

# The Cornerstone Group

## Investing in Colombian Private Equity and Infrastructure

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### Background

Over the last decade, Colombia has emerged, in its region, as the fastest growing economy in terms of GDP (PPP)<sup>1</sup>. The achievement of political stability quadrupled total FDI and tripled exports over the past 12 years. The teeming population and increasingly diversified economy continue to put pressure of the nation's underdeveloped infrastructure. Colombia's deplorable road infrastructure, energy, and power sector challenges have been a significant obstacle to the nation attaining economic competitiveness.

The Government is scheduled to pump about US\$55bn in just transport infrastructure projects, alone, over the next 10 years and an additional 6.6 GW in the total installed power capacity is slated for 2020(EDC, 2012).

Through the institution of reforms in the Public Private Partnerships law (PPP) in 2010, Colombia seems determined to catch up with its South American neighbors (Chile, Peru, and Brazil) which possess stronger institutional frameworks and a longer track record of co-investment concessions. Compared to Peru and Chile, Colombia's larger population and strategic geographical location present compelling infrastructure investment opportunities for investors willing to operate within this newly formed legal and policy framework.

### Motivation

The Cornerstone group ("CSG") is an investment fund established in 2011 to take advantage of the tremendous growth opportunities in South America and Colombia in particular. The fund was structured to function as a local investment team furnished with full financial backing from the Alberta Investment Management Corporation ("AIMCo"). Though seeding a homegrown investment team to engage in investments overseas was a strategy that parted with convention, this approach presented several advantages to AIMCo.

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<sup>1</sup> PPP used here refers to purchasing power parity per capita

The primary rationale behind employing a local team is to gain access to the local business network, deep business relationships and deep-seated understanding of the local cultural nuance that will escape a North American team conducting business in South America. Investing through a local team also creates significant savings for investors since they are not baited into bidding wars for the few attractive opportunities shopped around in all the local investment houses. Through this vehicle, AIMCo is able to scout new projects and develop them since they have Cornerstone working as their “eyes on the ground” in Colombia

**Governance**

At the highest level of the fund’s investment strategy execution are top-notch local board of directors and management team with a deep knowledge of the country and long-established relationships with key business people and government officials.

While the Cornerstone team is in charge of investment execution and scouting new investment opportunities, AIMCo exerts control through the quality of personnel selected to the Board and management team of the fund. As owners of the fund management company, AIMCo also runs the operating budget of the fund and maintains the evergreen capital pool established to receive proceeds from the various investments. In order to maintain transparency, AIMCo formulates the investment policies and outlines the investment criteria in order to align interests and expectations on both sides.

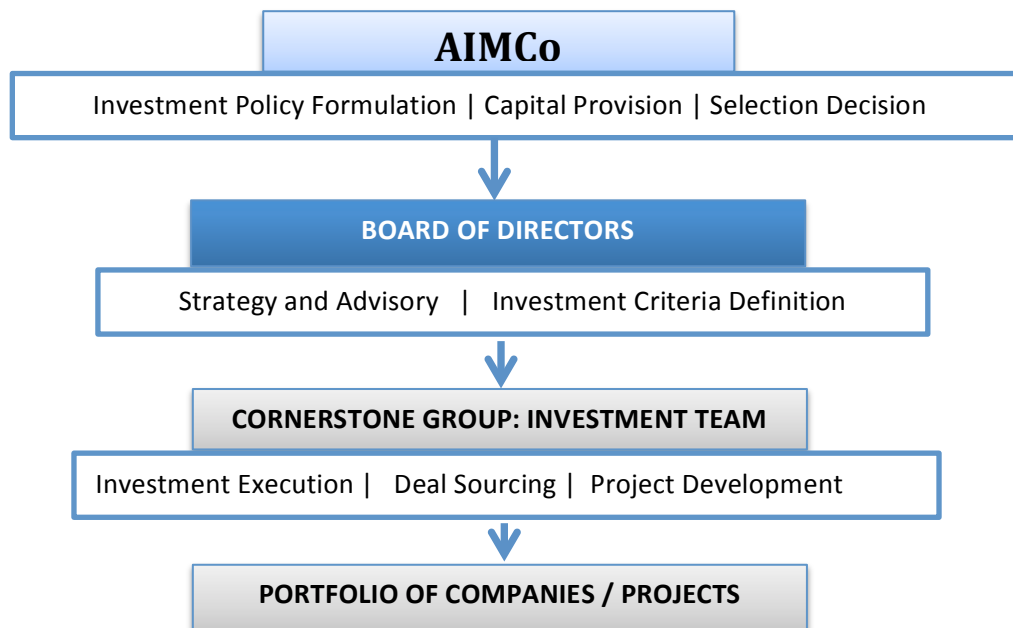


Figure 1

## Method of Operation

The CSG fund currently manages about of USD\$500 million in committed capital from AIMCo and has already closed transactions amounting to USD\$300 million since its inception. The fund is able to engage in direct investments by tapping into their networks of the CSG sources deals from the team's investment committee and management team's network of sponsors, developers, local banks, investments bankers, government officials, industry leaders, and technical consultants. The investment team works on developing new projects on a proprietary basis using their relationships and knowledge of the market. Due to the scarcity of already developed deals, CSG generates new deals by working with entrepreneurs and businesses to create the most optimal business structures to guarantee the smooth operation of these enterprises. By finding these new projects to adding value to develop them CSG avoids the issue of overpaying for the few readily developed ventures.

## Investment Approach

In order to generate risk-adjusted returns, the fund managers strive to create a balanced portfolio of assets at various stages of development from greenfield ventures to more mature projects with a medium to long-term horizon perspective. CSG also invests directly in companies in Colombia via equity and equity-like securities, as well as convertibles. The private equity investments allow CSG to add value to their portfolio of business by influencing the governance, strategy, commercial and financial decisions that are made in these companies at the board level.

By actively managing and monitoring their investments, CSG is in tune with the needs of each investment and able to make key decisions that ensure the ongoing success of these companies. Having a local based investment team allows CSG to scout and source deals from a diverse range of fields such as Infrastructure, power, mining, agribusiness and oil and gas. The fund uses three main tools to protect themselves are drag and tag along clauses, minimum return buybacks and convertible instruments.

By incorporating drag and tag along clauses in investment contracts as a minority stakeholder, CSG is accorded the same rights and terms offered to a majority stakeholder during a sale. Convertible instruments are a protection mechanism that allows CSG the flexibility to switch from equity to debt or vice versa based on the particularly favorable characteristics they offer in a given situation. Due to CSG's medium to long-term investment horizon, the primary exit strategy is to go public after holding the asset for 5-7 year period. However, a majority of the investments are held beyond 8 years. The IPO option has become increasingly attractive with the integration of stock exchange markets of Chile, Peru and Colombia known as Mercado Integrado Latino America (MILA) in May 2011 (IDB, 2011).



## Case Study: Petrotiger

### *Description*

Petrotiger is a group of oil services and infrastructure companies with more than 2400 employees operating in more than 16 countries, and generating over USD\$ 200 million in revenues. CSG entered the picture to help drive strategy and fund the company's expansion.

### *Deal and CSG's Role*

CSG acquired a significant minority stake which gave CSG one seat on the board of directors with an investment of USD 80 million.

### *Outcome*

Petrotiger used Cornerstone's investment as an additional source of equity to fund the acquisition of strategic assets. The funds were also added to Petrotiger's depleting working capital in order to execute the firm's aggressive expansion plan.

## Review

One might argue that CSG's investment strategy of primarily focusing on Greenfield opportunities and new ventures is unbalanced since it subjects the fund to early project development risks. This approach will not work for all funds since recruiting the talent with right combination of local knowledge, finance expertise, and relationships to turn these pre-development prospects into viable investment opportunities.

Getting involved with entrepreneurs and new businesses ventures early in the development process can help companies achieve financial viability by attracting more capital from other sources due to the additional value created by CSG; however if these new projects fail before other investors join , CSG bears the financial brunt.

Cornerstone's "patient capital" approach leaves the fund with very few exit options except going through the public equity markets. The relative political stability in the region goes a long way to allay the fears of investors however since most of their investments are held for over 8 year, this raises the element of political risk considering the region's history of expropriations(See Bolivia(Economist,2012),Venezuela(Economist,2010)).

In terms of the organizational set up and governance, one oversight body that AIMCo took a while to establish was an independent board of directors. Adding an additional layer of oversight through the Board helped align interests and expectations helped developing projects from scratch rather than waiting for projects to come to you. Led by the Chairman, the board is composed of three Independent members with distinguished business and political careers as well as two AIMCo executives. This combination of locally based board members working alongside AIMCo representatives helped ensure balance. Another shift in strategy that Cornerstone seems to have incorporated was to have a more regional focus earlier.



Another shift in focus that CSG's management team wish they had adopted earlier was to go from local to regional or at least adopt a regional focus earlier on. Nations such as Peru and Chile despite have been experiencing equal or better economic growth (6.0% and 5.0 % respectively (IDB, 2012) region while also enjoying the same level of political stability associated with Colombia. In hindsight, going into these markets much earlier would have offered some would have been setting up a board earlier.

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