

CAPITAL MARKETS

BIG-PICTURE ECONOMICS

Traditional private equity isn't the only way to invest in the future growth of Hispanic entrepreneurs.

// BY JOEL RUSSELL

“THE EMERGENCE OF HISPANIC MARKET DEALS IN THE MIDDLE MARKET IS RECENT, AND THERE ARE NOT MANY PRIVATE EQUITY INVESTORS WITH EXTENSIVE KNOWLEDGE AND EXPERIENCE IN THE MARKET.”
MARCOS RODRIGUEZ
PALLADIUM EQUITY PARTNERS



“MINORITY BUSINESSES CONTINUE TO FACE SYSTEMIC BARRIERS TO ACCESSING THE CAPITAL MARKETS,” ACCORDING TO A 2004 REPORT FROM THE MINORITY BUSINESS DEVELOPMENT AGENCY (MBDA). This capital blockage stems partly from a lack of information about minority companies, especially the companies large enough to interest investment bankers or venture capitalists.

The scarcity of data, and the lack of a historical track record of successful investing in Hispanic companies, creates a heightened sense of risk for financiers. A 2000 policy proposal by the California State Treasurer's office blames the capital gap on “persistent, negative stereotypes about the risks of investing in ... underserved communities” and “a lack of information as to the opportunities for capital to be successfully invested in communities historically bypassed by institutional capital sources.”

Despite the obstacles, institutional investors and pension funds now realize the growth potential of minority economies, says Betsy Zeidman, director of the Center for Emerging Domestic Markets at the Milken Institute. “This is coming from the demographic bulge and how it plays out in business ownership. So you're seeing many new funds targeting Latinos or minority entrepreneurs generally,” she says.

In trying to establish a track record for the U.S. Hispanic economy, investors and government agencies have developed various models of capitalization. They include:

- Regular private equity funds,
- So-called “double bottom line” funds, and
- The federal government's Small Business Investment Company (SBIC) program.

The Wall Street Solution

Traditional private equity funds invest to make small businesses large enough for either a strategic sale or a public offering.

These funds usually expect a full return on their investment in five to seven years, with an annualized return of 20 to 30 percent, according to Luis Nogales, CEO of the Los Angeles-based private-equity fund Nogales Investors.

Currently, 13 private-equity funds target the U.S. Hispanic economy (see table, “Private Equity Companies in the Hispanic Market”). All these funds have started since 2003, making it difficult to assess their track record. (For a chronology of major equity investments, visit www.hispanicbusiness.com/magazine)

Marcos Rodriguez, managing member of Palladium Equity Partners in New York, sees “no unique difficulties or limitations of investing in Hispanic companies,” because Hispanic CEOs have the same financial needs as any other entrepreneur. But “the emergence of Hispanic market deals in the middle market is recent, and there are not many private equity investors with extensive knowledge and experience in the market,” he says.

Currently, no fund concentrates exclusively on Hispanic entrepreneurs.

Hispania Capital Partners in Chicago channels the Hispanic consumer (see accompanying story, “In Hot Pursuit”), while Palladium looks at specific industries with an added emphasis on Hispanic angles. “Our fund targets small businesses, among them Hispanic-owned businesses, or businesses that cater to the Hispanic consumer,” says Mr. Nogales. “So we are not exclusively Latino, but we look for those businesses. The fact that we understand the

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PRIVATE EQUITY COMPANIES IN THE HISPANIC MARKET

Bastion Capital II

Target Fund Size: \$300 million

Target Deal Size: \$20 million–\$50 million per transaction

Hispanic Investments: Although Bastion II is still raising funds, Acon-Bastion is making investments in the U.S. Hispanic market through a Special Purpose Investment Vehicle. ACON's recent Hispanic investments are in ImpreMedia and Radiovisa.

Leading Principals: Guillermo Bron and ACON Investment partners

Central Valley Fund

Target Fund Size: \$80 million with \$100 million more by early first quarter 2006.

Focus: Growing California Central Valley firms with at least \$5 million in revenues and \$1 million in cash flow.

Target Deal Size: \$2 million–\$5 million per transaction

Hispanic Investments: N/A

Leading Principal: José Blanco

Clarity Partners LP

Capital Commitments: N/A

Focus: Exclusively on investments in communications, media, and related services and technologies within those sectors.

Target Deal Size: \$25 million–\$200 million per transaction

Hispanic Investments: ImpreMedia LLC

Leading Principals: Dr. David Lee, Barry Porter, Stephen Rader, and R. Rudolph Reinfrank

The Carlyle Group

Total Funds: \$14.9 billion (aggregates all global funds)

Focus: Sectors in which the company has demonstrated expertise: aerospace and defense, automotive and transportation, consumer and retail, energy and power, healthcare, industrial, real estate, technology and business services, and telecommunications and media.

Target Deal Size: Minimum \$4 million for venture funding, \$10 million for

mezzanine. Revenues of more than \$50 million for buyout.

Hispanic Investments: Uni Boring Inc. (Hispanic-owned), Hispanic Tele-services Corp.

Leading Principals: William E. Conway Jr., Daniel A. D'Aniello, and David M. Rubenstein

Darby-BBVA Latin America Private Equity Fund (DBVA)

Fund Size: \$175 million

Target Deal Size: \$15 million–\$40 million

Hispanic Investments: Border Media Partners

Leading Principals: Julio Lastres and Jaime Salinas Solano

Hispania Capital Partners

Capital Under Management: \$125 million

Target Deal Size: \$5 million–\$10 million per transaction; SBIC focusing on Hispanic-owned and U.S. Hispanic market companies

Hispanic Investments: PrensAmerica Corp. (publisher of *La Raza*; investment realized), CSA Group, Samy Companies, Hispanic Yellow Pages of America Inc.

Leading Principals: Victor Maruri, Carlos Signoret, and Amador Bustos

Ibero American Investors Corp.

Focus: Ibero American Investors seeks to provide capital to any small business provided that they meet size standards as defined by the Small Business Administration.

Target Deal Size: \$50,000 to \$500,000

Hispanic Investments: EIC Electronics

Leading Principal: Domingo Garcia, CEO

Nexos Private Equity Growth Fund

Target Fund Size: \$225 million

Target Deal Size: \$10 million–\$25 million transactions focusing on Hispanic-owned companies. Enterprise values in the range of \$25 million to \$75 million; corporate revenues typically range from \$15 million to \$100 million.

Leading Principals: John McIntire y

Salazar, Eduardo Bohorquez, Joseph Vadapalas, and Justo Frias

Nogales Investors – Fund I

Fund Size: \$99 million

Target Deal Size: \$5 million–\$20 million transaction; Hispanic-owned or -managed companies.

Hispanic Investments: Graphic Press (Hispanic-owned)

Leading Principal: Luis G. Nogales

Palladium III

Target Fund Size: \$500 million

Target Deal Size: \$15 million–\$50 million per transaction, focusing on the Hispanic market and Hispanic-owned companies

Hispanic Investments: N/A

Principals: Marcos Rodriguez, David Perez, Alex Ventosa, and Peter Joseph

Pinto America Growth Fund, LP

Target Fund Size: \$75 million

Target Deal Size: \$5 million–\$10 million per transaction; Hispanic market companies in the U.S. Southwest

Hispanic Investments: Meximerica Media

Leading Principals: Rodrigo Amaré, Richard Vaughan, and Guido Caranti

RC Fontis

Target Fund Size: \$150 million

Target Deal Size: \$5 million–\$10 million per transaction; U.S. Hispanic market opportunities in the U.S. Southwest

Hispanic Investments: Meximerica Media

Leading Principals: Daniel Villanueva Sr. and Daniel Villanueva Jr.

Vestar Capital Partners

Total Funds: \$14 billion (aggregates all global funds)

Hispanic Investments: Border Media Partners, Valor Telecommunications

Leading Principals: Federico F. Peña, Daniel O'Connell, and James P. Kelley

Source: HispanTelligence®

For additional and contact information visit: www.hispanicbusiness.com/pefunds

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» Hispanic consumer market puts us in a position to invest in that sector.”

Both Nogales and Palladium obtain investment capital from public pension funds. In fact, about 90 percent of the money that Mr. Nogales manages comes from public employee retirement accounts. “Public funds have been more ready [than private financial institutions] to look for investor management that can take advantage of the large and growing Hispanic consumer base and employee base,” he says.

A Second Bottom Line

An innovative approach to the risk calculation for Hispanic economic development involves “double bottom line” (DBL) funds, which attempt to measure the value of results in terms of both financial return on investment and socioeconomic impact.

In 2000, California Treasurer Phil Angelides launched a massive DBL program that mostly focused on heavily Hispanic inner-city real estate. In an October 2005 report, the California Public Employee Retirement System cited an impressive 22.2 percent return on its DBL urban real estate partnerships.

However, measurement of the second bottom line remains a challenge. The Roberts Enterprise Development Fund – a philanthropy that “provides guidance, leadership, and investment to a portfolio of nonprofit social enterprises” – has developed a complex formula for calculating socioeconomic results, but the DBL industry lacks an accepted method for judging success. A report from Social Enterprise Associates, a consulting firm, found that “since few [organizations] have yet found affordable or standardized answers, the classic qualitative client success story prevails as the proxy for social return.”

Eduardo Rallo, managing director of California-based DBL fund Pacific Community Ventures, measures his fund’s social component in job creation, specifically seeking companies that will hire low- to moderate-income employees as they grow. “We look [for returns] in the mid- to high teens,” Mr. Rallo says. The fund’s only exit has been Timbuk2 Designs, a manufacturer of custom messenger bags. The investment yielded four times the fund’s target return and more than \$1 million in a special “wealth creation plan” using stock options, Mr. Rallo reports. (For more information on DBL funds, see accompanying article “Bridging the Gap.”)

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SBICs: “Turbo-Charged” Returns

Historically, the federal government’s main program for equity finance has been Small Business Investment Companies. However, in 2004 the Small Business Administration (SBA), which supervises SBICs, suspended the equity portion of the program. “We are not proposing to reinstate the Participating Securities Program at this time,” SBA Administrator Hector Barreto told a congressional hearing in February 2005.

However, those SBICs previously licensed continue to operate in the private equity markets. Hispania Capital Partners was one of the last to obtain a license, and remains the only SBIC with a Hispanic focus.

Hispania currently has \$125 million to invest, of which about \$52 million comes from firms such as Verizon, Chase, Washington Mutual, Wells Fargo, Citibank, and LaSalle Bank. The rest of the money comes from the SBA.

“The SBA in that regard operates as a preferred limited partner; they get their money before the other investors,” says Hispania partner Victor Maruri. “The good news is their return is capped. So if you can exceed a 13 or 14 percent return, you turbocharge the returns for the other investors.”

However, Mr. Nogales says other investors object to the SBA’s preferential treatment. “A lot of public pension funds want no partnership with an SBIC,” he says. “If one investor asks for a special deal, the others want the same deal.”

The Future of Money

The different financing models provide the power of choice for Hispanic entrepreneurs. “There are a variety of approaches, but a number of investors are realizing the opportunity,” says Ms. Zeidman.

Besides the lack of data, Ms. Zeidman cites another factor that makes Hispanic companies look risky: few personal relationships with financiers. “Minority businesses often do not know venture capitalists or ways to penetrate the private equity community,” according to the MBDA report.

Ms. Zeidman notes that Milken and other organizations are addressing the data problems, and the new funds specialize in building those crucial human relationships. Mr. Rodriguez of Palladium concurs, predicting that “we will see an increased number of successful Hispanic market equity transactions in the future.” □