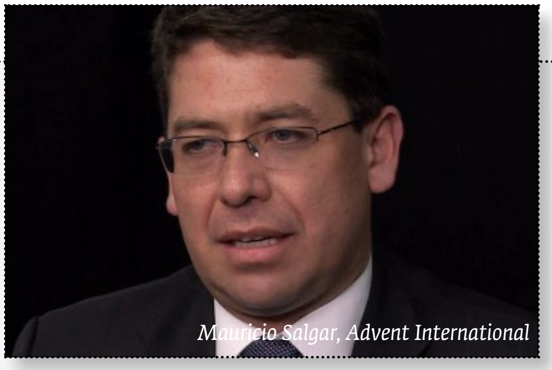
"There are companies that are growing very fast and they don't know how to handle it because they don't have the professionalized team," Garcia de la Fuente said. "Private equity is contributing to significantly improve that for medium-size Colombian companies. It's another option, rather than going to the bank to ask for funds. Private equity is offering them an alternative to professionalize management."

Still, offers of assistance are not always welcomed with open arms. Often managers at successful companies don't want to acknowledge that they need help. After all, their companies are growing—they must be doing something right.

"If you ask them in public, they will never acknowledge that they require help, because they've been successful," Salgar said. "Generating the trust so that the counterparty accepts that you can help can only be developed in time, and that's why growing this industry will take time."

In many cases, families that own companies—usually smaller companies with less-sophisticated management—ask Salgar to put them in touch with families his company has done business with, in Mexico and Brazil, so they can learn how the process works and be assured that private equity is effective.

"You're dealing with a family," he concluded. "Even if you write the most comprehensive shareholder's agreement that covers you inside out, if you don't develop trust with the family and a relationship that works, that's a recipe for disaster."


Mauricio Salgar, Advent International

A Family Affair

Private equity's presence in Colombia is growing. But many entrepreneurs in the region are still under the impression that they can sell their companies for a lot of money and head for the nearest beach.

"We try to convince the business owners that the entry price is maybe not as high as they would want it, but if they remain with the company and enhance it, then four, five, six years down the road, when we both exit together, we're going to make a lot of money," Salgar said. "That's a great story to tell. But when you're sitting there with the entrepreneur and his kids, the second and third generation, well, that can be a tough message to get across."

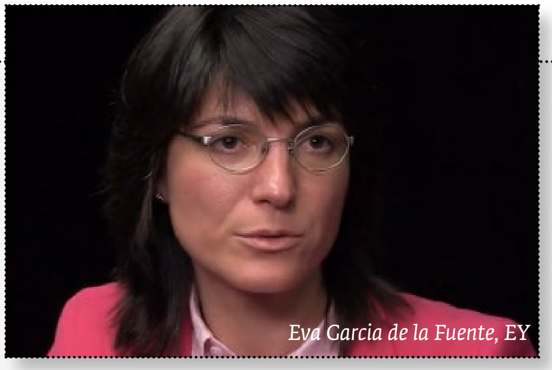
And then there's the wife. Salgar recalled an occasion when he was discussing investment with a business owner and his better half. Salgar was explaining that, as part of the arrangement, the owner would step aside as CEO. "In the middle of the conversation, the wife says, 'Really? He's going to be at home every day? No way.' That was a deal breaker."

4. Healthcare reform presents investment opportunities in many areas.

Changes throughout the Colombian economy are opening the door to private equity. Some of the biggest changes are happening in the healthcare sector. The country has achieved universal coverage, but there are still major fixes needed. Government is eager to implement them, and PE firms are keen to see the results.

"We're focused on more than insurance companies," Iragorri said. "We're not yet in pharma. We're more in healthcare providers. We've done some deals there, and we're looking at deals in other places. A lot of the public sector has gone private. Public healthcare providers, public hospitals and clinics, are either going to be privatized or go to a public-private association, and there are some big opportunities in that area now."

Salgar said Advent is likewise pursuing healthcare opportunities across the value chain, with special emphasis on pharma, as expansion in the space is driven by improving economic fundamentals.



Eva Garcia de la Fuente, EY

Insufficient Diligence

Private equity firms always want to know what they're buying before they buy it. But conducting due diligence in Colombia can be a challenge, especially since most entrepreneurs in the country don't keep meticulous records and are not comfortable being questioned by outsiders.

"Due diligence in Colombia is not very sophisticated," Garcia de la Fuente said. "It needs to be much more developed. It really is very difficult finding out exactly what the business is underneath."

For instance, many business owners still treat their companies like a personal ATM. It's hard to separate what belongs to the entrepreneur and what belongs to the business.

"You have to redo the numbers and isolate exactly what is the business," said Garcia de la Fuente. "There are quite a lot of operational and nonoperational issues. It reminds me of Spain 10 or 15 years ago. But I think that the quality of information, which has been very weak so far, will definitely improve."

"GP per capita has been growing very fast, and there's a lot of unmet demand that needs to be filled," he explained. "We have invested in a pharma company where we're taking good advantage of that consumption, and it is growing strongly. And we're waiting to see how this reform evolves, to see if we invest in the healthcare-provider space. Across the region, this is happening. GP per capita grows, and then the standard of living generates. We see the same thesis here, in Peru, in Mexico, as well Brazil, and we're looking at opportunities across the chain."

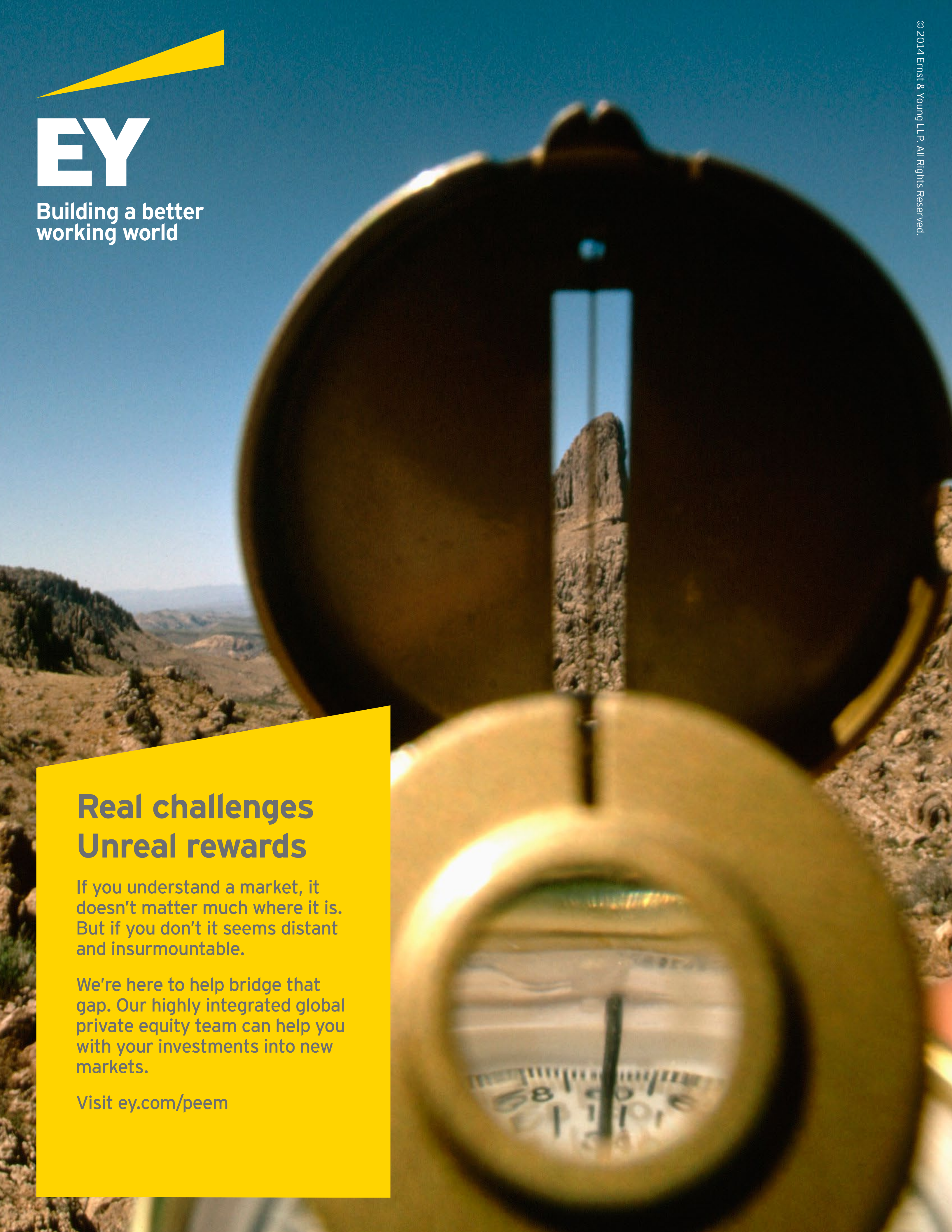
5. PE firms are increasingly investing in Colombia's booming oil and gas sector.

Another area in which Advent is active is oil and gas, where production has doubled in the past 10 years, from 500,000 barrels a day to a million barrels a day.

"Production doubled, and local consumption is under 300,000 barrels a day," Salgar said. "It's a self-sufficient energy economy, and exports have grown dramatically. To be able to double production in such a short period of time has required a huge amount of investment across the value chain—in exploration, in production, field development, midstream assets, pipelines, ports, refineries. And this generates, on the back end, investment in oil-field-services companies, in engineering firms, in all the equipment required. And that's been a boom in Colombia."

A large share of private equity investment in the sector is in small and medium-size exploration and production firms, as well as in oil-field-services companies. Recently a lot of money has flowed into pipelines and midstream assets.

Tribeca in 2008 invested in an exploration and production company, and Iragorri said the investment had been a success. "We're in the middle of exiting the company, which is very interesting for a bigger player. We don't think, at least at Tribeca, that there's more space in the E&P sector, because a big chunk of the Colombian future in oil will be big exploration, unconventional offshore exploration—and that's for big players. We'll exit this company, hopefully very successfully, and for us that's that in E&P. But probably in the midstream and downstream we could work something in the future." ◆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Expert Q&A

with Eva Garcia de la Fuente
Executive Director
EY Colombia

How does EY help private equity firms perform better due diligence when doing deals in Colombia?

A GP calls us and then the first things that I ask them are, "Is it a family owned business? Is it audited? What type of different jurisdictions do they work with? Do we have different management teams geographically or what type of control are the stakeholders performing in the company." I ask questions that give me some feeling about the quality of the information that I'm going to find.

As it usually happens here in Colombia, the quality of information is not good, so you really have to dig in and perform a very detailed analysis for understanding exactly what the business is and isolate and do some carve-out of all the non-operating assets of all of the expenses which are not normal in the business. That obliges you to dedicate quite a lot of time to understand the numbers.

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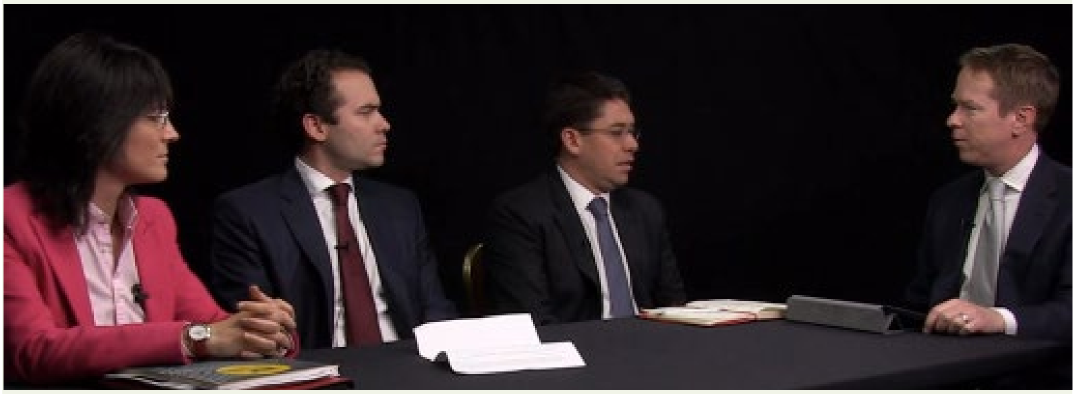

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