Renaissance Technologies' Robert Mercer

Jacobo Llanza of Alantra

Citadel's Ken Griffin

Our Top 100 Hedge Funds

Quants dominate the overall numbers, but a value manager ranks No. 1

By Lawrence C. Strauss and Eric Uhlfelder

THE WINNER OF *BARRON'S Penta*'s 2017 ranking of the Top 100 Hedge Funds doesn't tick a lot of the boxes for the typical big investor. There's one mark, however, that would catch any investor's eye: performance.

Amid wildly erratic hedge fund results, our victor, Madrid-based Alantra Asset Management's $390 million EQMC Europe Development Capital fund (Class A), posted a 26% annualized return net of expenses from 2014 through 2016. In contrast, the average hedge fund's annualized three-year return didn't quite reach 3% in that time, according to BarclayHedge's return database. EQMC's gains were nearly three times those of the surging Standard & Poor's 500 index. To learn more about Alantra and EQMC's strategy, read our profile of and interview with Alantra CEO Jacobo Llanza and the fund's overseer, Francisco de Juan, page 31.

Alantra and its hedge fund stand out from the hedge fund crowd in a lot of ways. The small fund doesn't sell stocks short, use leverage, or employ confrontational tactics to get its way. It borrows heavily from private equity's tool kit to work with managements to improve results.

Another distinction: The asset manager and its key fund take an active, fundamental approach in an era when quantitative investing is booming among leading hedge funds. *Barron's Penta*'s champ a year ago, Hong Kong–based Parametrica Asset Management, guided by Xiongwei Ju, who holds a doctorate in finance, uses an equity market-neutral strategy based on statistical arbitrage across many global markets. Parametrica finished at No. 5 this year.

Other quant-based firms whose various funds again excelled this year include a Donald Trump favorite, Robert Mercer's Renaissance Technologies (Nos. 6 and 24); math-and-science talents John Overdeck and David Siegel's Two Sigma Investments (No. 11); quant pioneer David Shaw's D.E. Shaw Group (Nos. 18 and 32); and Ken Griffin's Citadel (Nos. 30 and 37).

Reflecting the difficulty of generating consistent returns in recent markets, a record 61 firms on the *Barron's Penta* Top 100 list this year didn't rank a year ago. In one of many cases of rapidly changing fortunes, a fund we monitor, Mudrick Distressed Opportunity, posted an impressive 39% gain in 2016, following a 26% drop in 2015, preventing it from making our ranking, which is based on three-year returns.

Despite some spectacular 2016 returns like our No. 2 finisher Mangrove Partners' 51% gain, hedge fund performance continues to disappoint. The average return of the 100 funds on 2017's list is 11.78%, versus nearly 17% a year ago.

The low and volatile returns are having an adverse effect on clients. Pension funds and financial institutions are seeking incremental returns to meet their own obligations; many funds simply aren't delivering them. Among the big institutional investors to announce that they would curtail hedge fund investments last year were MetLife, American International Group, and the New Jersey State Investment Council. That makes it harder for hedge funds to refill their coffers. "It will continue to be difficult for fund managers to raise capital, and keeping what you've got will be tough," says Amy Bensted, head of hedge fund products at Preqin, a London-based alternative-asset research firm.

Total hedge fund assets under management hit $3 trillion last year for the first time, but that was thanks to higher security prices. Net outflows persisted, and fund liquidations totaled 1,057, the highest level since the financial crisis, according to Hedge Fund Research.

It isn't just the lesser-known firms that are falling short. Failing to gain a *Barron's Penta* ranking this year were perennial participants such as David Einhorn's Greenlight Capital, David Tepper's Appaloosa Management, Leon Cooperman's Omega Advisors, and Larry Robbins' Glenview Capital Management.

Is there any good news for investors? Yes. They now "hold many of the cards and can exert pressure in areas like fees," says Bensted. The 2% annual management fee and 20% take of profits is history. In last year's fourth quarter, the average fee structure fell to 1.48% and 17.4%, respectively, according to HFR. Some funds, such as Candlewood Investment Group and PSAM, are offering more-innovative approaches, like tiered pricing structures based on how much is invested.

And the longer that poor relative performance persists, the closer we are to an improvement among active managers. As of March 31, Preqin's broad hedge fund index had returned 11.61% over the previous 12 months. Granted, that vast improvement still trails the 17% return for the S&P 500.

Best of all, as you'll see on the following pages, there are many funds, net of their fees, that have topped the returns of the stock and bond markets over the past three years. Others have some catching up to do in the next year. Read on. ■

Oliver Contreras/The Washington Post/Getty Images; Gianfranco Tripodo; David Paul Morris/Bloomberg

BARRON'S PENTA TOP 100 HEDGE FUNDS

Alantra Asset Management's EQMC Development Capital fund, based in Madrid, took top honors in a tough year in which quantitative funds provided the most consistency.

Rank 2017	Rank 2016	Fund	Fund Assets (mil)	Fund Strategy	3-Year Compound Ann. Return	2016 Return	Firm Name / Location	Firm Assets (mil)
1.	N.R.	**EQMC Europe Development Capital Class A**	$390	European Equity Long Only	26.21%	26.39%	Alantra Asset Mgmt. / Madrid	$3,300
2.	N.R.	**Mangrove Partners**	682	Equity Long / Short	23.34	50.58	Mangrove Partners / New York	780
3.	19.	**Segantii Asia-Pacific Equity Multi-Strategy**	1,923	Asia Multistrategy	23.06	6.69	Segantii Capital Mgmt. / Hong Kong	1,923
4.	71.	**Sherborne Investors**	705	Activist / Event Driven	20.97	27.80	Sherborne Investors Mgmt. / New York	705
5.	1.	**Parametrica Global Master**	400	Equity Market Neutral	18.35	0.35	Parametrica Asset Mgmt. / Hong Kong	666
6.	37.	**Renaissance Institutional Equities**	14,935	Quantitative Equity Long-Bias	17.75	21.46	Renaissance Technologies / New York	38,800
7.	N.R.	**Knight Vinke Institutional Partners Int'l**	860	Equity Long-Only Activist	17.68	46.18	Knight Vinke Asset Mgmt. / Monaco	860
8.	N.R.	**Credence Global Class C**	326	Relative Value Arbitrage	17.33	11.64	Splendor Capital Mgmt. / Hong Kong	407
9.	N.R.	**Verde FIC FIM**	434	Multistrategy	17.24	15.13	Verde Asset Mgmt. / Sao Paulo	9,600
10.	27.	**ISAM Systematic (USD)**	1,730[1]	CTA	17.03	–12.17	ISAM / London	2,030
11.	31.	**Two Sigma Compass Cayman**	893	Managed Futures	16.79	10.33	Two Sigma Investments / New York	41,000
12.	N.R.	**Blue Diamond Non-Directional**	398	Statistical Arbitrage	16.76	21.78	Blue Diamond Asset Mgmt. / Pfäffikon, Switzerland	398
13.	N.R.	**Waterfall Victoria**	704	Asset-Backed Loans	16.13	10.69	Waterfall Asset Mgmt. / New York	6,600
14.	46.	**Harvest Small Cap Partners**	450	Equity Long / Short	15.41	10.60	Harvest Capital Strategies / San Francisco	2,200
15	41.	**MW Market Neutral TOPS Class A (USD)**	1,559[2]	Equity Market Neutral	14.87	12.38	Marshall Wace / London	29,764
16.	69.	**Anson Investments**	437	Equity Long / Short	14.82	3.74	Anson Funds / Dallas	549
17.	65.	**Element Capital**	9,500	Macro	14.66	19.37	Element Capital Mgmt. / New York	9,500
18.	N.R.	**D.E. Shaw Valence**	2,472	Equity & Equity-Linked Strategies	14.51	11.55	D.E. Shaw Group / New York	41,000
19.	16.	**STS Partners**	1,640	Mortgage-Backed Securities	14.35	8.65	Deer Park Road Mgmt. / Steamboat Springs, Colo.	1,790
20.	14.	**GSA Trend**	2,870	CTA	14.18	–2.31	GSA Capital Partners / London	6,690
21.	57.	**MIG Master Class A**	590	Equity Long/Short	13.61	14.18	MIG Capital / Newport Beach, Calif.	700
22.	N.R.	**Welton Global Directional Portfolio**	463	Managed Futures	13.45	11.08	Welton Investment Partners / Carmel, Calif.	689
23.	N.R.	**Pharo Gaia**	2,380	Emerging Markets	13.14	14.18	Pharo Global Advisors / London	7,322
24.	86.	**Renaissance Institutional Diversified Alpha**	10,500	Quantitative Global Multistrategy	12.74	10.67	Renaissance Technologies / New York	38,800
25.	N.R.	**ADG Systematic Macro**	398	Systematic Futures	12.70	14.40	ADG Capital Mgmt. / London	398
26.	N.R.	**Gemsstock Class B (USD)**	647	Global Macro	12.68	19.83	Gemsstock / London	696
27.	4.	**DUNN World Monetary & Agriculture**	557	Systematic Futures	12.49	–5.39	Dunn Capital Mgmt. / Stuart, Fla.	956
28.	63.	**Stratus (9% Target Vol)**	5,424	Quantitative Systematic Trading	12.47	–3.72	Capital Fund Mgmt. / Paris	7,530
29.	N.R.	**Asgard Fixed Income I (Euro)**	587	Fixed-Income Arbitrage	12.46	18.14	Plinius Capital / Copenhagen	587
30.	47.	**Citadel Kensington Global Strategies**	16,581	Multistrategy	12.43	4.71	Citadel / Chicago	26,243
31.	N.R.	**PH&N Absolute Return**	1,149	Multistrategy	12.41	33.46	RBC Global Asset Mgmt. / Vancouver	298,000
32.	66.	**D.E. Shaw Composite**	10,848	Multistrategy	12.24	6.25	D.E. Shaw Group / New York	41,000
33.	6.	**Marlin**	513	Equity Long-Bias	12.15	26.52	Masters Capital Mgmt. / Atlanta	894
34.	N.R.	**Hawk Ridge Partners**	347	Equity Long-Bias	12.12	17.93	Hawk Ridge Capital Mgmt. / Los Angeles	347
35.	11.	**The Children's Investment Fund**	12,800	Equity Long / Short	12.00	13.50	TCI Fund Mgmt. / London	19,000
36.	17.	**CC&L Q Global Equity Market Neutral**	1,369	Equity Market Neutral	11.81	3.59	Connor, Clark & Lunn Investment Mgmt. / Vancouver	36,020
37.	N.R.	**Whitebox Relative Value Partners**	396	Convertible Arbitrage	11.69	26.92	Whitebox Advisors / Minneapolis	4,816
37.	42.	**Citadel Global Equities**	3,511	Global Equity Market Neutral	11.69	–1.12	Citadel / Chicago	26,243
39.	N.R.	**SECOR Alpha**	538	Diversified Systematic Global Macro	11.60	2.00	SECOR Capital Advisors / New York	871
40.	33.	**Teton Capital Partners**	1,099	Equity Long / Short	11.47	3.80	Ancient Art / Austin, Texas	1,099
41.	N.R.	**Chatham Asset High Yield Master**	527	Credit Long / Short	11.42	24.20	Chatham Asset Mgmt. / Chatham, N.J.	2745
42.	N.R.	**Contrarian Emerging Markets**	831	Distressed Emerging Markets	11.26	22.71	Contrarian Capital Mgmt. / Greenwich, Conn.	3,980
43.	N.R.	**CFM IS Futures (10% Target Vol)**	478	CTA Long-Term Trend Follower	11.25	–6.83	Capital Fund Mgmt. / Paris	7,530
44.	7.	**BlackRock European Hedge**	2,146	European Equity Long / Short	11.21	–11.39	BlackRock / New York	5,100,000
45.	2.	**Camox**	466	Equity Long-Bias	11.06	–8.87	Cologny Advisors / London	466
46.	N.R.	**Varden Pacific Opportunity Partners**	523	Credit Long-Bias	10.96	33.28	Varden Pacific / San Francisco	573
47.	N.R.	**Pine River Liquid Rates**	1,568	Fixed-Income Relative Value	10.87	17.28	Pine River Capital Mgmt. / Minnetonka, Minn.	9,825
48.	N.R.	**Clareant Structured Credit Opportunity II**	549[3]	Asset-Backed Loans	10.82	18.46	Alcentra / London	30,904
49.	N.R.	**Autonomy Global Macro**	3,500	Global Macro	10.77	24.96	Autonomy Capital / New York	4,100
50.	N.R.	**Pure Alpha Major Markets II**	5,253	Global Macro	10.70	12.90	Bridgewater Associates / Westport, Conn.	160,000
51.	8.	**Chenavari Toro**	317	European Asset-Backed Securities	10.67	3.85	Chenavari Investment Managers / London	5,500
52.	79.	**Sachem Head Offshore**	2,090	Equity Long / Short, Event Driven, Activist	10.47	–0.66	Sachem Head Capital Mgmt. / New York	3,739

N.R. = not ranked.

Rank 2017	Rank 2016	Fund	Fund Assets (mil)	Fund Strategy	3-Year Compound Ann. Return	2016 Return	Firm Name / Location	Firm Assets (mil)
53.	N.R.	AQR Absolute Return	$2,159	Multistrategy	10.42%	10.92%	AQR Capital Mgmt. / Greenwich, Conn.	$175,200
54.	21.	HMI Capital Partners	713	Equity and Credit Long Bias	10.38	10.91	HMI Capital / San Francisco	836
55.	N.R.	Quantedge Global	1,139	Macro	10.30	26.84	Quantedge Capital / Singapore	1,139
55.	N.R.	Thélème Master	2,300	Equity Long / Short	10.30	14.20	Thélème Partners / London	N/A
57.	N.R.	TCA Global Credit Master	426	Asset-Backed Loans	10.28	9.66	TCA Fund Mgmt. Group / London	426
58.	53.	Camden Equity Overlay	437	Convertible Arbitrage	10.27	15.31	Camden Asset Mgmt. / Los Angeles	4,772
59.	N.R.	AQR Systematic Total Return	493	Diversified Growth	10.23	6.91	AQR Capital Mgmt. / Greenwich, Conn.	175,200
60.	N.R.	Tide Point	882	Equity Long / Short	10.21	16.15	Tide Point Capital Mgmt. / Old Greenwich, Conn.	1,365
61.	N.R.	Dorsal Capital Partners	2,036	Equity Long/Short	10.20	5.07	Dorsal Capital Mgmt. / Redwood City, Calif.	2,036
62.	N.R.	GAA Systematic Global Macro	435	Diversified CTA	10.17	14.46	Ramsey Quantitative Systems / Louisville, Ky.	548
63.	64.	VR Global	3,520	Distressed	10.15	17.00	VR Advisory Services / London	3,520
64.	48.	Verition Multi-Strategy PMI	370	Multistrategy	10.12	5.67	Verition Fund Mgmt. / Greenwich, Conn.	394
65.	N.R.	Polygon Convertible Opportunity Class A	487	Convertible Arbitrage	10.10	12.05	Polygon Global Partners / London	1,551
66.	N.R.	SPM MBS Agency	717	Mortgage-Backed Securities	10.02	10.33	Structured Portfolio Mgmt. / Stamford, Conn.	2,100
67.	N.R.	Cheyne Total Return Credit 2017 (USD)	361	Fixed-Income Directional	9.97	46.48	Cheyne Capital Mgmt. / London	2,163
67.	55.	Napier Park European Credit Opportunities	650	Credit Long Bias	9.97	12.55	Napier Park Global Capital / London	7,600
69.	N.R.	Clareant Global Special Situations III-A1	578[4]	Event Driven	9.93	9.70	Alcentra / London	30,904
70.	N.R.	Amplitude Capital (Klassik)	936[5]	Systematic Short-Term CTA	9.90	29.41	Amplitude Capital Intl / Zug, Switzerland	1,511
71.	N.R.	AllianzGI Structured Alpha 1000	871	Absolute Return	9.69	10.72	Allianz Global Investors U.S. / New York	88,000
72.	N.R.	Värde Investment Partners	2,543	Opportunistic Credit	9.65	16.06	Värde Mgmt. / Minneapolis	12,400
73.	87.	Man AHL Evolution	5,100	Managed Futures	9.64	6.17	Man Group / London	80,900
74.	N.R.	AlphaQuest Master	827[6]	Managed Futures	9.59	7.10	Quest Partners / New York	1,069
75.	28.	Adage Capital Partners	27,700	Equity Long/Short	9.39	9.50	Adage Capital Mgmt. / Boston	27,700
76.	N.R.	Sound Point Beacon	332	Stressed / Distressed Credit	9.35	9.85	Sound Point Capital / New York	10,500
77.	92.	Millennium International	34,070	Multistrategy	9.25	3.34	Millennium International Mgmt. / New York	34,070
78.	N.R.	Long Pond Capital QP	1,199	Equity Long / Short	9.19	11.47	Long Pond Capital / New York	2,239
79.	18.	BloombergSen Partners	1,314	Equity Long-Only	9.08	4.79	BloombergSen / Toronto	1,890
80.	N.R.	Linden International	1,446	Multistrategy	9.07	12.23	Linden Advisors / New York	1,675
81.	24.	Hildene Opp Master Fund II	479	Asset-Backed Securities	9.02	6.44	Hildene Capital Mgmt. / Stamford, Conn.	1,127
82.	N.R.	Aspect Capital (Diversified)	4,057	Diversified Systematic	8.97	–9.16	Aspect Capital / London	5,877
83.	62.	Saemor Capital Europe Alpha Class B	480	Equity Long / Short	8.83	–10.06	Saemor Capital / The Hague, Netherlands	480
84.	N.R.	Tilden Park Investment	3,658	Multistrategy / Fixed Income	8.75	12.39	Tilden Park Capital Mgmt./ New York	4,126
85.	N.R.	IPM Systematic Macro (USD)	512	Global Macro	8.73	7.40	IPM Informed Portfolio Mgmt / Stockholm	6,600
86.	N.R.	CCP Core Macro (USD)	1,400	Systematic Macro	8.67	1.28	Cantab Capital Partners / Cambridge, U.K.	3,600
87.	N.R.	Black Diamond Thematic	1,400	Equity Long / Short	8.60	18.96	Carlson Capital / Dallas	8,500
88.	59.	SEG Partners	2,259	Equity Long / Short	8.59	1.04	Select Equity Group / New York	19,019
89.	N.R.	LMR	1,657	Multistrategy	8.58	9.16	LMR Partners / London	2,500[7]
89.	N.R.	Pinpoint Multi-Strategy	336	Multistrategy	8.58	0.93	Pinpoint Asset Mgmt. / Hong Kong	1,440
91.	N.R.	BAM ZIE	917	Equity Long / Short	8.56	3.78	Balyasny Asset Mgmt. / Chicago	12,964
92.	N.R.	Capula Global RV Class F (USD)	9,529	Fixed-Income Arbitrage	8.55	8.94	Capula Investment Mgmt. / London	14,200
93.	N.R.	Polar Multi-Strategy (USD)	1,480	Multistrategy	8.51	15.01	Polar Asset Management Partners / Toronto	2,457
93.	N.R.	AQR Global Stock Selection	430	Equity Market Neutral	8.51	4.14	AQR Capital Mgmt. / Greenwich, Conn.	175,200
95.	N.R.	Greylock Global Opportunity Master	440	Emerging Markets Distressed	8.50	22.86	Greylock Capital Mgmt. / New York	990
96.	N.R.	Drawbridge Special Opportunities	4,771	Distressed Securities	8.48	9.70	Fortress Investment Group / New York	69,600
97.	N.R.	Guggenheim Partners Opportunistic Invmt Grade Securities	2,367	Asset-Backed Securities	8.28	11.02	Guggenheim Investments / Chicago	209,211
98.	N.R.	Serengeti Lycaon	339	Credit	8.20	10.30	Serengeti Asset Mgmt. / New York	1,116
99.	N.R.	Moab Partners	527	Event Driven	8.19	10.16	Moab Capital Partners / New York	527
100.	N.R.	PanAgora Diversified Risk Multi-Asset	3,436	Global Macro	8.04	13.25	PanAgora Asset Mgmt. / Boston	42,700
				***Barron's* Top 100 Hedge Fund Avg**	**11.78**	**11.74**		
				BarclayHedge HF Avg	**2.98**	**6.10**		
				S&P 500 Total Returns	**8.87**	**11.96**		
				Barclay Global Agg. Bond TR	**-0.19**	**2.89**		

N.R. = not ranked. [1]ISAM also runs a 10V fund, whose assets are mixed into the ranked fund's AUM, from which the firm will not distinguish. [2]MW Fund and Firm Assets are as of January 2017. [3]Clareant Structured Credit has $262M in commingled assets, $189M in SMAs that are run pari passu, and $98M in in-house fund of funds. [4]Clareant Global Special Situations has $126M in commingled assets, $166M in SMAs that are run pari passu, and $286M in an in-house fund of funds that's run pari passu. [5]Amplitude has $23.9 million in a commingled fund and $911.8 million in SMAs run pari passu. [6]AlphaQuest has commingled assets of $257M, a fund of $110M, and 12 SMAs ($460M), all run pari passu. [7]LMR firm assets are as of August 2016.

The Winner's Picks

An interview With No. 1 Alantra's Jacobo Llanza and Francisco de Juan

By Sarah Max and Eric Uhlfelder

Francisco de Juan, left, and Jacobo Llanza, who oversee the EQMC hedge fund.

Photograph by Gianfranco Tripodo

MADRID ISN'T EXACTLY THE EPICENTER OF GLOBAL FINANCE, BUT when Jacobo Llanza and roughly 15 of his former colleagues set out to launch the investment firm N+1 in 2001, Spain's capital made sense on many levels. It's a hub for cheap, direct flights to most major European cities, and its low cost of living, warm weather, and lifestyle are a boon for recruiting. The location is also indicative of the partners' aim to put a different spin on midmarket investment banking and asset management. And Madrid is the perfect vantage point for what some believe could be a new bull market in Europe.

Alantra, as it was recently renamed, now has 60 partners and roughly 350 employees. The firm went public in 2015 to monetize shares and attract high-caliber partners. Even so, it continues to position itself as unconventional, an "open firm articulated around principles of entrepreneurship, partnership, innovation, and flexibility." An exception is the figurative "wall" between investment banking and asset management, which occupy two separate floors in Alantra's headquarters.

Llanza, who is CEO of Alantra Asset Management, has been mindfully growing assets under management in four categories—private equity, real estate, direct lending, and what the firm calls active management. "We don't want to have an investment supermarket," says Llanza, who was a founding partner and head of research for Mexico-based AB Asesores Moneda, which he and his partners sold to Morgan Stanley in 1999. "We want to focus on niche strategies."

"We don't see ourselves as a hedge fund. We don't do leverage."

Returns for the firm's EQMC Europe Development Capital fund give credence to this philosophy. The fund has averaged more than 20% a year, net of fees, since its inception in 2010. On an annualized three-year basis through the end of 2016, it gained more than 26% a year, putting it at the top of *Barron's Penta's* 2017 ranking of Top 100 Hedge Funds.

BarclayHedge categorizes the 328-million-euro ($357 million) fund as an event-driven hedge fund, but that's for lack of a more suitable classification. "We don't see ourselves as a hedge fund," says Llanza, 49.

Instead, EQMC takes a private-equity approach to small, publicly traded companies in Europe. The managers keep a concentrated portfolio of 10 to 15 companies, with their largest individual positions often accounting for upward of 20% of the fund's assets; in 2016, roughly half of the fund's total return was driven by two companies.

The companies in this compact portfolio are wide-ranging, but most are global leaders in their niches; current holdings include leading carwash systems maker WashTec, professional tripod-and-camera specialist Vitec Group, and Fenner, which makes conveyor belts and enhanced polymer technology. "We own European companies, but they have customer diversity," says Francisco de Juan, 41, who joined the firm in 2006, helped launch EQMC, and oversees the fund's day-to-day management. The largest single market for the portfolio's current roster of companies is the U.S., which represents 25% of revenue.

Llanza and de Juan say that most of their returns are driven by good stock-picking, but they also employ what they call "friendly active investing" to nudge core holdings to improve corporate governance, operations, capital allocation, and strategic decisions. Most company chiefs—typically first-time CEOs of public companies—welcome the managers' guidance. When they don't, Llanza and de Juan keep their position small, or move on.

For investors, the process is transparent. The managers chronicle their triumphs and frustrations in quarterly reports that include frank accounts of their interactions with and impressions of company management. Here are their thoughts from a recent Q&A session with *Barron's Penta*.

***Penta*: Your approach goes beyond traditional stock-picking, but you aren't activists, either. How do you describe what you call active investing?**

Llanza: "Activist" is a word I don't like. We tend to be very constructive. Our strategy is to see how we can create value and help managers. We don't see ourselves as a hedge fund. We don't do leverage. We don't short. This is a long-only strategy. We take a concentrated portfolio of 10 to 15 side. He had taken Rational [maker of commercial ovens] and turned it around by doing more product innovation. We agreed that the company's growth should be more product-centric and not based on mergers and acquisitions.

He also had a mandate to make more shareholder-friendly changes on the board. We brought in a long-term incentive program where the board members invested with their own capital. They would get a multiplier provided they hit certain targets. That was something that had never happened in Germany.

They moved to double-digit top-line growth, and because the company was no longer pursuing M&A, it had excess cash. In 2015, it returned 20% of the prior year's market cap to shareholders through buybacks and dividends.


A vacuum furnace for industrial coatings at Bodycote.

Bodycote

Are most management teams receptive to your guidance?

De Juan: Eight out of our 13 portfolio companies today are run by first-time CEOs of public companies. These guys might be good at sales or product development, but they typically are not experts in market-related aspects. If you position yourself as a constructive guy who wants to help, to provide your judgment at no cost, they only have upside.

Can you tell us how you came to own Vitec and what you like about it?

De Juan: Vitec appeared in our screenings due to its high return on capital employed and attractive free-cash-flow yield. When we started to dig, we found that its double-digit Ebit margins were supported by a very strong brand in the photo and broadcasting accessories niche for professionals. It has a broad product range, a unique route to market, and an efficient production footprint.

We also liked how management had implemented measures to reduce costs and boost cash flow during very challenging years. So after months of research, we concluded that the risk/reward was attractive and completed our seed investment in 2013.

Our main concern was to better understand their weak top-line trend. We identified that their retailers, including B&H and Best Buy, were consolidating and that many smaller players were disappearing due to the growing share of Amazon. The change from traditional to online distribution resulted in a severe reduction of stocks in the value chain, hurting Vitec's revenues in the short term, despite the healthy underlying demand from customers.

It took us several quarters of industry checks to reach this conclusion. In parallel, we also wanted to have a period of time to get to know the businesses, management, and board better. We wanted to make sure that the company was on the right path and that we could constructively contribute with our initiatives, if needed.

Once we got comfortable on these fronts, and given the low price/earnings ratio during 2015 and 2016, we decided to significantly increase our position. We then started to focus on a few new aspects: promoting the communication of a long-term plan and strategic ambition—managers and board agreed that it was time for greater transparency—and implementing a new long-term incentive plan, while making sure that excess capital would be deployed in a disciplined way.

Can you share an example where a company wasn't interested?

De Juan: A number of years ago, we had a seed investment with vacation company Club Med, and tried to engage with management. We decided it would be only a financial investment and at a certain point we would move out. The management team had an agenda. We bought a stake because the stake was cheap. They were not transparent, but at the end of the day, the management, with another investor, launched a takeover. That was a situation where sometimes management has another agenda. You decide to make it a financial investment only.

What if you think the company's own plan has potential?

De Juan: One recent example is a United Kingdom company called E2V Technologies, a high-value-added electronic-components company. We got engaged because we believed that by simplifying the holding company and focusing on the profitable sides of the business, they could rerate. We bought at a P/E of 11. We spoke with other shareholders, did the full due diligence, and started with a seed position. We decided to support the ongoing strategy. The company started to improve operations, and we decided to increase our position to 5%. The idea was that, in three or four years, they would move from low-growth areas to higher growth, but in late 2016, a U.S. competitor, Teledyne Technologies, launched a takeover with a 50% premium. We exited with north of 30% return on invested capital over 30 months.

There's a lot of talk about fees these days. How are yours structured?

De Juan: We have four classes of shares, and the two most common have a 1.4% management fee and 15% performance fee, with a three-year soft lockup and penalties for early redemption. The other is a 1.2% management and 12.5% performance fee, with a four-year hard lockup.

Your outlook for Europe is generally upbeat, but you note that increased integration is key. Can you elaborate on what that means for small companies specifically?

De Juan: Greater integration implies improving trade conditions, deregulation, and labor flexibility. This should lead to a more-efficient corporate Europe and a better allocation of both labor and capital resources. Our companies are small from a market-capitalization perspective, but they are also very well-established global leaders in their respective niches, with average annual revenues of €600 million to €1 billion. Removing barriers to the flow of goods, services, labor, and capital not only provides them with additional business opportunities in and outside of Europe, but also gives them access to more-efficient input sources. We believe that both aspects would equally favor our investments, given their global exposure.

Your quarterly shareholder reports are very detailed, chronicling your performance and holdings, and in many cases offering critical commentary about your holdings. It's a far cry from many of your peers. Is this by design?

Llanza: We have done this all along. That's what we like as investors in a company, and this is a partnership with our investors. We owe it to them to share anything we can disclose that would represent an issue for the portfolio company.

Thank you, gentlemen. ■

"When you think about our value creation, two-thirds of the returns we've obtained are from good stock-picking, and one-third, the cherry on the cake, is the work we do."

companies, and in some cases, we take 15% to 20% positions.

How is that similar to or different from private equity?

De Juan: We are value investors by the way we think. But on the other side, we do have this element of private equity with a superdeep dive into the research, and sometimes we try to create catalysts that can close the price gap. The difference is that we take minority positions in public companies, and private equity takes majority positions in private companies. Our returns—around 20% annually, net of fees, since our 2010 inception—are on the upper end of the returns you can obtain in private equity, but we believe we can obtain it with less risk. We are 10% in cash and 90% long, and underlying assets have very little debt. Private equity takes control and leverages up the deals.

We've made 35 investments since inception and lost money in four. Of those, we had core positions in a total of 10 companies, representing around two-thirds of our capital. When you think about our value creation over time, basically two-thirds of the returns we've obtained are from good stock-picking, and one-third, the cherry on the cake, is the work we do.

Before we talk about the work, tell us how you initially find these companies.

De Juan: There are around 8,000 small-caps in western Europe, defined as below $1 billion. The first filter is that we pass on certain sectors. We believe investing is about predictability and capital preservation. Finance, real estate, all-or-nothing biotech or minerals, we would typically pass on. We would also pass on companies that have not been profitable in the past or don't meet our minimum liquidity requirements. That gets it to 600 or 700 companies. That is really our universe. From there, we focus on the top quartile, based on return on capital and free cash flow.

We have a team of seven analysts who look at about 70 to 80 companies a year, across several phases of due diligence. The first phase might just be a day, to make sure it's not a value trap, a company with no future. The second phase goes into more depth, including meeting with management. If, after a couple of weeks of work, there are no big red flags, we go into phase three, looking at the accounting, talking to competitors and customers. We want a strong track record in value creation and structural moats, and all of this priced attractively.

How is that possible?

De Juan: Typically, the businesses we would find are great companies that, for a short-term reason, are on the surgery table. What can happen are short-term operational issues, or strategic issues, or it can be a great company that has not communicated with the capital markets at all.

PROMISING **EUROPEAN** SMALL-CAP PLAYS

Four key holdings of Alantra's Europe EQMC Development Capital hedge fund.

Name / Ticker	Country	Comment
Bodycote / BOY.UK	United Kingdom	Global leader in outsourcing of industrial heat treatment is ready to restart earnings growth. Excess cash to accelerate returns via bolt-on acquisitions and dividends.
Fenner / FENR.UK	United Kingdom	Manufacturer of conveyor belts and enhanced polymer technology was hit by the commodity crisis. Structural growth plus dynamic business-portfolio management boost value creation.
Vitec Group / VTC.UK	United Kingdom	Maker of professional video and tripod equipment about to reach operational inflection point, coupled with smart use of capital.
WashTec / WSU.Germany	Germany	Carwash-systems company is undergoing business transformation under new management.

Source: Alantra Asset Management

When and how do you decide to take a big position?

De Juan: The investment typically starts small. We call it seed. That seed would be 2% to 3% of our capital and 1% to 5% of the company's ownership, and we hold there for 12 to 18 months. That is critical. We need to see operations, make sure revenue and margins are going in the right direction. You need time to get conviction. I like to see managers on a number of occasions. I like to see how they react to problems, and I want to see if I can engage with them. During that time, we also start to learn from traders, build relationships with other investors, and, finally, talk to the board.

After a process that could take a couple of years, we might decide the fundamentals are good and will really size up the investment. If we find it impossible to engage, we might decide, "Let's go."

Aren't you worried about missing the window on price?

Llanza: If the stock takes off during the seed stage, we sell the position and we make money. If the price goes up after all the work, we are still creating a library of research. It's not a sunk cost because if the stock comes back down we may buy it again.

An example is Bodycote, a British company that does industrial coatings for the aerospace, auto, and other industries. We bought a stake in 2010. The company had a tremendous run for a long period of time, and we made the decision to either double our position at a greater price or exit. We had other alternatives, so we sold the company two years ago. Then we bought it back this year.

What happened?

Llanza: The company was exposed to the industrial market in Europe and, on the back of the commodity crisis, was a laggard. Now it is a seed position again.

Take us through a core position.

De Juan: The largest position in the fund is Germany's WashTec. We've owned it for six or seven years but started the active campaign about three years ago.

They produce carwashing machines, the rollovers and washing panels that are sold to stations. About 60% of their revenues is equipment and the rest is service and chemicals. Sales are north of €400 million, and it has opportunities around the world.

It looked like a boring, mature business. The company had been stagnant on the top line, growing at 1%, and margins had deteriorated. Historically, it had respectable margins for earnings before interest and taxes. What we liked was that the product was special. We estimate that in Europe they have more than twice the market share of their next-largest competitor, and they provide the service on their equipment, which is hard for competitors to replicate.

What triggered your decision to start an active campaign?

De Juan: The company was continuing to do fine, but they wanted to raise capital to make acquisitions, and we thought that was troublesome. We thought it was time. We led the process to drive change in leadership in 2014. The former chairman retired. We brought in Dr. Günter Blaschke, who is a superstar on the product