Absolute Return + Alpha

The Negotiator

May 01, 2012 *Michelle Celarier*

With his unusual background and laid-back demeanor, Greylock Capital founder Hans Humes has emerged as the ambassador of choice between indebted emerging markets, banks and their hedge fund creditors.

WHEN GREECE'S DEBT DRAMA SEEMED destined to end in tragedy last fall, global markets tanked as European banks began dumping the country's bonds. For Willem (Hans) Humes, the president and chief investment officer of Greylock Capital Management, it was finally time to buy. Humes had been tracking the Greek mess for two years, waiting for the banks to get realistic about the necessity of a Greek default — and the losses they'd have to take. But Humes wasn't just a passive investor. As he has done in more than a dozen debt restructurings around the globe,Humes quickly got involved in the creditors committee, offering up Greylock's conference room at 99 Park Avenue in New York City as a meeting place for the group of international financiers monitoring the situation.

Hans Humes: The hedge fund manager played a key role in Greece's debt restructuring (Photographs by Adam Friedberg)

At that meeting in October, Charles Dallara, the managing director of the International Institute of Finance, who led the negotiations with Greece,took Humes aside to ask him to take on a larger role by joining the creditors' steering committee. Humes was a smart choice. He has close relationships with the bankers at Lazard advising Greece and its attorneys at Cleary Gottlieb Steen & Hamilton, having sat across the negotiating table from them numerous times. Suddenly, the head of a small — $600 million — hedge fund firm would be working closely with the CEOs of Europe's largest banks to fashion the terms of the €205 billion ($270 billion) Greek restructuring, the biggest in history.

Humes is characteristically modest about the role he played. "A lot of it would be calling Lazard and saying: 'This is where we're at. This institution's playing hardball. These guys want this. No way we can do that because the Germans want this,' " he explains, describing the behind the-scenes banter during the unofficial negotiations. "The thing was sort of drifting; people were pushing one way or another. A lot of stuff was getting thrown out there. Basically, I was providing transparency to the other side."

Earlier this year Humes was on a number of calls with the bank chiefs. The group had one glaring weak point: The Germans were so desperate to get a deal done that they were willing to concede everything. If that happened,Humes told them, hedge fund investors would balk, and Greece wouldn't get enough participation in the deal for it to succeed. As Humes sees it, his role is to point out to all parties that getting to the middle ground is in their interest. When the Greek deal finally was struck in March, it was still tough to swallow. Banks had been holding the line at a 50 percent reduction in the value of their Greek debt as recently as last spring. But they finally agreed to a 75 percent haircut, taking both principal and coupon reductions into consideration. To sweeten the deal, Greece also included €30 billion' worth of GDP warrants, debt securities that will payout if the economy grows substantially. About 97 percent of creditors have signed on to the bond exchange offer.

Humes's "dream team": (top to bottom) Juan Pedro Moreno is director of research, and Diego Ferro and Ajata Mediratta are partners and portfolio managers.

"Hans has a very good vision of what can and cannot be acceptable to investors," says Eric Lalo, Paris-based managing director in Lazard's sovereign advisory group. "He's a very pragmatic chap."

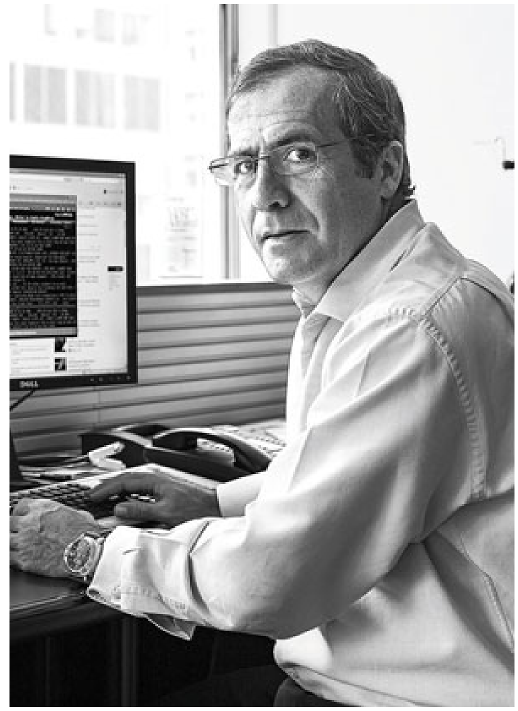
The Greek restructuring talks were just the most recent event in which Humes found himself a trusted go-between among countries, banks and hedge fund investors. It's a role he's played since founding Greylock in 1997 — and one for which he is highly suited. Humes started his career in finance in the 1980s during the heady days of Latin American debt restructurings at money center bank Manufacturers Hanover Corp. in New York. But perhaps more important, a vagabond childhood — spent in Nigeria, Morocco, Canada, Chile and Mexico — gave him an international world view unusual for an American. That sensibility most likely accounts for what even some of his opponents have called Humes's statesmanlike approach to the contentious world of sovereign restructurings. With sovereign debt crises on the rise and migrating from the emerging markets to so-called peripheral Europe (the highly indebted euro zone countries),Humes's role in Greece has given him international visibility and put his hedge fund in a powerful strategic position.

Greylock's investments span the globe, with 30 percent in Latin America,26 percent in the Middle East, 18 percent in Africa, 7 percent in Asia and 1 percent in Eastern Europe. About 18 percent of the portfolio is invested in peripheral Europe, with 14.5 percent of that in Greece. Greylock has invested in the debt of Ireland and Iceland, and now is focusing on Greece,Portugal and Spain. It's a geographic area that's likely to become a bigger part of the fund. "I wouldn't be surprised if you started seeing a lot of debt-for-debt and debt-for-equity deals in peripheral Europe a year or two down the road," Humes says.

In 1998, the second year of Greylock's existence, Russia defaulted and the firm eked out a 5.61 percent gain. In 2008, however, Greylock lost 41 percent. In contrast to many hedge funds that year, Greylock let investors take their capital out of the fund, so the portfolio declined from about$650 million at the start of 2008 to less than $200 million. The fund has clawed its way back after hitting its high-water mark on September 1,2009, gaining 94 percent for the year. It rose 6.68 percent in 2011 and was already up 8.58 percent in 2012 through March. Greylock boasts a 16 percent annualized return since inception, far outdistancing many rivals. The hedge fund now has $380 million. The rest of the firm's assets are held by two mezzanine funds that focus on Latin America and Africa.

Debt write-downs are the linchpin of a fund where the balance of the portfolio is in corporate high-yield and restructurings. Sovereign restructurings make up only 8.6 percent of Greylock's hedge fund portfolio. Once sovereign debt is restructured, it becomes sovereign high-yield, as was the case with Greece recently. That comprises 42 percent of the portfolio. The balance is in corporate high-yield and corporate restructurings. Whether it's Greece, Côte d'Ivoire or Argentina,the playbook is the same.

“Almost everything gets mispriced,” explains Koonal Gandhi, who invests in emerging-markets managers for the Kaiser Family Foundation, a Menlo Park, California, nonprofit organization with $540 million in assets. Kaiser first gave money to Greylock in 2007. Because of the importance of sovereign restructurings to the development Humes’s “dream team”: (top to bottom) Juan Pedro Moreno is director of research, and Diego Ferro and Ajata Mediratta are partners and portfolio managers of emerging markets, Humes sees the future of his market niche differently from many of his peers. “I bet you in five years the term ‘emerging markets’ will disappear,” suggests Humes, who points out that before that phrase existed, terms like “third-world debt” followed by “LDC debt” (for lesser-developed country debt) held sway. Now things are changing again.“What do you see out there now?” he asks. “A bunch of European countries with debt-to-GDP ratios way out of whack to any so-called developing country.”



THE 47-YEAR-OLD HUMES MIGHT be called the accidental hedge fund manager. He strikes a boyish, insouciant tone as he readily admits he had no interest in Wall Street as a youth. With all its traffic and people, “New York gave me a headache,” he says. Wearing a suit and working in finance was not appealing to him either.

The son of a U.S. academic and a Dutch mother, Humes was three when the family moved to Nigeria, where his father taught local government at the University of Ife for three years. Humes was just six when they left for Morocco.

To this day, Humes says his first love is Africa despite admitting that cynicism develops from seeing how difficult it is for change to take hold. But, he says, “I’m not judgmental about things, and I don’t have an American-centric point of view and assume the way we do things is better.”That may well be the key to his success.

The family moved to Canada in 1973, when Humes was in the third grade. Then his parents split up, and Humes moved again. He was a teenager when he joined his mother and stepfather (another academic) to live in Latin America. The first stop was Chile, where his leftist stepfather’s work as an opposition research analyst put the family under surveillance.

Humes was living in Mexico when that nation defaulted on its debt in 1982. He was shocked by the change in day-to-day life. “You drive a beat-up old VW bug, and all of a sudden you have to learn to repair the car because you can’t get money out of the bank,” he recalls.

After living in Mexico for two years, Humes returned to the U.S., where he had been born, to attend private school, then Williams College. Humes admits he was not that serious about his academic studies; playing Frisbee and wearing African garb were more to his liking. He majored in English literature and Spanish.

Although Humes had no math background, a postgraduation stint waiting tables and working construction in Williamstown,Massachusetts, led him to think finance might not be so bad after all. So he threw all his belongings in the back of his 1968 Saab and drove to New York to stay on the floor of a college friend, Jan van Eck, a son of John van Eck, the founder of the eponymous emerging markets-oriented mutual fund business where Humes would later work. He landed his first job at Manufacturers Hanover in 1988,thanks largely to his Spanish-language skills. He was suddenly immersed in the high-finance world of sovereign restructurings and looking at the Mexican default from the point of view of the banks that were trying to avoid collapse by restructuring the loans they'd made to Mexico.

A series of positions in Wall Street firms, including Lehman Brothers, eventually led Humes to Van Eck Global, where he worked on Latin American transactions that in a roundabout way spawned Greylock. He had been putting together debt-for-development conversions with a Scottish priest living in Ecuador, Colin Mac-Innes, who introduced him to the Catholic archbishop in Ecuador,Monsignor Antonio Arregui Yarza. Humes worked on deals that helped invest $2.3 million in clean water for a small town outside the Ecuadorean capital of Quito and $28 million to feed orphans of the Catholic Church. He then did a currency swap for Arregui, who was holding sucre-denominated Ecuadorean notes, that gave the Church $25 million. "I called the archbishop and asked, 'Where do I send the money?' He said, 'You're in finance, you invest it.' " Greylock was born, with the Ecuadorean archbishop as its seed investor.

Rodger Lawson, Humes's boss at Van Eck who later became president of Fidelity Investments, suggested the hedge fund and today says there's one particular characteristic that sets Humes apart from many of the people he has managed over the years: "He doesn't seem to have a ridiculous ego."

Humes's easygoing personality may seem at odds with his chosen profession. Distressed investing comes in for a fair amount of criticism, especially in the sovereign area, where hedge funds run by Paul Singer's Elliott Management have earned a reputation for playing hardball after taking countries to court to demand full payment on their defaulted debt.

That's not Humes's style. "Our value is being part of the solution," he says. "We want to be involved in these countries. If you can alleviate the debt load, it opens up more opportunities."

Although distressed-debt investors are often called vultures, Humes bristles at the term. "It's such negative imagery," he says. "The backdrop to what I'm supposed to do is take people's money and get them a good return. If I've got a guy who's willing to sell me something at a price for whatever reason, and I think I can take it and get a good return, why shouldn't I do it?"

Humes says he wouldn't go as far as some of the vultures, who've sued to get paid the face value of their bonds. Elliott, for example, has been engaged in a lengthy legal battle with Argentina since refusing to engage in that country's 2005 restructuring, while firms like Greylock who agreed to Argentina's terms have ended up profiting handsomely. Argentina was by all accounts an intransigent negotiator after defaulting on its sovereign debt in 2002 of $93 billion, the largest in history before Greece.

"Argentina was impossible to talk to," says Humes. "We reached out to them every way we could to see if we could find a middle ground."

The original exchange offer was low, between 26 and 30 cents on the dollar, but Argentina sweetened the deal with GDP warrants. The annual payments on the warrants were triggered when economic growth rose above 3 percent and the inflation-adjusted value of the country's GDP was above the base-case scenario laid out in the warrants, which began to pay off in 2009. Since then, Greylock's Argentine warrants have gained 398 percent.

Humes also played an unusual role in Nicaragua's private sector debt restructuring, starting in 2007. In that case, the creditors committee was comprised entirely of hedge funds, some of which had already sued Nicaragua and won. But Humes, who was on the committee, was able to convince the hedge funds to drop their cases and agree to a 95 percent reduction of principal, concluding the restructuring in 2009.

At the time, the World Bank had just established a debt-reduction program for highly indebted poor countries (known as HIPC), with Nicaragua qualifying for additional funding as a result. “The World Bank was extremely happy about the structure and about the constructive approach displayed by all the hedge funds,” says one of the individuals involved in the deal. “Without Hans, I doubt very much it would have been able to happen.”

Latin America still accounts for the biggest portion of the portfolio, split between Argentina and Venezuela. Venezuela has been shunned by the capital markets because of what Humes calls “the Chávez effect,” in reference to President Hugo Chávez’s extreme left politics. That said, Venezuelan debt is Greylock’s biggest winner so far in 2012, gaining 23 percent through March. The country sits on more oil reserves than Saudi Arabia, has a relatively low debt-to-GDP ratio of 25 percent, and has plenty of resources to service its debt in the medium term even with its rising borrowing costs.

Greylock’s move into the Middle East impressed Jack Killion, managing general partner of fund of funds Eagle Rock Partners, which invested in Greylock in 2002. Says Killion of Humes: “His whole shift to investing in the Middle East is intriguing, entrepreneurial and smart when other people would be spooked. When things were rough over there with Egypt, he said, ‘That just makes the opportunities better. We can buy things cheaper.’ ”

This year Greylock’s second-best performer is MBPS Finance, the finance arm of MB Petroleum Services, an Oman-based oil field services company. It gained 16 percent through March.

ON AN EARLY MARCH AFTERNOON, Hans Humes could be found in his office, still dressed in his biking gear — a not uncommon sight. It had already been a long day. He started it off with a 3:45 a.m. international call with the Greek creditors steering committee to put the final touches on a press release heralding the details of the country’s long-awaited debt restructuring.

The early-morning call didn’t change Humes’s routine. As he does just about every weekday he is in New York, he biked from his apartment in Park Slope, Brooklyn, to his office in midtown Manhattan after dropping off his eight-year-old daughter at school. As a result, he’s still wearing black bike pants and an orange Côte d’Ivoire soccer T-shirt, which leads him into a riff on the history of the country. Humes is the first to admit that his background is unusual, but he puts a positive spin on it. “You can take a skill set that doesn’t look immediately applicable to finance, and it can work,” he says. “Compared to our competitors, we do better.”

The financial crisis of 2008 threw a lot of talent onto the Street, and Humes was able to boost Greylock’s expertise by bringing on two seasoned emerging-market players as equity partners, who now share 49 percent of the ownership. Humes now has what he calls his“dream team.” That means Humes can focus on the parts of the business he most enjoys — like sovereign workouts, which he considers“fun.”

The dream team includes Diego Ferro, whom Humes first hired in 1993 while at Lehman and who had gone on to become co-head of Latin America fixed-income trading and structuring at Goldman Sachs. An Argentinian, Ferro splits his time between New York and Buenos Aires, where Greylock has an office. The other partner is Ajata (AJ) Mediratta, whom Humes has known since their days together at Williams in the 1980s. Mediratta was head of Bear Stearns International Debt Capital Markets Group prior to joining Greylock.

Humes had been talking to the two men about joining him for more than a decade, but was able to get them to come on board only as a result of the crisis. Another key employee is director of research Juan Pedro (JP) Moreno, who has done stints at Lehman, Goldman Sachs and Merrill Lynch. Moreno joined in 2008.

The New York team is relatively small. Including Humes, eight men sit at computers in a small trading room with a flat-screen TV at one end and a map of the globe covering the wall. It's a mini United Nations. Others in the room include associate Andres Correa from Ecuador; director Corey Modeste from Grenada; director Andrey Popel, a Ukrainian who oversees Eastern Europe; and Anthony Bitz,whom Humes calls "the token gringo." Greylock, which has a total team of 18 people, also has offices in Ghana and Singapore and a representative office in Buenos Aires.

Greylock tends to take long-term positions and now has 30 in its portfolio, although 18 make up more than 80 percent of the net asset value of the fund. "They have a very clear conviction when they go into a position, and it may be the nonconsensus trade in the market,but the way they make money is by rolling up their sleeves and getting the work done," says Gandhi.

In the past two years, when Greylock gained 20.51 percent and 6.68 percent, respectively, most of the gains came from the corporate side. The top performer was Amsteel, a Malaysian corporate restructuring that gained 132 percent, followed by a 62 percent gain of Iraq Paris Club sovereign debt, lent by the world's biggest economies for such issues as war funding and debt relief. In Africa the FinanceBank of Zambia jumped 29 percent. Two other sovereign debt names that did well were Republic of Congo, which rose 18 percent, and Côte d'Ivoire, which gained 12 percent.

In addition to its flagship fund, Greylock's Africa Opportunity Fund has $70 million, and its Latin America Opportunity Fund has $150 million. These are mezzanine funds with seven-year lockups that get a third of their investment capital from the Overseas Private Investment Corp.

"I'm more in love with Africa," admits Humes, citing his childhood and the warmth and kindness of the people there. He points out that West Africa grows "tons and tons" of tomatoes but ships them to Indonesia and China, where they are turned into tomato paste and then shipped back to Africa to create tomato-based products. Why not build factories in Africa that can make the tomato paste? "This is one place where private enterprise and the public good are incredibly aligned," he says.

Still, Humes is the first to admit he's not simply a do-gooder. Since Greylock bought Greek bonds at about 20 cents to the dollar last fall,it will likely profit despite the draconian terms of the exchange offer. If you ask Humes why an emerging-market hand like him would be involved in Greece, his answer is simply: "Why wouldn't I be? The trajectory of the whole thing was an emerging-markets process.

In Greece, as elsewhere, the country is most concerned about cash flow, banks want as much principal protection as possible, while other creditors are looking at the net present value of the debt. Humes says that finding the middle ground can often be accomplished with a shorter-duration bond with a higher coupon on the back end.

Humes's role in the Greek default talks gave the hedge fund manager renewed international recognition when he appeared in the media blitz about Greece's restructuring on such outlets as NPR and Bloomberg. Greylock's small size makes Humes's stature in international circles even more remarkable. "It's because of his personality," says Kaiser's Gandhi. "People just trust him."

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