

# VENTURE EQUITY LATIN AMERICA

WWW.VE-LA.COM



SEPTEMBER 30, 2005 VOLUME IV, NUMBER 10

## Conduit Strategizes Energy Investment after Close of Third Fund

By Alex Burgess

Conduit Capital Partners, LLC is continuing its activity in Latin American energy investment with two recent closings of its third fund. To date, \$168 million has been raised for the Latin Power III Fund, and Conduit is now beginning to make new investments in Latin American electrical energy industries. Sixty million dollars of that total came from U.S.-based Overseas Private Investment Corporation (OPIC) as debt financing under OPIC's guaranty program. The Latin Power III Fund will raise money from the same type of non-U.S. institutional investors that dominated Conduit's prior funds, Scott Swensen, the Chairman of Conduit, told VE-LA.

### Seeking control positions

Conduit will model its latest investment strategy after the success of its second fund by seeking control positions with majority stakes. Its first fund, which was raised in 1993 and conducted primarily minority stake investments in privatized power plants, grossed a less-than-hoped-for return in the mid-teens. The second fund changed its investment strategy to buying majority stakes in power plants and was met with a higher return rate of twenty-four percent, without the sale of additional assets.

Swensen explained the success of using control positions as having several components: "In our experience owning a minority stake in a company, we have found that strategic investors by and large manage for earnings. This focus sometimes conflicts with cash flow; strategic investors will turn down cash flow if it hurts the reported earnings of their company. For example, after you build a green field plant and get it running, very often you can put more leverage against the company once you have a proven cash flow by refinancing the debt. Strategic investors would veto such an initiative because the increased leverage would mean more interest expense, which would in turn mean lower earnings coming from the asset." While Conduit prefers to give the main investment managers substantial compensation, strategic

investors often balk at such significant incentives, Swensen said. Lastly, Swensen prefers a control-position because it allows his company to act faster. "In Fund II when we have issues, we sit down, we make a decision, and we go implement it," he said. "We don't have to wait months for others arguing with us about how to fix something, and it works far better."

### Exit from Second Latin Fund

Conduit recently made an exit from its second Latin Power Fund with the sale of its thirty percent stake in San Isidro, a thermal power plant in Chile that was owned in partnership with CDC Globeleq. The exit wasn't a profitable one, as gas shortages in the area caused limited output of electricity. A sale to partner Endesa Chile allowed Conduit to exit at the price at which they initially valued the asset. Conduit hopes to have two more exits by the end of the year from its first two funds. With Latin Power III, Swensen says that investments will once again be targeted to the electrical energy sector. Just about all of Conduit's investments have been put into generating plants thus far, and there is no change of plans in sight. There was a sizeable decrease in Conduit's green field construction in its second fund, moving to fifty percent green field construction as opposed to eighty percent in its first fund. Will the new fund invest in green field construction projects? Swensen says that it is too early to tell; much will depend on whether strategic companies will sell at prices that Conduit finds reasonable.

According to Swensen, one of the most important parts of Conduit's investment strategy is investing in economically competitive plants. The company's renewable energy projects have been particularly profitable in Mexico because of the rapid increase in value of carbon credits. Conduit has been assuming a value of four dollars a ton for carbon credits, and Swensen says that the credits are now trading at thirty Euros a ton.

### Choosing the Right

Targets In looking for countries to focus its investments, Conduit focuses on three main criteria for success. "First, a country has to be very foreign investor friendly and must respect its laws and regulatory environment. The lack of such a condition because of a change in local government is perhaps the biggest risk to investors in Latin America; but I don't think that's likely to happen because of their need

for foreign investment. Second, the growth potential and supplydemand situation must be optimal. Third, we must see the ability to get good credit-worthy off-takers, to obtain project financing, and to acquire non-recoursed debt in the country,” says Swensen.

The first priority of countries to invest in will be Mexico, which seems ripe for investment in electrical energy markets because “Mexico has an enormous shortage of electrical generating capacity and regulations impede the development of additional facilities,” says Swensen. Conduit hopes to capitalize on increased clearing prices of electricity that the company expects will be created by shortages in electrical generating in the country. Due to its stability Chile is also being targeted. Chile’s standing is enhanced by Conduit’s successful previous experiences there.

Although Peru has relative political instability, the country will be Latin Power III Fund’s next focus because of its increasing demand for electrical energy. Costa Rica and Panama are the next and final on the list of countries that Fund III will focus on.

Swensen dismissed the likelihood of investing in Brazil’s energy sector because the company fears possible currency changes in Brazil. “Brazil is the only country in Latin America where it is illegal to index to the dollar. We do not take currency risks,” he explains.

Swensen is beginning to see a new trend in Latin American private equity investment. Last fall, Conduit sold its interest in Electricidad de Puerto Cortés, an electric power generation plant in Honduras, to a Honduran family.