Institutional Investor Profile: Peter Derendinger, Partner and CEO, ALPHA Associates

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Peter Derendinger on Central and Eastern Europe, on managers with a regional focus, on market correction, on the appeal of co-investments and on the dangers of financial engineering.

Zurich-based ALPHA Associates manages private equity funds of funds and accounts for institutional and private clients and has about CHF2bn of assets under management.

Its current fund products include 5E Holding, ALPHA's first fund of funds dedicated to private equity investment in Central and Eastern Europe (CEE); ALPHA CEE II, ALPHA's second private equity fund of funds focused on investment in CEE, launched in 2006 with a size of €309m; ALPHA 2001, a tailor-made globally diversified private equity fund programme for a group of Swiss institutional investors; and an SWX-listed fund of funds, Private Equity Holding. ALPHA's strategy includes primary fund commitments, the acquisition of fund interests on the secondary market and direct co-investments.

Peter Derendinger is partner and CEO of ALPHA Associates, having led the MBO of the firm in 2004. Prior to ALPHA Associates, he was a member and delegate of the Swiss Life Private Equity Partners board of directors. Previously, he was a financial and legal consultant. Derendinger began his career as an attorney-at-law, and held several positions at Credit Suisse, most recently as CFO and head of the Corporate Center at Credit Suisse Private Banking. Previous appointments at Credit Suisse included managing director and general counsel of Credit Suisse Group, and head of Legal and Tax at Credit Suisse First Boston (Europe). He is a member of the board of Elektrizitäts-Gesellschaft Laufenburg and of Bank Sarasin in Basel.

What is your investment focus?

'We build and manage globally diversified private equity fund portfolios for institutional clients and launch funds of funds with a specialised investment focus in areas where we have particular expertise. We are the leading private equity fund of funds manager for CEE. We have invested and managed more than €400m in close to 40 private equity fund and direct investments in CEE since 1998.

For our CEE funds, we look to commit to a dozen top fund managers in the region, with a focus on the new EU member countries. There are a number of managers that have large multi-country funds, and also some that manage country-specific, smaller funds. We are looking to build a portfolio that is diversified by stage, but with a focus on mid-market buy-outs and expansion financing, by country and by manager. We expect that our managers diversify by sector. There are almost no sector-focused funds investing in CEE. Most of the fund managers are generalist but with an emphasis on the fast growing consumer-facing industries. They have some sector preferences and we take that into account when we build our portfolio.'

What is your average bite size?

'For our ALPHA CEE II fund, the average bite size is about €15m to €20m. On the direct co-investment side, it is smaller.'

Do you invest in first-time funds?

'We follow all the funds that are active in the region. We would not rule out investments in first-time funds, although we would not invest in first-time teams. Teams may split or spin out of an organisation and this can create attractive opportunities.'

How do you source good deals?

'We source opportunities through our broad network in CEE. We have been investing in the region since 1998. We know all the fund managers active in CEE and have longstanding relationships with them.'

Do you co-invest?

'We have been an active co-investor in CEE for ten years now. We make co-investments alongside strong, trustworthy partners with a local presence and hands-on value creation strategies. We see a number of interesting opportunities in the region and we often refer these to a local fund manager to act as lead investor, typically one of our portfolio funds.

For ALPHA CEE II, we have already made two co-investments to date. The first is in Ceske Radiokomunikace, which is the market leader for GSM, radio and TV broadcasting in the Czech Republic as well as a stake in T-Mobile Czech Republic, a leading mobile operator in the country. The second was alongside a longstanding venture investor, who we have known through his investments in other parts of the world. We invested in Elmarco, a Czech company which has a world-leading, patented technology for the manufacture of machinery for the production of nanomaterials.'

How would you look to construct a diversified portfolio for an institutional client?

'We would recommend building a portfolio that is globally diversified, with an emphasis on Europe and the US, as well as diversified by stages, industries and vintage years. The exact allocation targets depend on our clients' portfolio profiles.'

What does your investment process involve?

'We actively screen the markets in which we invest. We collect information, meet managers and create a shortlist that fits our clients' investment criteria and target allocation. The investment committee then decides how to allocate the resources for due diligence.

We conduct very thorough due diligence, with multiple on-site meetings with the managers, a comprehensive quantitative and qualitative analysis including track record and deal attribution, reference checks, etc. The team that is responsible for the due diligence prepares a recommendation to our investment committee, which is discussed in detail. If questions are not answered satisfactorily the team is sent back for further inquiries. Eventually, a final decision is taken, both on whether we invest or not and also on the size of the commitment. '

What areas are of interest to you going forward?

'When we raise funds of funds we focus on niche strategies where we have particular expertise, know-how and access, and which can therefore provide a value-add to investors who may normally not invest in funds of funds. We like markets that are at the point of becoming emerged. We are not early movers in emerging markets. There are four questions we always ask. The first is whether the macroeconomics are interesting enough. Is the region going to grow at an attractive rate going forward? That is the case in CEE. You could argue that China is growing even faster, but CEE is certainly moving at a very interesting rate compared to Western Europe and the US.

The second question concerns the stability of the political, legal and regulatory environment. Once you have committed to a fund, it is a ten or 12-year marriage. The advantage in Eastern Europe is that you can invest in emerging market growth at a risk that is today comparable to that of Western Europe as most of the countries are now firmly entrenched in the European Union.

The third question is whether we think that there is a sufficient number of institutional-quality managers within the investment theme or region. You mentioned first-time teams; we do not like to invest in regions where there may be hundreds of managers who have only been established a year or two ago. We like to see a certain maturity in the private equity industry, like in CEE, where some of the managers are now at their fourth or fifth fund. They have gone through both the good and bad times. Even good managers sometimes make mistakes or are unlucky with some of their investments. But, at least they could draw lessons from this and we would hope and expect that they would not fail again in the same way. If you go into a region which is very hot but without any established private equity industry you could be taking a tremendous risk.

The fourth question is the exit environment. We do not invest in markets which do not attract meaningful M&A activity and where the stock exchanges are undeveloped. We like to invest in markets which offer viable exit routes for private equity and where there is also a track record of successful exits in the past.'

What is the most pressing issue facing the private equity industry at the moment?

'I believe the crisis in the financial markets also presents an opportunity for private equity. Valuation expectations will come down and teams that have raised money recently are likely to be able to invest in a more interesting buyer's environment, at lower multiples. I was worried a year ago when multiples and leverage packages were going through the roof. I am glad that there was a correction. It is good for the market because what happened in some parts of the market was very hype-ish.

With Private Equity Holding and some of our other mandates, we did not really invest in the mega buy-out funds. We were worried, long before the crisis, that deals that depended on financial engineering and huge leverage packages at low interest rates carried too much financial risk given their return targets.

We like to work with managers that have a strong operational background, that have proven they can make their companies more efficient and that lead them into the right strategic direction.

For many of our mandates we have significantly increased our allocation to distressed funds, starting around two years ago. We are very pleased with their performance so far. We believe that some of these distressed managers are currently enjoying some very interesting hunting grounds.'

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