OQUENDO CAPITAL

Bringing something different to the table

Alfonso Erhardt of Oquendo Capital explains why, for investors seeking niche strategies and diversification, Spain is worth a closer look

Madrid-based Oquendo Capital is currently in the market raising its third private debt fund vehicle, which has a target of €150 million and hard cap of €200 million. In the interview that follows, the firm's co-founding partner Alfonso Erhardt reflects on the origins of the firm nine years ago and how it has evolved in line with changing market dynamics since then. Spain, we discover, is a small market – but one which has much to offer investors looking for something a little different.

Alfonso Erhardt

Q Could you take us back to the formation of the firm and what the rationale was at the time?

We started back in 2007, so we have been around for some time. We started off with a mezzanine strategy as it was the only segment of private debt which existed at the time. Our second fund was raised in 2013, at a time when unitranche and other types of product were just starting to feature. This fund has built-in flexibility to invest across the capital structure, although it has predominantly invested in mezzanine.

The market has evolved a lot since 2007 and we have also started to invest in sponsorless situations, which now make up 40 percent of the fund, whereas our first fund was 100 percent sponsored mezzanine. We are now raising our third fund which will continue with the strategy of our second fund: providing flexible debt capital solutions to lower-mid market instruments using unitranche, mezzanine or minority equity.

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The market is becoming more competitive with many new funds and strategies entering the market. Although we are the longest-standing investor in Spain and we face limited competition from the large international funds, we have realised that offering flexibility and tailored solutions to our target universe is what allows us to differentiate from our competitors and continue to lead the market.

Q Tell us a little about the nature of the Spanish debt market and why mezzanine has been the focus?

Spain is a smaller market than the main European markets. It's smaller than the UK, France, Germany and the Nordics, and approximately on a par with Italy. Companies are of a smaller size so deal flow tends to concentrate in the lower mid-market rather than the traditional mid-market.

In terms of financing, Spanish banks are very active in mid-market LBOs and they will look at any business with EBITDA north of €5 million, offering long-term financing with pricing under 300bps and leverage levels reaching 3.5-4-0x topped by 1x of mezzanine financing. In this context, unitranche providers are finding it quite difficult to compete, as their offering is more expensive and Spanish borrowers tend to prefer cost over flexibility.

Unitranche in Spain has yet to repeat the success of other markets. Due to the abundance of banks, senior debt and unitranche funds have mostly featured in complex credits or sectors with limited bank appetite such as construction, building materials or renewable energies. So it has been tough for unitranche up to now and good for mezzanine – and that's the case all the way down to the smaller companies.

We're happy with a big part of our portfolio being mezzanine. We like to partner with the banks, which have an incredible commercial reach, instead of competing against them and we are also comfortable holding junior paper at the appropriate leverage levels.

Q How do you view market conditions looking ahead?

We don't see things changing much over the next three to four years. Although banks will gradually retreat from some forms of financing, we think that this trend will happen at a much slower pace than everyone anticipated.

Although we have slowly seen leverage levels ticking up, it is quite seldom that we see a structure with total leverage above 4.5x in the Spanish market. This is still lower than other countries, where mid-market leverage levels are generally higher. Our portfolio averages just below 3.5x. So you can say that we have been able to find an attractive risk-return combination.

We believe prospects are good over the next few years. The Spanish private equity market is very healthy, with over 15 managers which have recently raised an aggregate of over €3 billion of capital, which, coupled with an active banking environment, should produce enough sponsored deal flow to keep us busy going forward.

On the sponsorless side of the market we are seeing increased deal flow. In our case, mezzanine instruments have worked quite well to address the needs of family-owned businesses which are averse to private equity. You might, for example, have two brothers and one wants to buy the other out but avoid having someone new come into the company. There is a strong educational process to explain to all market participants what mezzanine can do for them in these type of situations but we have been working on that for a few years and we are starting to see the effects. We have jumped from zero sponsorless deals in Fund I to 35 percent in Fund II and currently 75 percent of our deal flow is sponsorless.

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Q What's the competitive environment like at the moment?

In terms of competition, we are the only local dedicated mezzanine provider, so our competition changes from deal to deal. There are a few local funds that do senior debt with a small allocation for mezzanine, big international funds that can overlap with our larger deals and some French mezzanine funds that have a small basket for investment in Spain. We like to think that our specialisation, flexibility and local origination provide us an edge over our competitors.

Q Do you also target the Portuguese market?

Portugal is a very small market. We do look at it but private equity penetration is very low so there are only a few deals. We have looked at 10 deals there in the last four years.

Q What is investor appetite like for this kind of proposition?

Over time we have managed to build a loyal and well diversified investor base, but it's generally investors who write small cheques and we still have a strong concentration of Spanish investors, who make up 65 percent of our funds.

We have obviously benefited from the growing interest in the private debt asset class but we have certain constraints due to our size and our target geography. New investors to the asset class start with large funds and plain vanilla strategies which is exactly the opposite of what we do. We eventually hope that as the asset class matures, people search for niche strategies delivering higher returns and they find us. Investment advisors are paid to bring something different to the table and help to find small funds not previously heard of. That can only benefit the likes of us. ■

OQUENDO QUICK FACTS

Formed: 2007

Headquartered: Madrid

Strategy: Preferred equity and debt instruments targeted at family-owned businesses and financial investors that require funds for acquisitions, growth and shareholder reorganisations

Team members include: Alfonso Erhardt, partner; Daniel Herrero, partner; Leticia Bueno, investment director; Ricardo Junco, investment director; Rocio Goenechea, controller and investor relations

Recent deals include: Multiasistencia, property claims management services for insurance groups; Rotecna, manufacturer and distributor of equipment for pig farms; Caiba, Spain's largest independent PET industry manufacturer; Discefa, a frozen octopus processor and distributor