

PRIVATE EQUITY INTERNATIONAL

PEI 300

Guess who's back on top?

THE ORACLE SPEAKS

David Rubenstein on the future of private capital

SECONDARIES ROUNDTABLE

Keeping LPs front and centre

WHY PRIVATE EQUITY?

The asset allocation special

PLUS:

the PEI Q1 Fundraising Report; IRRs vs money multiples; introducing the CEPRES model portfolio; Texas TRS goes Canadian; inside the PE retail blowouts; and much more...



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Senior Editor, Private Equity
Toby Mitchenall
Tel: +44 207 566 5447
toby.m@peimedia.com

Americas Editor, Private Equity
Marine Cole
Tel: +1 212 633 1455
marine.c@peimedia.com

Editor, Private Equity International
Isobel Markham
Tel: +1 646 380 6194
isobel.m@peimedia.com

Asia Reporter
Carmela Mendoza
Tel: +852 2153 3148
carmela.m@peimedia.com

Reporters
Rod James
Tel: +44 207 566 5453
rod.j@peimedia.com

Alex Lynn
Tel: +44 207 566 5463
alex.l@peimedia.com

Contributors
Dominic Diongson
Andrew Hedlund
Adam Le
Victoria Robson

Senior Production Editor
Mike Simlett
Tel: +44 20 7566 5457
mike.s@peimedia.com

Production and Design Manager
Miriam Vysna
Tel: +44 20 7566 5433
miriam.v@peimedia.com

Head of Marketing Solutions,
Private Equity Group
Alistair Robinson
Tel: +44 20 7566 5454
alistair.r@peimedia.com

Subscriptions and Reprints
Andre Anderson, +1 646 545 6296
andre.a@peimedia.com

Jack Wharton, +44 203 8627492
jack.w@peimedia.com

Sigi Fung, +852 2153 3140
sigi.f@peimedia.com

For subscription information visit
www.privateequityinternational.com.

Director, Digital Product Development
Amanda Janis
Tel: +44 207 566 4270
amanda.j@peimedia.com

Editorial Director
Philip Borel
Tel: +44 207 566 5434
philip.b@peimedia.com

Director of Research & Analytics
Dan Gunner, dan.g@peimedia.com

Publishing Director
Paul McLean, paul.m@peimedia.com

Chief Executive
Tim McLoughlin, tim.m@peimedia.com

Managing Director – Americas
Colm Gilmore, colm.g@peimedia.com

Managing Director – Asia
Chris Petersen, chris.p@peimedia.com

For more on this month's cover art, see p. 67

Riding high



ISOBEL
MARKHAM
EDITOR'S
LETTER

The *PEI 300* is, without a doubt, *Private Equity International's* most hotly anticipated issue of the year, and the one people return to the most after publication. I'm sure this iteration will be no exception.

The 2018 ranking is record-breaking. Between them, the 300 firms that make up our ranking have a five-year fundraising total of almost \$1.5 trillion, with the top 10 alone accounting for almost \$400 billion.

This is cause for celebration. Limited partner appetite for the asset class clearly isn't abating. As David Rubenstein tells us on p. 32, when you see enormous amounts of money going into the asset class, you have to conclude investors believe it represents a good opportunity.

But our blockbuster *PEI 300* also comes in a month in which private equity was dealt a significant blow. Norway's finance ministry decided to block its sovereign wealth fund – the largest in the world – from investing in private equity, partly due to concerns over transparency on fees.

And Norway isn't the only one with apprehensions. Last month we shared views from an industry conference in Edinburgh at which pension fund managers, trustees and advisors cited hidden fees, liquidity issues and a lack of transparency over financial engineering at portfolio companies as reasons why they were steering clear. This month, Sarah Smart of pensions administrator TPT Retirement Solutions looks at some of those concerns in detail (p. 10).

So what does all this mean? Well, that the industry can't take anything for granted. Yes,

historically it's been successful, but it needs to work hard to avoid becoming a victim of that success. The signs are already there that this is starting to happen.

Sandra Robertson, chief investment officer and chief executive of the UK's £3 billion (\$4.3 billion; €3.4 billion) Oxford University Endowment Management, which manages assets on behalf of 32 investors, including the University of Oxford, 25 colleges and six associated charitable trusts, echoed many LPs this month when she drew attention to the challenges of accessing top-quartile managers who have the luxury of selecting their LP base and limiting their fund size.

Speaking at a panel discussion during the Fiduciary Investors Symposium at the University of Oxford, Robertson also questioned LPs allocating to the asset class on the basis of past returns, making the assumption these will continue. As our analysis of the history of our ranking, from the earliest days of the *PEI 50* in 2007 shows (see p. 46), past performance is no guarantee of future success.

There will no doubt be some that say Norway's decision – and the reticence of some other investors to dive into the asset class – is neither here nor there. After all, there's clearly more than enough LP capital to go around. But if the industry is to grow as much in the next decade as it's done in the last, it must take heed of the concerns of potential future LPs. After all, what are private equity funds without their investors?

Enjoy the issue

Isobel Markham

e: isobel.m@peimedia.com

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NEW YORK
130 West 42nd Street, Suite 450
New York, NY 10036
+1 212 633 1919
Fax: +1 212 633 2904

LONDON
100 Wood Street
London EC2V 7AN
+44 20 7566 5444
Fax: +44 20 7566 5455

HONG KONG
19F On Hing Building
1 On Hing Terrace
Central, Hong Kong
+852 2153 3240
Fax: +852 2110 0372

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Building Value
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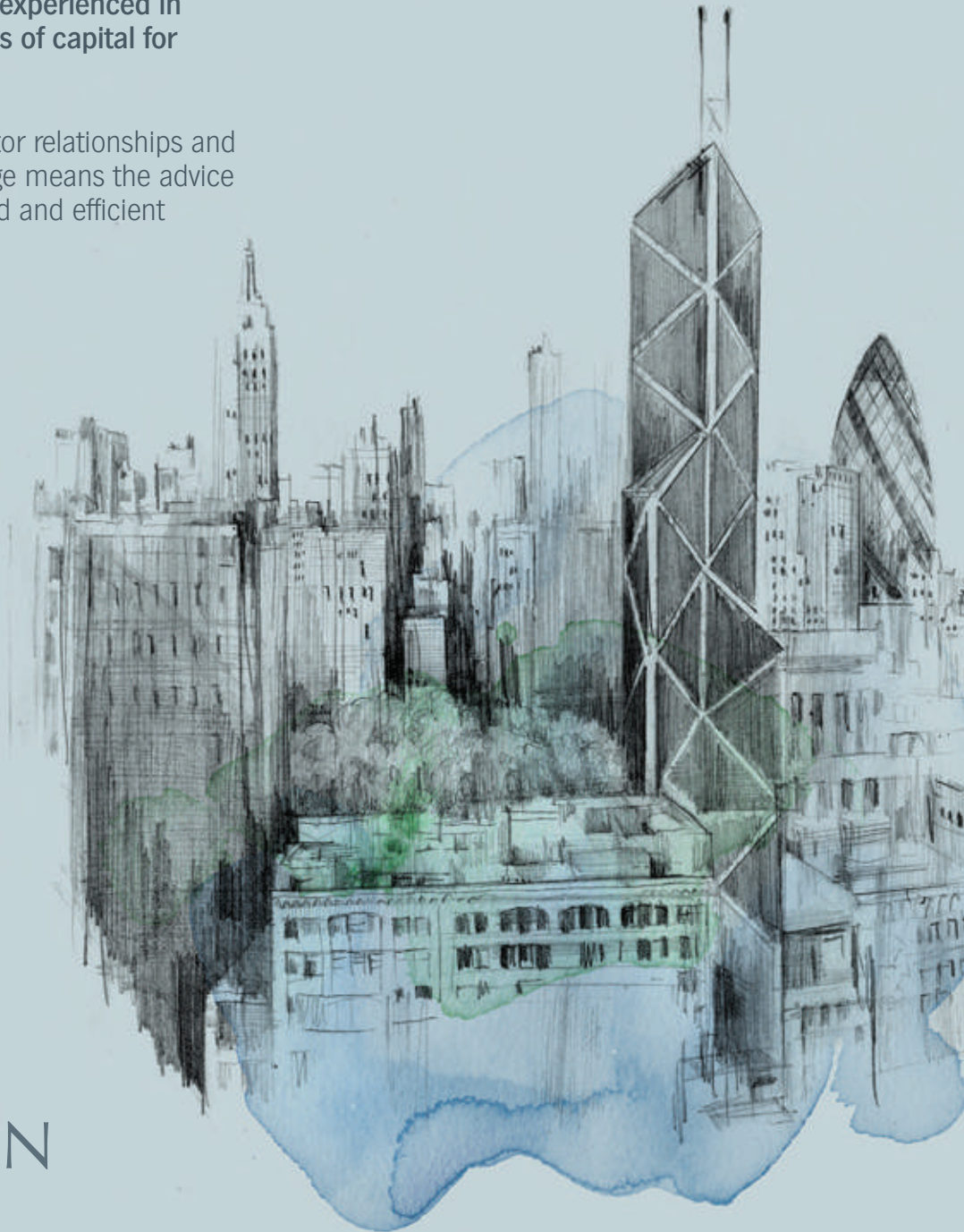
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SECONDARIES

Inside a giant GP-led

What's it like being the manager at the centre of what could be the largest ever GP-led secondaries transaction? **Toby Mitchenall** asks Nordic Capital managing partner Kristoffer Melinder

The ink is still drying on what some are calling the world's largest GP-led secondaries transaction.


This emerging type of deal comes in many different hues, but the common thread is that the manager – in the latest case Nordic Capital – instigates a process on an ageing fund to allow investors to walk away with a distribution or remain invested in some way.

In this instance the fund in question was Nordic's 2008-vintage flagship fund. Nine unlisted assets held in Nordic Capital VII, which had a net asset value of €2.5 billion as of

30 September, were moved into a continuation vehicle named Nordic Capital CV1. Campbell Lutyens advised on the deal and Collier Capital and Goldman Sachs were on hand to buy the interests of the investors that wanted to cash out (at a premium of 11 percent). The pair ended up buying around €1.5 billion of NAV.

The deal, which officially closed in mid-April, is the largest such transaction to close and it represents another step forward in the development of this corner of the private equity market.


€1.5bn
 NAV traded
 in the deal


11%
 Premium paid
 on September
 2017 NAV

Private Equity International caught up with managing partner Kristoffer Melinder hours after the deal closed to get the GP's view on a GP-led.

Q How should we view the five-year continuation vehicle? Is it structured like a mini private equity fund?

No, it's a vehicle with nine companies which have access to additional capital. I don't think technically you would call it a fund, as it is not open to making new platform investments. It is open to support these businesses with capital. »



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Q How does the transaction make more capital available to the companies?

There is a primary component [to the deal]. In the old fund we didn't have access to further drawdowns of primary capital. Once a fund's commitment period is terminated you can't go back and ask LPs for more money, unless it is 100 percent consent, which you don't get.

Q How much more capital is available?

We are not disclosing that.

Q Did the transaction push the fund into carry?

We don't disclose fund returns, but of course the premium [paid] has an impact on returns.

Q Would it not be simpler just to seek fund extensions to give yourself more time?

Sometimes limited partners and general partners talk about assets. We talk about companies. Companies have management teams and employees who have strategic plans. They ask us: "If we go ahead with transformative M&A, buy-and-build strategies, do you, Nordic, have the time and capital to support such a strategy?" We now have five years, and we have sufficient capital to support the growth of these businesses.

Q These can be divisive processes and you can't please all the LPs all the time. Were you concerned that you would alienate some investors?

No. I think people understand that this is done in order to maximise value for all participants. It was

about generating a significant additional financial gain for all investors, whether they are participating or whether they elect to sell at a very high premium.

I would say that ensuring that we got the best possible price was a central component to that, and if we hadn't agreed good pricing, it would probably have been more difficult to get support from all the LPs in the process.

Q You were careful to disassociate this transaction from the raising of your latest primary fund. Are Coller or Goldman limited partners in the new fund?

US securities regulation prevents us from commenting on any fundraising efforts that are ongoing. What you have seen in the press release is that Coller has been a secondary investor in many Nordic Capital funds, as has Goldman, which I think has been helpful. We have longstanding relationships with them. Some others of these [deals] have been stapled transactions. There is no staple in this transaction.

Q Did LPs come to you directly with concerns about the process?

I believe that when it came to the actual decision to roll or not, some LPs felt that it was a short response time. It was a standard response time, but for a complex transaction it put a strain on LP resources to make a decision and it came at a busy time for some investors.

For us, this was one of the key learnings around it. When you do things that are very complex, you need to respect that LPs need a significant amount of time. ■



When you do things that are very complex, you need to respect that LPs need a significant amount of time

Kristoffer Melinder

MULTIPLES

The month in numbers

75.4%



Male staff's bonuses are, on average, this much higher than their female colleagues' at Blackstone

€15.6bn



Deployed in the EMEA region in Q1, 56% lower than the same period in 2017 (S&P Global Market Intelligence)

61



Healthcare-focused buyouts in the Asia-Pacific region in 2017 (Bain & Company)

\$4.9bn



Amount gathered by Dyal Capital Partners for its fourth GP-interest fund, which is on track to close this summer

23%



Proportion of secondaries buyers that have lowered their return targets over the past year (UBS 2018 Secondary Market Survey and Outlook)

\$890m



Size of rejected takeover bid from toy manufacturer Isaac Larian for over 200 US and all Canadian Toys "R" Us stores

74%



Percentage of PE executives who struggle to assess the effect tech could have on portfolio company value (EY Global Private Equity Divestment Study)



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FUNDRAISING

Aussie cools

Archer Capital is the latest Australian private equity firm to halt fundraising. **Carmela Mendoza** reports on the institutional shift that has left the country with fewer GPs

Australian GP Archer Capital will not return to market for a sixth fund, instead focusing on maximising the performance of its existing investments, it told investors in late April.

Founding partner Peter Wiggs is also set to retire in the next few years once his commitments to Archer's existing funds are complete, *Private Equity International* understands. The latest fund, the 2011 A\$1.5 billion (\$1.2 billion; €940 million) Archer Capital Fund 5, will be his last at the firm.

One long-time investor tells *PEI* the firm had frozen fundraising last year and the latest step simply confirms it is no longer a "temporary suspension".

Archer, a longstanding fixture in Australian PE, was reportedly set to raise up to A\$1.5 billion for its sixth fund early last year. Its last fund, the 2011-vintage, A\$1.5 billion Archer Capital Fund 5, is among the 10

largest funds in the country, according to *PEI* data. It counts the British Columbia Investment Management Corporation, Alaska Permanent Fund, Alaska Retirement Management Board and ATP Private Equity Partners among its investors.

A source with knowledge of the firm countered reports that Archer is closing up shop, saying it is instead "focusing 100 percent of its efforts on maximising value creation opportunities within its existing portfolio of eight companies".

The source added there is no change to each portfolio company's strategy and the announcement was only made to its LPs and investors to clear up speculation about Archer's fundraising plans and Wiggs's decision to retire. The firm's current portfolio includes two assets in the 2007-vintage A\$1.36 billion Fund 4 (Supercars and Craveable Brands) and six in Fund 5, *PEI* understands.

Archer declined to comment or provide details on fund performance. One of the firm's investors says the firm's funds show "mediocre" performance, although he adds this is not necessarily a problem. "As fund sizes get too large, you'd naturally expect a tail off in returns."

OPEN LANDSCAPE

While industry-watchers are naturally interested in Archer's future plans, this is as much a story about the changing LP-GP landscape as it is about one firm. Buyout managers in the country have been slowly closing their doors for years because fundraising is getting harder.

In the words of one local investor: "When the Australian LP base fell away it got harder to benchmark themselves against a global manager universe. Often today LPs are looking for specialised managers, or managers where they get fee-free co-investments, and those two aspects have not been available within the Australian market until recently."

GPs that have closed shop include CHAMP Ventures and Ironbridge Capital.

"It's the latest in the ongoing evolution of the Australia GP landscape, given that superannuation funds are increasing direct investments," Wen Tan, co-head of private equity for Asia Pacific at Aberdeen Standard Investments says.

"This is an indicator of future trends, where you will have established GPs being disintermediated from the private equity landscape."

GPs further afield should take note. ■

CAPITAL OF AUSTRALIA

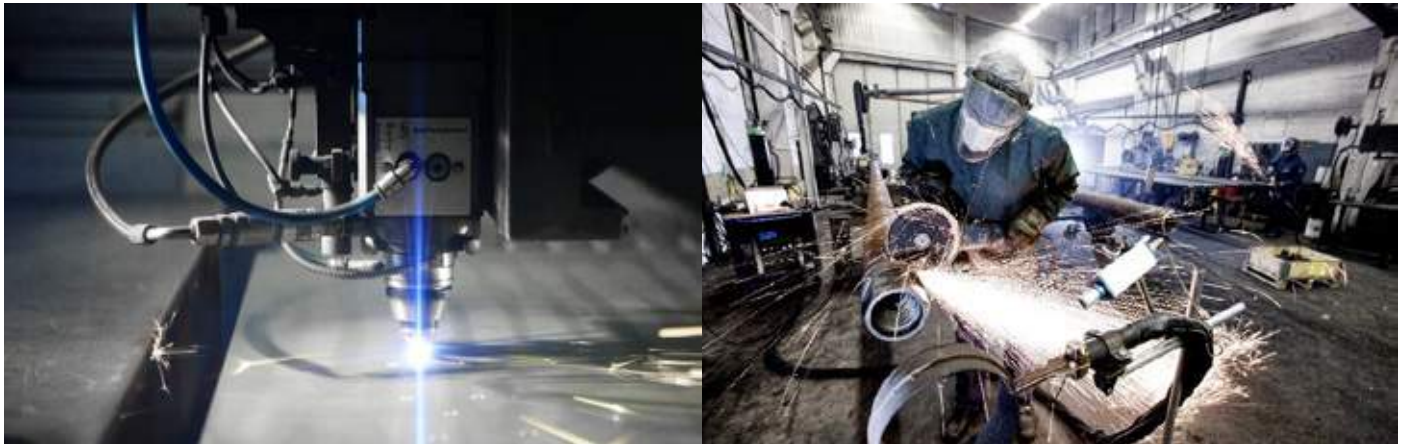
The 10 largest funds based in the country to have closed since 2008

FUND	FIRM	\$M	VINTAGE
Pacific Equity Partners IV	Pacific Equity Partners	3,332	2008
Archer Capital Fund 5	Archer Capital	1,565	2011
Pacific Equity Partners V	Pacific Equity Partners	1,537	2014
CHAMP III Fund	CHAMP Private Equity	1,376	2009
MF Venture Private Investments Infinity	Medici Firma Venture	950	2016
Quadrant Private Equity No. 6	Quadrant Private Equity	880	2017
EMR Capital Resources Fund II	EMR Capital	860	2016
Quadrant Private Equity No. 4	Quadrant Private Equity	764	2014
Macquarie Korea Opportunities Fund II	Macquarie Group	730	2010
Quadrant Private Equity No. 5	Quadrant Private Equity	728	2016

Source: *Private Equity International*

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INSTITUTIONAL INVESTORS

Is private equity running on a 'fad cycle'?

UK public pensions have not been seduced into private equity's growth as successfully as some other investors. Sarah Smart, chairwoman of pensions administrator TPT Retirement Solutions, suggests some reasons why. By **Rod James**

Few at the Pensions and Lifetime Savings Association conference in Edinburgh in March saw the private equity asset class as attractive.

Sarah Smart is the chairwoman of TPT Retirement Solutions, which manages around £9 billion (\$12.8 billion; €10.3 billion) of assets on behalf of UK pension schemes. She explains the concerns for the country's retirement plans.

Q Is it beneficial for pensions to invest in PE?

There are some things which work against it. The concept of commitment is difficult for pension fund

investors because a bulk of the work happens before you make the investment. There is a natural resistance among investors to paying for something before you've actually invested your money, particularly if that period takes a long time.

And generally, the fee levels are difficult for many. PE still has a bad reputation from the early 2000s, of making money from offering geared exposure to the equity market while taking huge fees off the top.

Q Are PE funds sufficiently transparent when it comes to fees?

I think fees need to be a lot more transparent. Investors should pay commitment fees but should pay less when the investment is made and more depending on what the manager does. They should really understand whether growth [in portfolio companies] is being delivered from the manager's direction or by other means.

My personal view is that no performance fees should be paid until all the fund investments have been exited, when you can see what the whole return to the investor is. But I know that's difficult because the market is [designed] for people to get bonuses every year and how do you pay for that?

The disintermediation between managers and investors in the UK has been very unhelpful and I find consultants' models to be generally very unhelpful. There should be a much more intelligent conversation between fund managers and private equity investors as to what exactly they are doing, what it costs them and therefore what the fees are.

It makes winning business more costly and time-consuming but I think there's a danger that private equity just runs on a fad cycle. Investors don't really know whether managers are good or not.

Q The 89 UK local authority pension funds are being consolidated into eight schemes and consolidation is also taking place in private pensions. Is this likely to have an impact on private equity?

The hope would be that as investors consolidate they will all, largely, have their own internal teams and become much more informed buyers of the different offerings out there. I think that would be a good thing for the less vanilla offerings like private equity. I look at how much governance time we have within our organisation. We don't have the time to spend on that. ■



Edinburgh: venue for Pensions and Lifetime Savings Association conference

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RETAIL

Left on the shelf

Retail blowouts are hitting the headlines, but many of the problems date from before the global financial crisis. **Andrew Hedlund** examines the sector's ongoing challenges

Household retail names have been casualties in recent years. What once seemed a solid bet for private equity turned out to be less certain than thought, and the secular shift will require the industry to reinvent itself.

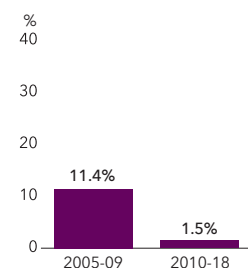
"People who bought in [did so] when retail was good cashflow, it was relatively easy to grow each year and add new locations," says Al Koch, managing director at advisory firm AlixPartners, who has helped turn around many major retailers. "That's a good way to double your money pretty quickly. What was a pretty safe investment isn't a safe investment anymore."

The acquisitions of Toys "R" Us by Bain Capital, KKR and Vornado Realty Trust and Sports Authority by Leonard Green & Partners have been two of the highest-profile busts. Perhaps uncoincidentally, both were buyouts done before the GFC, with Toys "R" Us completed in 2005 and Sports Authority in 2006.

"Before the financial crisis, private equity funds were eager to acquire retailers using leverage, in large part because the sector was expected to grow and liquidity was not a concern," says Gregory Plotko, a partner at law firm Richards Kibbe & Orbe specialising in bankruptcy. "Credit was more easily available and contained less covenants. After the crisis, we experienced a dramatic tightening of credit along with a systematic change in consumer trends and the growth of online shopping. Liquidity

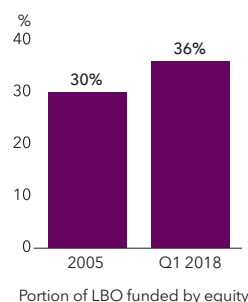
THE PRICE OF SHOPPING

Write-off rate of retail deals



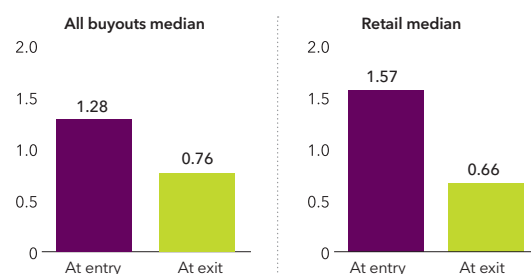
Source: CEPRES

Equity contributions in LBOs



Source: Thomson Reuters

Debt-to-equity (2007-17 investments)



Source: CEPRES

has become a major concern."

Consumer retail deals from 2005-09 have a write-off rate of 11.4 percent, according to analytics firm CEPRES. In other words, private equity firms lost all their money on over one in 10 retail deals during that period. The data span 46 private equity funds buying 70 companies backed by 160 financing rounds. From 2010 to present, the write-off rate based on 79 funds buying 130 retailers is only 1.5 percent. "Revenue growth was not great on those

retail companies bought pre-GFC," says CEPRES president Christopher Godfrey. "It took on average seven years to break even on the deals. They have benefitted from recent [valuations]. The IRRs [for the retail deals] in that period were bad due to the longer holding periods and the write-offs, but the multiples overall were decent."

The Toys "R" Us buyout is an example of how different capital structures today can look. The deal, valued at \$6.6 billion in 2005, was financed with only \$1.3 billion of equity, according to Toys "R" Us's 2005 annual report. Gordon Brothers was also an investor on the deal.

Court filings indicate this to be a factor in the toy store's downfall: "Toys 'R' Us ... has been operating for more than a decade with significant leverage, necessitating the use of substantial amounts of cash each year [approximately \$400 million] to service the more than \$5 billion of funded indebtedness," read a declaration by board chairman and chief executive David Brandon.

Bain, Gordon Brothers, KKR and Vornado could not be reached for comment on the capital structure.

Equity investments have increased in recent years. In 2005, equity cheques in large, broadly syndicated buyouts were just under 30 percent, according to data from Thomson Reuters' *Leveraged Loan Monthly*. In Q1 2018, equity contributions were 36 percent. Of the 24 bankruptcy >>

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London
+44 20 7786 9000

Katherine Ashton
Geoffrey Kittredge

New York
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David J. Schwartz

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» filings by retailers in 2016 and in the first three quarters of 2017, two-thirds were backed by private equity shops, according to data from financial trade publication *The Deal Pipeline* cited in an article in the *American Bankruptcy Institute Journal*. Of those 16, six were done in the 2005-08 timeframe.

Portions of this stem from private equity's appetite for retail pre-GFC. Almost 40 percent of retail LBOs over the last decade occurred in 2007-08, when the growth prospects of the industry looked a little rosier, according to *The Deal Pipeline* data.

"Many of these companies were operating relatively well and expected to grow into their capital structure over time," says David Silverman, a senior managing director covering retail at Fitch Ratings.

BROKEN MODEL

Fickle customer tastes, the growth of Amazon and niche online retailers and over-expansion have turned out to be real challenges, maybe existential threats, for retailers. Those factors don't discriminate by balance sheet or whether a company is sponsor-backed.

Private equity-backed retail failures may dominate the headlines, but the underlying trend is widespread, and the retail model will need to change. "I don't know that private equity backing has that much to do with it other than what's your leverage," says AlixPartners' Koch, who served as the chief financial officer at K-Mart when it reorganised in bankruptcy in 2002.

"It gave me a unique insight into what it was like to compete against Wal-Mart," he says. "In K-Mart's case, our 'Amazon' was really Wal-Mart. Sales dropped by 25 percent, and



they never came back. The history of that time was sales would drop and they'd come back."

We've seen portions of this movie before. An April 2008 article ran in *The New York Times* with the headline, "Retailing Chains Caught in a Wave of Bankruptcies". At the time, Linens N Things, owned by Apollo Global Management, was on the rocks and later sought court protection, and electronics seller Sharper Image had just filed for bankruptcy.

The GFC claimed many different retail victims, including the department store chain Mervyn's, which was backed by Sun Capital and Cerberus Capital Management, and bookstore chain Borders, which was a publicly traded company.

But this time it's worse. Retail sector defaults stood at 8.2 percent in 2017, up from 5.7 percent in 2009. There is little reason to believe this year will be better. Retailers from Sycamore Partners-backed Nine West Holdings to Apollo-backed Claire's Stores are among the spate of companies seeking court protection that, together, hold billions of dollars in debt.

Private equity-backed retailers are

Toys Were Us: the failed toy chain had been highly leveraged

not alone in taking on debt, a fund manager noted, pointing out that some retailers take on asset-based loans. The sponsor-backed companies are getting an "undue amount of attention", this person said.

"For certain stronger brands or segments of the retail industry, this will be a point where balance sheets and operations will be restructured, allowing the company to right-size its operations, adapt its footprint and reduce the amount of funded debt they are holding," Plotko says.

Though it closed hundreds of stores, Gymboree, a \$1.8 billion Bain 2010 leveraged buyout, successfully emerged from bankruptcy owned by myriad distressed debt firms, including Apollo, Brigade Capital Management, Marblegate, Nomura Securities, Oppenheimerfunds, Tricadia Capital Management and Searchlight.

Other retailers both with and without private equity sponsors have emerged from bankruptcy. It's worth noting, though, successfully completing a Chapter 11 case does not guarantee a Cinderella story. Multiple retailers have gone through that process a second time, colloquially known as a Chapter 22 filing. ■



After the crisis, we experienced a dramatic tightening of credit along with a systematic change in consumer trends and the growth of online shopping

Gregory Plotko

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VENTURE CAPITAL

Capital gains

Corporate venture capital has become a force to be reckoned with, writes **Marine Cole**

Investment by corporate venture capital arms has more than tripled in the last five years.

In 2017, they invested more than \$30 billion, up from \$25 billion in 2016, according to data provider CB Insights. Before 2014, the amount invested per year always stood below \$10 billion.

The sector has historically been seen as focusing on making a quick buck, rather than finding emerging technologies. The exception was traditional tech companies such as Intel, which has had a VC arm since the early 1990s. But over the last decade the focus has evolved. The big tech corporations are still the biggest, but companies in other areas such as food, retail and entertainment are launching venture capital arms, says Joe Marks, a managing director at Capital Dynamics in San Francisco.

Bryan Pearce, a global entrepreneurship and start-up leader at EY,



The real driver this time around is getting external innovation

Bryan Pearce

Sesame Street: today's return is brought to you by the letters "V" and "C"

agrees: "The real driver this time around is getting external innovation. In the last couple of cycles, some were doing it for that reason, but many were doing it because they thought it was a nice get-rich-quick scheme from a financial return on investment perspective."

There is still a heavy concentration of tech firms in the top 20 corporate VC investors, but the growth has come from corporations that were not traditionally focused on technology.

From Sesame Workshop, which produces educational children's TV series *Sesame Street*, to meat and protein company Tyson Foods, it's hard to find a company that hasn't set up a venture arm in the past few years.

TECH INFLUENCE

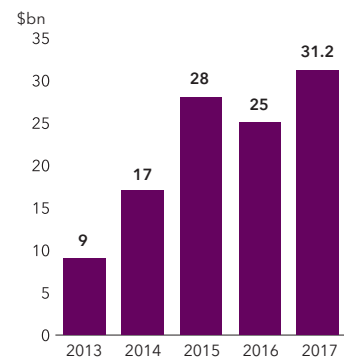
Since the start of 2018, confectionery and pet food maker Mars has started a \$100 million fund focused solely on backing pet-care products, tech and services, while the world's largest automaker Renault-Nissan-Mitsubishi has launched a \$1 billion fund.

"What we are seeing is that because of the industry convergence that's happening – technology and business models that are found in the tech world are now coming to all industries – you see a variety of other businesses that are not traditional tech firms that are trying to access that," Pearce says.

Mainstream venture capitalists are beginning to realise the benefits corporates provide. Since they often

ON THE RISE

Annual investment by corporate VC has boomed



Source: CB Insights

take minority investments, corporate VCs had been seen as only supplying money.

Corporate VCs are now much more hands on – although still not taking seats on boards. They can become a start-up's first customer and help with the commercialisation of a product, which benefits regular VCs.

While Marks sees corporate VC investing as cyclical, reaching a high at the top of the economic cycle, Pearce sees a structural change as an increasingly broad pool of corporations sees the benefits of launching investment arms.

"I don't think innovation is going to go away anytime soon, that's why I think it's important to look at the drivers of this," Pearce says. "I don't see any change in the fundamental drivers. Most companies have just scratched the surface on how to use those. The trend is not going away anytime soon." ■



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REGULATION WATCH

Minding the gap

Blackstone reveals its pay by gender, the industry prepares for GDPR and the SEC turns up the heat on fee and expenses. **Dominic Diongson** reports



BLACKSTONE INITIATES GENDER PAY REPORTING

Blackstone is the first private equity firm to report its gender pay gap in line with new UK legislation.

Male workers are paid 34.9 percent more than women on a median hourly basis, wider than the UK national average hourly pay gap of 9.1 percent recorded by the country's Office for National Statistics.

Male staff bonuses are on average 75.4 percent more than those of female colleagues.

A Blackstone spokesman said “the figures are impacted by the legacy under-representation of women in higher paid investment positions in finance”, but the firm has “multiple initiatives dedicated to hiring and retaining greater numbers of women”.



GDPR: ARE YOU READY?

Time is ticking on the EU's General Data Protection Regulation, which comes into effect on 25 May.

EU-based PE firms or firms outside the EU that hold investments in the bloc need to review the way they manage and store data on employees as well as the way they hold data on investors, portfolio companies and management of portfolio companies.

Pay slip: new UK laws are highlighting gender pay gaps; GDPR is just days away; but you'll have to wait three years for carried interest

The penalties can be hefty: as much as €20 million or 4 percent of total global annual revenue, whichever is higher.

Many firms have been preparing for GDPR for as long as two years. But one cybersecurity executive at a law firm says those who aren't fully prepared shouldn't worry, adding that the 25 May deadline should be viewed as part of a long process.



HOLDING PERIOD ON CARRIED INTEREST

The new tax law in the US imposes limitations on carried interest. Investments need to be held for longer than three years to qualify as long-term capital gains.

Tax expert David Helprin says that shouldn't be a problem for private equity firms because most generally hold their investments for longer than three years.

A change in the limited partnership agreement should not be needed, says Helprin, a principal at Eisner-Amper who provides specialised tax consulting to private equity firms.

Still, Helprin says “there could be instances where the fund has early

exits or made later add-on investments that may be impacted by the new provision”.



SEC PUTS ADVISORS ON ALERT

The Securities and Exchange Commission put investment advisors on notice for improper fee and expense practices in a recent risk alert.

The Office of Compliance Inspections and Examinations observed overbilling due to incorrect valuations by advisors using a metric different from that specified in the client's advisory agreement. It also found advisors were billing clients on a monthly basis, rather than quarterly, and billing fees in advance.

Duff & Phelps said in a comment on the SEC's observations that “there is increasing evidence that the Commission is leveraging more of the deterrence tools in its arsenal to discourage misconduct” and advisors should view the risk alert as “an early warning advisory and take the opportunity to evaluate – and promptly mitigate and remediate – any material exposure” regarding fees and expenses. ■



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SECONDARIES

Be careful; these staples look sharp



TOBY MITCHENALL

THE SIDE LETTER
Industry analysis
from the senior
editor's desk

Why it can be problematic to connect a GP-led secondaries deal to a primary fundraising

“The GP has one eye on the other side of the staple – the new fund – so the pool of buyers is narrowed to those who will commit primary capital

Toby Mitchenall is the Senior Editor for private equity at PEI Media. He is responsible for and regular contributor to the private equity coverage across Private Equity International, Secondaries Investor and private funds management and is based in PEI's London office.

As Nordic Capital tiptoed its way through its general partner-led secondaries transaction, it was adamant about one thing: there was no stapled element.

Stapled secondaries – in which an investor buys stakes in an existing portfolio and commits to a new fund – are not new and needn't be controversial. However, in some respects they appear to push at the boundaries of fiduciary duty, which is why they were the subject of scrutiny by the Securities and Exchange Commission in 2015.

The timing of Nordic's transaction – driven by the 10-year life of its 2008 fund – was not without complication; it came during the marketing of the firm's ninth flagship fund.

When I spoke to managing partner Kristoffer Melinder, he was clear about the lack of a staple (see p. 4). The fundraising was as good as done as early as February this year, we understand, and separate advisors were at work on the two different projects: MVision on the fundraising and Campbell Lutyens on the GP-led.

Are Coller or Goldman, the two buyers in the secondaries transaction, among the investors lined up for Fund IX? Because of SEC rules, Melinder was unable to say.

He stopped short of criticising stapled deals when we spoke, choosing his words carefully.

“As I understand it there are many reasons why funds might contemplate doing a transaction like this. For us it was very clear: we saw tremendous value potential in the portfolio that was impossible to realise in the existing fund structure. This has enabled us to do so.”

EQT and BC Partners have both successfully run stapled secondaries processes

to push along primary fundraising efforts within the last year.

But I can't quite get comfortable with one part of these processes.

A process (an auction, typically) to acquire fund stakes from limited partners is being orchestrated by the GP, or at least an advisor selected by the GP. An auction exists to achieve the best possible deliverable price. The GP, however, has one eye on the other side of the staple – the new fund – so the pool of buyers is narrowed to those who will commit primary capital. Logic dictates this must depress the price offered to LPs.

The counterpoint to this is that the GP's fiduciary duty is to the fund, not to the investors. And if LPs are not compelled to sell, then there should be no problem. As BC Partners' outgoing investor relations head Laura Coquis said of their staple, LPs needed the “option to ignore it”.

And if LPs really want liquidity and don't like the price on the table, they can start a sale process of their own.

Yet there is a potential problem with this option: the control that the GP normally exercises over LP stake sales. Sure, if you don't like the bid tabled by the GP's chosen partner, then you are free to look elsewhere, but are you likely to do this knowing that – technically, anyway – the GP could frustrate this process? It is unlikely a GP will veto an LP's plans – this is a relationship game – but it may well come up with reasons to delay a deal in the interests of the fund.

It may be an academic concern at the moment, but it is one GPs should keep in mind. ■

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INVESTMENT STRATEGY

Looking north, going direct



MARINE COLE

LIFE LESS LIMITED
The world according to institutional investors

Adopting the Canadian investing model is not impossible for US pension plans, but it takes time to transition. Texas TRS gets this

Faced with an increasingly competitive private market place, a growing trust size and a lower return environment going forward, the Teacher Retirement System of Texas might eventually go fully Canadian, managing most of its assets internally as opposed to relying on external managers.

But in the short term TRS wants to focus on laying the ground work to transition towards a more internally-managed model. That will include pursuing certain niche strategies internally, such as focusing on emerging managers and investing in royalties. It will also boost support for its investment team, particularly in technology and operations.

Jerry Albright, chief investment officer of TRS, is asking for 120 new hires in his growth plan over the next five years, but noted it could hire fewer, according to discussions at the TRS February board meeting.

Other key initiatives to become what TRS calls a “best-in-class global investment management fund”, include having more participation on boards, making more direct real estate investments, having more innovative partnerships with external managers and more global offices among others.

Going Canadian is not an easy transition for US public pension plans, which typically have a greater oversight from their board of trustees, may be more politically influenced and don’t always have the ability to retain talent.

This is why TRS, which has \$150 billion in assets under management and plans to grow to \$200 billion in five years, could be applauded for embarking on such a transition one step at a time.

Its private investments are currently split between 20 percent directs, which TRS refers to as principal investments, and 80 percent through external managers. External managers across asset classes at

TRS cost about 98 basis points, or \$1.4 billion in fees a year. If assets continue to grow according to plan and the model remains the same, costs will rise to \$2 billion a year in five years.

Instead, in the next five years, it wants to increase directs in private markets to 30 percent, still lower than Canadian pension plans, which often have at least half of their private assets in direct investments and sometimes much more.

“That’s a stretched goal for us,” Albright said of a 50/50 split between internal and external in private markets. “Maybe five years from now we may move toward the Canadian model, but that’s not what we’re going to do now. We have to get a lot of things done before.”

MORE FLEXIBILITY

A Canadian plan like the Ontario Teachers’ Pension Plan also spends about half what TRS does on external managers across asset classes. Under the new initiatives, Albright believes external fees could go down to 72 basis points a year in five years.

To be fair, TRS has already started laying some of the groundwork. In private markets, it has forged strategic partnerships with both Apollo Global Management and KKR and has focused more on co-investments to lower fees, including the opening of a London office in November 2015 to screen more deals.

Now Albright is asking the board for more flexible authority particularly in hiring and compensation.

“We’re not here to go to a different direction,” Albright said. “We’re here to build on what we’ve done and on our success.”

Details of the new initiatives will be fully fleshed out by June. ■

e: marine.c@peimedia.com

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30%



Source: PEI

As Americas Editor for Private Equity, **Marine Cole** oversees and directs the deployment of resources across PEI Media's portfolio of private equity-focused titles in North America, including Private Equity International, private funds management and Secondaries Investor

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CHANGING STRATEGIES

Redefining direct secondaries



ADAM LE

SECOND THOUGHTS
Views from
the secondaries
market

Verdane Capital Partners' success raising in its debut buyout fund is a sign investors are willing to back new strategies from proven managers

Nordic direct secondaries firm Verdane Capital Partners closed its first buyout fund, Verdane Edda, in March, on its SKr3 billion (\$357 million; €291 million) hard-cap. The firm's move is the latest shift in a constantly evolving secondaries market.

If you're not familiar with Verdane, you should be. The firm, which opened an office in London last year to complement the four in the Nordics, has returned to market on average every two-and-a-half years since 2003 with its flagship direct secondaries vehicles. The latest – Verdane Capital IX – raced to final close in just five months and has deployed around 50 percent of its Skr 3 billion in under two years. It's clear the firm has little trouble finding attractive deals, particularly tech ones, in the “digitally savvy” Nordic region.

The firm usually acquires direct stakes via portfolio deals, but almost half the deals from its latest secondaries fund have so far been single assets and some were majority acquisitions, such as Norwegian software company Lingit.

DIRECT TO MARKET

Whereas a traditional secondaries fund invests in second-hand limited partnership stakes in funds, a direct one typically acquires equity stakes in companies themselves. This can, however, still be part of a portfolio deal. A seller with multiple assets it wants to offload, such as a venture capital fund, can sell a portfolio of stakes to a direct secondaries fund in a single transaction, such as when German VC firm Innoveas sold a portfolio of 12 stakes in early stage healthcare companies to Sobera Capital in February.

Traditional secondaries funds have also been known to get in on the direct action: last June Lexington Partners used its 2014-vintage flagship fund to acquire a

portfolio of 16 direct stakes from German media company ProSiebenSat 1 Media in a deal worth in the “mid-double digit” million figure in euros. HarbourVest Partners has also previously picked up direct stakes in companies, such as a 2016 transaction in which it acquired interests in at least four companies from UK buyout firm Bridgepoint.

Verdane has now evolved that direct model. According to managing partner Bjarne Lie, the firm decided to launch the buyout fund after realising there was a hole in the market neither its direct secondaries vehicles nor international tech-focused buyout firms could serve. With Edda – named after a piece of Norse literature – the firm can invest up to €50 million per company, more than triple the €15 million limit of its direct secondaries vehicles.

Verdane isn't the only direct secondaries specialist buying majority stakes in single companies. Hong Kong's NewQuest Capital Partners acquired 100 percent of back-office outsourcing firm Integreon in 2016 using its third direct secondaries fund and Vision Capital Partners picked up a majority interest in Swedish niche bank Nordax Group in 2010 through its Fund VII. The dividing line between a direct secondaries fund and a regular PE firm that does secondary buyouts has always been unclear.

Verdane's move is not a sign of waning interest in direct portfolio deals – the Edda fund is in addition to, not instead of, its established direct secondaries line. It is instead an indication that investors are willing to back new propositions from established managers that have demonstrated an ability to deploy capital in a challenging investment environment. ■

e: adam.l@peimedia.com

Adam Le is the News Editor for PEI Media's private equity publications, overseeing the flow of global news and analysis for PrivateEquityInternational.com and Secondaries Investor.

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INSTITUTIONAL INVESTORS

Easy does it

Private equity is an increasingly common component of investment portfolios. So why are some investors still cautious? **Victoria Robson** reports

Alternative asset classes, once seen as niche, are entering the mainstream. Total private assets under management topped \$5 trillion last year, driven by almost \$750 billion of fundraising, according to McKinsey. Helping this along were record levels of LP appetite for private equity. For investors assessing the balance of their portfolios as a whole, the promise of superior returns is grabbing their attention.

“Even the median manager in private strategies is delivering a better return than the best manager in long-only equity,” says Andrea Auerbach, head of global private investment research at advisor Cambridge Associates, noting that median return of private equity is 11 percent net of fees. “The upside potential is enormous.”

“We expect in the long run to harvest about 300 basis points above our public equity returns from private equity,” says Vince Smith, chief investment officer at New Mexico State Investment Council, with \$23.5 billion of assets under management and a 12 percent private equity allocation target. “That’s substantial now. Our forecast for US equities going forward is about 7 percent returns.”

In a historically low-interest-rate environment with volatile stock markets, private equity is also perceived to be more stable than publicly traded assets. “It’s one of the few asset classes that could exploit the opportunity created by the volatility,” says David Fann, chief executive at private asset advisor TorreyCove Capital Partners. “It can do things that public companies can’t, like restructure and reposition [a company].”

However, even some of the world’s most sophisticated investors remain unconvinced by the asset class. Norway’s Government Pension Fund Global, the world’s largest sovereign wealth fund with Nkr8 trillion

(\$1.02 trillion; €834 billion) assets under management, is not yet an investor in private equity, and that is unlikely to change soon. A government white paper published in April cited transparency issues and management fees as reasons the fund should not invest in unlisted equities beyond its existing remit.

Out of its 67 percent allocation to equities the fund holds an enormous 1.4 percent of listed companies globally.

If GPFG were to invest in private equity, size would undoubtedly be an issue. “Even some of the very large funds here in the US are struggling in the private asset space,” says Smith. “When you get north of \$150 billion or so it starts getting hard to get an adequate amount of capital invested.”

IN THE KNOW

As the industry continues to diversify in terms of fund size, strategy and geographic focus, the ability to pick the right manager is vital. “You need to be [invested] in the first or second quartile managers to have success with private equity,” says Fann.

But searching out top performers is not easy. Outperformance opportunities are likely to be generated by less well-known managers, Auerbach says. “The difficulty is these are private markets. Information is only disclosed to investors or potential investors. You need to avail yourself of information and put in the effort to get the reward.”

Surveying the entire landscape for the right managers requires time and resources. And while industry participants note managers have gone a long way to address transparency concerns with increasingly standardised reporting, for some investors the asset class can still seem complex.

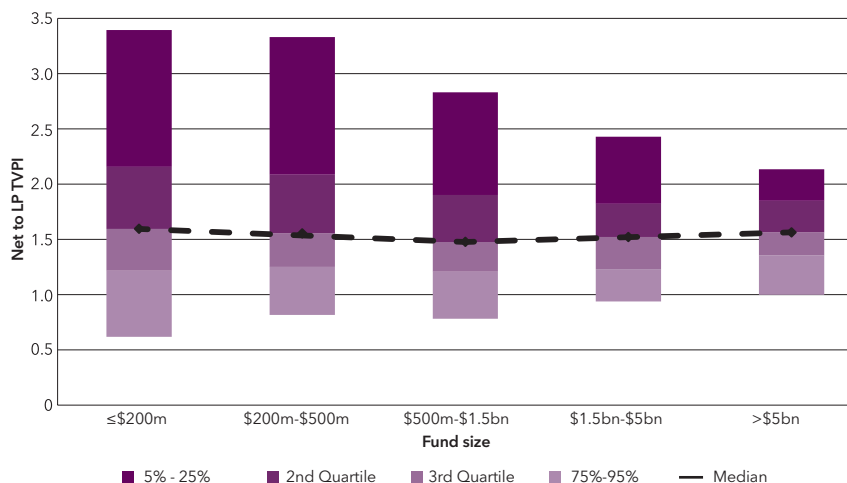
“There’s still a segment of the [investor] population that sees private equity as

“There’s still a segment of the [investor] population that sees private equity as something esoteric and challenging to get their heads around

David Fann

REACH FOR THE TOP

Only those invested with first and second quartile managers will see strong results from private equity



Data as of 30 September, 2017, includes funds raised between 1986-2014. Pooled returns are net of fees, expenses and carried interest. Private equity includes buyout, growth equity, subordinated capital and private equity energy funds.

Source: Cambridge Associates

something esoteric and challenging to get their heads around,” says Fann. In addition, there is often a misperception that the risks of investing in private equity are significantly higher than public markets, he says.

The illiquidity of the asset class and the associated premium may be a draw for LPs such as sovereign wealth funds with an infinite time horizon. For others, like public pension funds facing cash constraints, it is prompting a rethink of asset allocations.

“Private equity is still attractive to us, no question, but we are not keen on extremely long-dated, high-fee structures,” says Aoifinn Devitt, chief investment officer at the \$2.6 billion Policemen’s Annuity and Benefit Fund of Chicago. “We need to get cash in hand.”

PABF has reduced its private equity target from 7 percent to 5 percent as it seeks to address its 5 percent annual funding shortfall. At the end of last year, the

fund sold off the bulk of its private equity portfolio in six funds of funds, totalling around \$100 million. It continues to hold one fund of funds it could not sell.

The pension fund has earmarked allocations to private credit and infrastructure, where Devitt expects returns to be higher. “We are more in favour of investments with less of a J-curve. We like to see our cash back sooner. We particularly like private credit, which has a high cash component. Equally with secondaries, we would see some return sooner there,” she says.

COUNTING THE COST

Private credit is one of the fastest growing investment segments among TorreyCove’s clients. It offers higher returns than fixed income and higher liquidity but lower risk than private equity, as well as a strong current income component and an ability to

insulate against rising interest rates, says Fann.

An additional incentive for LPs to shift focus is the willingness of some private credit fund managers to negotiate on terms, including charging fees on only invested capital and reducing fees once the investment period is over. “Private equity has not modified its fee structure, while private credit has. That gives us more scope for fee breaks,” says Devitt.

The management fee model “has not kept pace with the expansion of the industry”, agrees Smith, who would like to see this change. “Two-and-20 on a \$200 million fund raised in the 1980s is one thing; 1.5-and-20 on a \$10 billion fund raised today is another. Fees including carry have become somewhat unaligned with costs. GP economics have gained significantly relative to LP economics over the last 35 years.”

NMSIC is “sensitive to operational transparency” regarding its fund investments, says Smith. To that end, in April, it hired a fee validation consultant, Colmore, for the first time to scrutinise “what’s been charged and how”, says Smith.

A related concern is GPs’ use of subscription credit lines to make an investment. “We don’t fully understand what that means in terms of calculated IRRs and that ultimately feeds into carry and GP compensation,” Smith says.

But, as LPs continue on their quest for greater clarity on the allocation of fees, the cost of investing does not appear to be a deterrent. “There is still a lot of demand for private equity because there is a shortage of investment opportunities everywhere,” says Devitt. “People see it targets 12-15 percent IRR and that is incredibly attractive. There is a willingness to tolerate the illiquidity and the fees.” ■

PERFORMANCE METRICS

IRR: Infernal rate of rubbish?

Some performance measures are better than others, but the battle for supremacy rages on.

Rod James analyses the options

“You can’t eat IRR,” said Oaktree Capital Management’s Howard Marks in a 2007 memo to investors. Though more than a decade has passed, the debate over the usefulness of internal rate of return rumbles on.

The way IRR is calculated places undue weight on distributions that come early in a fund’s cycle. This allows funds with strong early distributions to build up impressive rates of return – sometimes, some claim, by exiting investments before they should – and then coasting or declining.

One investor that *Private Equity International* spoke to believes “manipulation” of IRR has become worse in recent years. He argues the proliferation of subscription lines, which lead to capital calls being deferred, has further distorted the figures some funds present to investors.

Ludovic Phalippou, associate professor of finance at Saïd Business School at the University of Oxford, is one of the most outspoken critics of the metric. When asked why people still use IRR, his response

“ [Investors say] ‘Other people are using junk so I’m going to use junk so it’s a fair comparison’. It’s not fair. Junk is not comparable to other junk. You cannot rate junk

Ludovic Phalippou

was: mainly, because everyone else uses it. “[Investors say] ‘Other people are using junk so I’m going to use junk so it’s a fair comparison’. It’s not fair. Junk is not comparable to other junk. You cannot rate junk.”

THE ALTERNATIVES

Investors are increasingly favouring money multiples as a measure of performance. The total value-over-paid-in multiple, which combines the distributed- and residual-value to paid-in ratios, probably gives the

clearest idea of how much the amount invested grows or shrinks. A number greater than one means the investor got their money back and more, while anything less than one means the opposite. This allows for comparison between funds of different size and vintage, as returns are expressed in proportionate rather than absolute terms. However, unlike IRR, it doesn’t take into account the time taken for a return to be achieved.

“If you’re completely divorced from the notion of the time it takes to generate the multiple, you’re missing one of the critical components of underwriting private equity managers,” says Brian Rodde, managing director of Makena Capital, which spun out of Stanford Management Company in 2005 and now invests around \$500 million a year in private equity on behalf of endowments.

Phalippou argues that the best metric is the simplest: net present value. Take the returns, set them against a comparable public market benchmark, use an appropriate discount rate and check to see if the fund or investment has performed better or worse.

One investment director at a large family office agrees, as long as a suitable benchmark is used. “Some GPs that pitch to us will benchmark against the S&P 500,” he says. “Those stocks are way larger [than the average PE-backed company].”

But even investors who have encountered GPs with a creative approach to presenting their returns don’t feel strongly about pushing for change. In fact, “the more performance data we can get the better” was a common refrain. The investor should have the knowledge and the resources to make the best decision for themselves.

“It’s incumbent on LPs to ask questions until they get satisfactory answers,” said Rodde. ■



Different stripes: there are many ways of counting performance

FUNDS OF FUNDS

Good things, small packages

Adams Street Partners has significantly altered its allocation to the lower end of the market in a bid to avoid possible macro-economic headwinds, writes **Alex Lynn**

As public markets begin to wobble, some private equity funds of funds find themselves well-prepared with a carefully curated portfolio of potentially downturn-proof managers.

Chicago-based Adams Street Partners could be one such player. Four years ago, the firm analysed more than 1,600 realised company investments made by funds in its global database since 1999 and discovered small-cap and mid-market GPs had achieved an estimated 2.5x to 2.6x return over the last two decades, while larger managers returned just 2.0x.

While it may not be shocking to learn that smaller deals have the potential to outperform, what was a surprise was that small companies in the venture and buyout spaces are less likely to be impacted by systemic risks in the public markets, such as inflation. The research had significant implications for Adams Street's allocation to small and mid-caps; funds in these segments now account for around 75 percent of its global portfolio, up from 50 percent last decade.

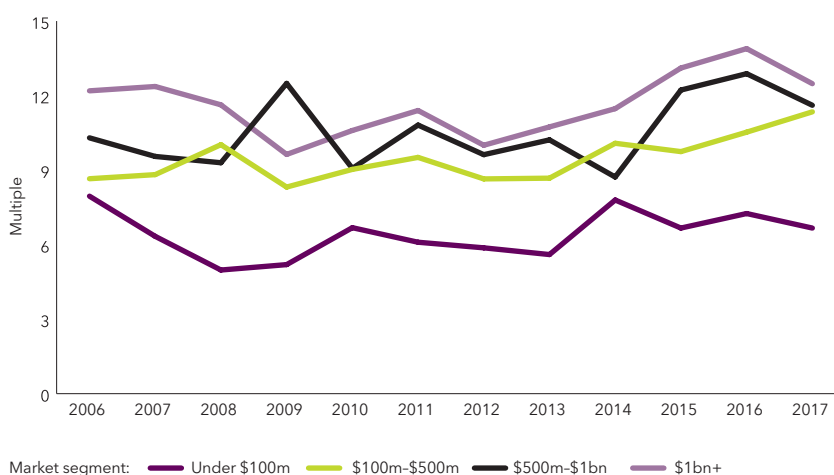
"Mega-funds are pretty much a safe pair of hands that will get you a good return, but we think they're going to be exposed to a lot of market risk, particularly the availability of leverage," Miguel Gonzalo, head of investment strategy and risk management at Adams Street, explains.

"We're looking for smaller companies that are not subjected to leverage levels and high purchase price multiples. That's where we're trying to navigate this environment more so than ever in trying to stay out of the way of a correction if there was one."

The allocation shift was achieved in part through taking a standardised approach to

MEETING IN THE MIDDLE

Heightened focus on the mid-market has seen deal multiples in this segment soar since 2015



Source: Murray Devine; Pitchbook

primary fund commitments, Gonzalo says. Keeping a consistent weight across GPs, regardless of fund size, compensates for blind-pool risk and results in a natural underweighting towards large-caps and overweighting to small-caps.

"In addition to getting you tilted towards the smaller end, it also mitigates the chance that any one fund does poorly, because quite often the best managers raise more funds, but if you follow them in and give them more money they may disappoint in a future fund," he notes. "Some of our mistakes are when we sit on the bus or stay with the GP one too many times."

Adams Street has reduced the number of GPs in its global portfolio from 100 to 40 over five years.

There are plenty of new opportunities for funds of funds targeting the small and

mid-market segments. IK Investment Partners raised €277 million for its debut small-cap vehicle in 2016 and held a final close on its second of these funds on €550 million in February. Northern Europe-focused Triton had also exceeded the initial €350 million target for its debut mid-market fund that same month, *PEI* reported at the time.

Growing competition for small and mid-cap assets threatens to negate some of their potential for outperformance. US M&A multiples, including private equity buyouts, for deals between \$100 million and \$500 million rose to 11.3x in 2017, up from 9.7x two years prior, according to Murray Devine's *Private Equity Valuations Report 2018*. Multiples for deals above this segment dropped sharply last year, in part due to increased attention lower down the spectrum. ■

PORTFOLIO PLANNING

Modelling it out

CEPRES created a model portfolio to allow us to analyse the performance of the asset class. In this first instalment **Simon Tang** introduces the portfolio and examines performance to date

How to invest in today's private equity market? To come up with a plan, it is important to understand where we are.

The construction of our model portfolio is based on a set of simple assumptions: an institutional LP has been investing in private equity since 2007 with a global strategy covering primary funds in the main private equity segments of buyout and growth, private debt and venture capital.

The portfolio consists of 78 funds invested across 10 years starting in 2007, which equates to approximately eight new fund commitments a year on average. The majority of GPs in our portfolio are based in the US (51 percent), followed by Europe (30 percent), with the remaining smaller proportion of GPs categorising themselves as global (10 percent) and Asia-based (8 percent). The geographic focus of the funds raised by these GPs follow these same lines.

In terms of fund stage focus, most of our capital commitments went to buyout (including growth equity) strategies (73 percent) where the average fund size was \$1.7 billion, indicating an emphasis on the mid-market. We also made peripheral investments in private debt (5 percent) and venture capital funds (6 percent).

Our portfolio's pooled fund net IRR and TVPI returns are 13.9 percent and 1.5x, respectively, and, as you would expect, outperforming Public Market Equivalents of all major global indices listed, proving that our private equity portfolio does in fact add alpha. But keep in mind that we are currently only referring to "ordinary"

returns, when in fact we should determine our portfolio's "risk-adjusted" returns by using CEPRES PE Analyzer 4.0 to quantify in our portfolio's alpha outperformance and the corresponding beta market risk for each of the PME's in specific terms.

If we now dissect the overall portfolio returns, we see that fund net IRR returns were weak for vintage year 2007 but incrementally increased in 2008 through 2010, tapering again from vintage years 2011 through 2013. Clearly the investments made at high, pre-crisis valuations dragged on returns, while those made in the depths of the crisis performed significantly better.

Between 2011 and 2013, market visibility was relatively better and investors could see indications that governments' efforts to stimulate economies were beginning to work; and as investment activity picks up, so does competition for deals. By 2014 and 2015, fund net IRRs stabilised to what you would consider as "normal" private equity returns of mid- to high teens, while 2016 and 2017 vintage years are clearly still too early to assess. In terms of fund net IRR returns by vintage year, our model portfolio looks quite healthy.

In terms of consistency of returns, our model portfolio's performance spread is healthy with 51 percent of the total number of funds within the 1.0-1.5x net multiple (TVPI) range, plus another 32 percent of the funds showing net multiple returns in excess of 1.5x; only 17 percent of the funds are defaulting or underwater with a net multiple of less than 1.0x. The portfolio's overall positive returns are due to a strong spread of returns across the positive side of the spectrum.

LIQUIDITY

Since our portfolio has been 10 years in the making, we have seen substantial liquidity coming back. Despite a weaker IRR in 2007, our fund commitments during that year have in aggregate distributed 1.09x or 109 percent of our paid-in capital to these 2007-vintage funds. We have almost completely recovered our risk exposure for 2008 (0.99x DPI), while our cash-on-cash returns for 2009 and 2010 are very strong. DPI begins to taper in 2011 at 0.95x and 0.51x for 2012, but that is to be expected as those funds are in their seventh and sixth years, respectively, and are in their harvesting periods.

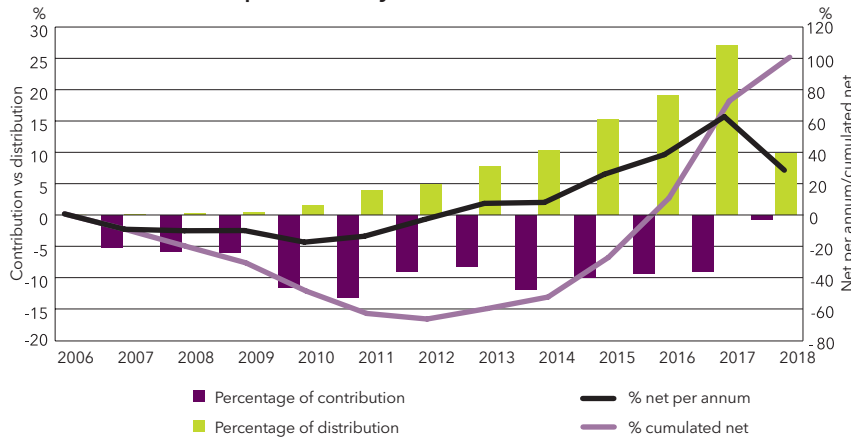
The remaining funds in vintages 2013 onwards are still relatively young and are either still in their investment periods or just starting to exit from deals. On an overall basis, the portfolio has provided robust liquidity and we have recovered nearly 80 percent of our total paid-in capital.

Looking at liquidity from a cashflow perspective, the J-curve maps out our overall

 **We now understand the return profile in terms of vintage year, fund stage focus and performance spread**

THE J-CURVE

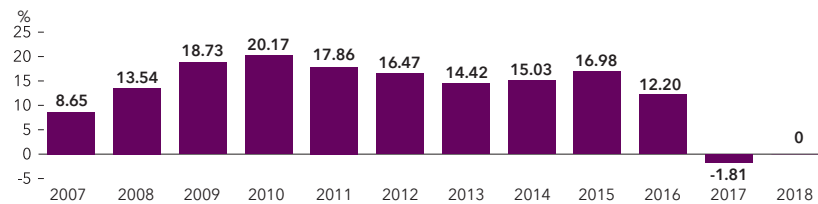
Portfolio becomes positive in year six



Source: CEPRES

HEALTHY RETURNS

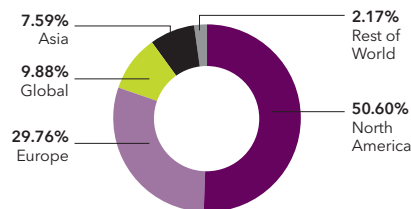
Fund net IRR by vintage year



Source: CEPRES

INVESTMENT MAP

Geographic breakdown of model portfolio



Source: CEPRES

Public market equivalents

PERFORMANCE VS PUBLIC MARKET	IRR (%)	TVPI
Model portfolio net (pooled)	13.88	1.51
PME MSCI World (median)	5.61	1.11
PME S&P 500 (median)	10.48	1.22
PME Russel 2000 (median)	10.07	1.21
PME Eurostoxx 50 (median)	4.42	1.09
PME SSE Composite (median)	4.39	1.09
PME High Yield (median)	6.85	1.13

Source: CEPRES

capital contributions and distributions to and from the funds in the portfolio by investment year (not vintage year). After indexing all of the individual funds' net cashflows to the same starting point of year zero, the purple bars show our substantial contributions during the earlier years and tapering, while the green bars are the opposite and represent distributions coming back to us, which is increasing over time as the portfolio matures.

The black line shows the net cashflow position on an annual basis, while the light purple line is our J-curve showing our cumulative cash position, or in other words, our capital gain development over the years. The J-curve clearly shows our model portfolio has delivered consistent liquidity over time and our portfolio gain crossed into positive territory in year six, which is the timeframe to be expected from private equity.

In this article, we've performed a portfolio monitoring of a typical institutional LP portfolio, and in doing so, we now understand the return profile in terms of vintage year, fund stage focus and performance spread, as well as the portfolio's liquidity and risk characteristics. The analyses presented here are merely a sample of the many other portfolio monitoring analysis that we can and should perform on our private equity portfolio.

By doing this, we can understand the current health and condition of our portfolio, which then forms a basis for the next goal: to understand the portfolio's trajectory. Accomplishing these two goals will enable us to formulate a stronger investment thesis that leads to smarter investment decisions, which ultimately results in a defensible portfolio that can weather macro threats and reach our return and liquidity targets. ■

Simon Tang is a Singapore-based partner at digital PE investment network CEPRES.





PRIVATELY SPEAKING

GUESS WHO'S BACK ON TOP?

As Carlyle is once again named the largest PE firm in the world, David Rubenstein, the architect of its fundraising success, talks to **Toby Mitchenall** and **Isobel Markham** about the future of private capital

PHOTOGRAPHY BY DOUG HOLT

\$100 billion in the next four years. That was David Rubenstein's bold assertion in 2016 about The Carlyle Group's fundraising prospects. At the time, Carlyle, known in the industry for its fundraising prowess, sat fifth in the *PEI 300*.

A few things have changed since then. For one thing, Japanese tech company SoftBank has somewhat normalised the figure by raising most of a quasi-private equity fund with that target. Second, Rubenstein and his co-founder Bill Conway have handed the reigns of the firm to Glenn Youngkin and Kewsong Lee.

And third, Carlyle is once again the largest private equity firm in the world. The firm has raised more than \$60

billion in the last five years, according to the latest *PEI 300*.

The firm is not alone in enjoying fundraising success. Its peers at the top of the *PEI 300* are hoovering up an increasing percentage of the capital flowing into private equity (see p. 36). And they are taking a larger slice of a pie that is itself growing; the total capital raised across the industry in 2017 was only just shy of the 2008 fundraising peak.

IMAGE PROBLEM?

Continued success, however, is never guaranteed. Amid the strong returns and growing institutional demand, there have been some high-profile »

» examples of LBOs-gone-wrong – with bankruptcies and job losses – that do nothing to correct an image of private equity as capitalism at its most predatory (see p. 12). “Private equity? It’s more like pirate equity” read the headline of a Bloomberg opinion piece in late March, just days before we caught up with Rubenstein.

So is the industry – which continues to ride high amid rampant institutional demand – ignoring a wider image problem?

No. To Rubenstein, investor demand is the first and best indicator of how private equity is perceived.

“As a general rule when you see enormous amounts of money going into private equity you have to conclude that generally these sophisticated LPs have assessed the alternatives and think that the risk-reward balance represents a good opportunity,” he says. “Why are all of these smart people doing this? I think it’s because they realise that rates of return are likely to, as they have in the past, outperform other asset classes.”

Rubenstein equates negative sentiment towards the asset class with the politics of envy; those who amass wealth attract criticism. “I can’t say that throughout history people that have made a lot of money have had people throwing daisies at them, telling them how wonderful they are. So it’s not just private equity; it’s banks or industrialists throughout history.

“I do think that private equity people have done a pretty good job of recycling the money into philanthropy and other things, but whether that is enough to mitigate the concerns, I don’t know.”

Rubenstein knows a thing or two about the importance of image. A willingness to appear in public that sees him host a television talk show as well as being executive chair of Carlyle, has, in his estimation, helped his firm become a fundraising machine. It has graced the top five of the *PEI 300* every year since the ranking started

in 2007 and is number one this year for the fifth time (see p. 38).

The firm’s co-founder sees the fact the world’s largest sovereign wealth fund, Norway’s Government Pension Fund Global, has not yet invested in private equity not as a negative, but as a reason to be optimistic. He argues it is one of many giant investors – like Japan’s Government Pension Investment Fund or Saudi Arabia’s Public Investment Fund – that represent huge pools of potential capital for the future.

In the weeks after our discussion, this optimism is dealt a blow; Norway’s finance ministry concludes GPFJ should not invest in private equity.

“Unlisted equity investments would challenge the management model based on transparency low management costs, and a limited degree of active management,” the ministry said in mid-April.

RETIRING QUIETLY

Another potential pool of future capital is individual investors. Those saving and investing through individual retirement accounts or 401(k)s are currently unable to access private equity, but “at some point I think the government will let some part of an IRA or 401(k) go into an illiquid private equity investment”, says Rubenstein.

It is a cause being championed by Rubenstein’s peer Tony James, the former chief operating officer of Blackstone and co-author of the 2016 book *Rescuing Retirement*, which sets out a plan to ensure US workers save sufficiently for retirement through individual accounts.

Rubenstein is optimistic that this money – or a portion of it – will find its way into private equity, but less clear on when this could happen. “It’s hard to know, but I think there is a general view that the government should let people who need higher rates of return invest in higher returning assets... but not unlimited amounts.”

Even if the government permitted 5

“I can’t say that throughout history people that have made a lot of money have had people throwing daisies at them, telling them how wonderful they are

percent of an IRA, “that’s an enormous amount of capital”, he says.

A number of firms – typically those operating in the fund of funds space – have developed IRA-appropriate offerings, but the floodgates have yet to open. For Carlyle’s part, “it is not our main focus today, as the government is going to have to do something about it”, says Rubenstein.

Instead the firm is seeing more capital coming from family offices. “It’s a gigantic growth area,” he adds. As is capital from feeder-funds: “Individual investors that don’t have family offices typically, but are being rounded up by Goldman Sachs, Credit Suisse, Morgan Stanley and so forth. We see a lot of that.”

Carlyle has shown itself to be a firm comfortable with trying out new strategies based on investor demand. A look through the firm’s early history on the *PEI* database



shows funds raised in the late 1990s and early 2000s focused on venture, energy, high-yield, Japan, Mexico and ‘the internet’. Indeed, in a 2016 interview with *Private Equity International*, Rubenstein suggested he and his partners “probably should have tried fewer things and focused only on those businesses where we had clear expertise and could scale quickly”.

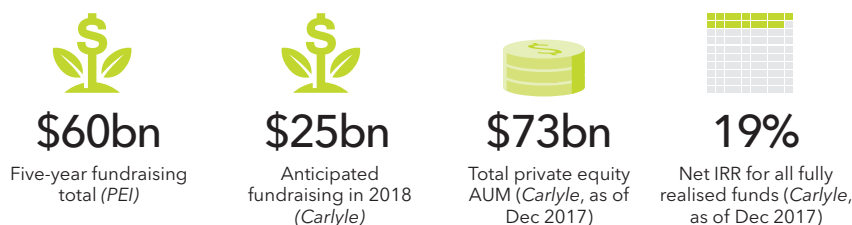
MAKING AN IMPACT

One emerging area of interest for institutional investors is impact investing: investments intended to have a tangible positive effect on society or the environment as well as generating financial returns. Bain Capital and TPG Capital are both established private equity brands that have successfully raised capital for the strategy, while KKR is plotting its own version of an impact fund. Goldman Sachs is also active in the niche, having acquired a specialist investment advisor in 2015, and Partners Group is currently marketing a \$1 billion private markets fund – PG LIFE – that will target deals in line with the United Nations Sustainable Development Goals.

Rubenstein does not seem particularly taken by the ‘impact’ label and what it suggests about other private equity funds. “We would say that we do impact investing all the time, because we’re not doing things that are destructive to the environment and are doing things that are, we think, socially useful,” he says. “But the way impact investing has been pigeonholed is that you can only do impact investing if it’s called impact investing and it’s designated as such.”

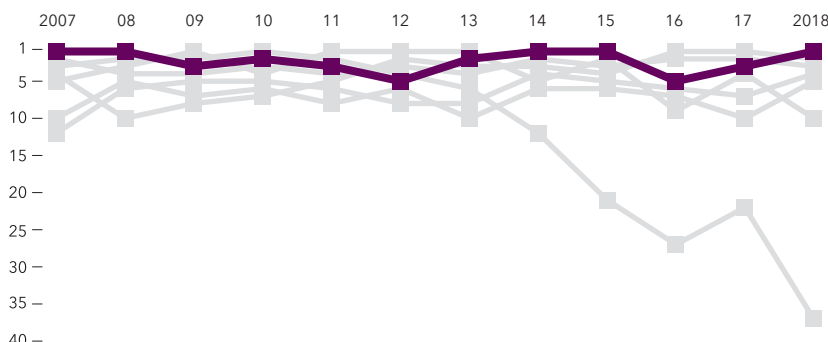
Is Carlyle thinking about a foray into impact? “We haven’t designated specific funds to be ‘impact investing funds’, but we are looking at whether that makes sense or not,” he says.

Of course, if Carlyle decides to take the plunge, it is likely to set impact fundraising records, too. ■



STEADY AS SHE GOES

Carlyle’s journey along the PEI 300



Source: Private Equity International

PEI 300





38 A reign supreme

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A reign supreme

This year's *PEI 300* ranking is record-breaking and sees Carlyle snatch back the crown. Is private equity in a second golden age?

Carlyle co-founder David Rubenstein announced a lofty goal during an earnings call with investors in 2016: to raise \$100 billion over the course of four years.

Any other firm declaring this aim in a call where it said it had raised \$400 million for private equity that quarter would probably have been met with disbelief. But this is not just any firm. Carlyle has long been blessed – or saddled, depending on your viewpoint – with the moniker “fundraising machine”, and as *Private Equity International* revealed last month, David Rubenstein is more than worthy to be crowned the industry's king rainmaker.

Since then, Carlyle has raised more than \$400 million per quarter. Much, much more. The firm steals this year's *PEI 300* top spot from Blackstone in spectacular fashion, with a five-year fundraising total almost \$20 billion higher than it posted last year. Meanwhile, a relatively quiet 2017 on the fundraising front for Blackstone sees its total shrink to \$52 billion.

On the firm's fourth-quarter earnings call in February – during which it announced it had raised \$19 billion for private equity for the quarter – Carlyle said it expects to raise approximately \$25 billion this year.

This is the fifth time Carlyle has been at the top of the *PEI 300*. It has held this title more times than any other firm, including in the inaugural ranking in 2007 when it was just the *PEI 50* (we chart the progress of all firms that made the original *PEI 50* list, which became *PEI 300* in 2009, on p. 46). Back then, its five-year fundraising total was a mere \$32.5 billion. That number

just goes to show how much the industry has blossomed in the last decade. This year's ranking breaks records across the board, with more capital raised by the top 10 (at \$394 billion), the top 50 (at \$876 billion) and the whole 300 (at \$1,485 billion) than ever before.

And capital is continuing to concentrate in the upper echelons; the top 10 accounted for 26.5 percent of the total capital raised, up from 23.8 percent last year and 22.9 percent in 2016. The top 50 also increased its reach, amassing 59 percent of total capital raised, up from 56 percent last year.

Strong performance has kept investors coming back for more; 84 percent of limited partners responding to *PEI*'s most recent annual *LP Perspectives* survey saw private equity performance in line with or exceed internal benchmarks during the preceding 12 months.

OUTPERFORMANCE

According to Bain & Company's latest *Global Private Equity Report*, as of mid-year 2017, the median net return of private equity holdings in the portfolios of public pension funds over a 10-year time horizon was 8.5 percent, compared with 4.2 percent for public equities, 4.5 percent for real estate investments and 5.2 percent for fixed income.

“That kind of outperformance is irresistible in a period marked by persistently low yields on most other investment options,” the report reads.

Turn the page to see how this year's top 10, top 50 and *PEI 300* have performed

THE PEI TOP 10

2018 Rank	2017 Rank	Firm	Headquarters	PEI 300 Five-Year Fundraising Total (\$m)
1	▲ 3	The Carlyle Group	Washington DC	60,034.54
2	▼ 1	Blackstone	New York	52,344.39
3	▼ 2	KKR	New York	51,839.40
4	▲ 7	Apollo Global Management	New York	45,372.19
5	▲ 10	CVC Capital Partners	London	42,389.99
6	▼ 5	Warburg Pincus	New York	33,312.91
7	▲ 31	EQT	Stockholm	28,733.01
8	▲ 9	Neuberger Berman Group	New York	27,645.69
9	▲ 23	Silver Lake	Menlo Park	26,086.50
10	▼ 4	TPG	Fort Worth	25,946.00

THE SMALL PRINT

How the rankings are determined

The 2018 PEI 300 ranking is based on the amount of private equity direct investment capital raised by firms between 1 January 2013 until 1 April 2018.

Definitions

Private equity: For purposes of the PEI 300, the definition of private equity is capital raised for a dedicated programme of investing directly into businesses. This includes equity capital for diversified private equity, buyouts, growth equity, venture capital and turnaround or control-oriented distressed investment capital.

Capital raised: This means capital definitively committed to a private equity direct investment programme. In the case of a fundraising, it means the fund has had

a final or official interim close after 1 January 2013. We count the full amount of a fund if it has a close after this date, and we count the full amount of an interim close that has occurred recently, even if no official announcement has been made. We also count capital raised through co-investment vehicles.

What does NOT count as private equity?

Funds of funds, secondaries, real estate, infrastructure, hedge funds, debt, mezzanine and PIPEs.

NB. The PEI 300 is not a performance ranking, nor does it constitute investment recommendations.

For a full methodology, email PEI's research manager, Daniel Humphrey Rodriguez (daniel.r@peimedia.com).

against each other and the public markets.

While the top three are made up of the usual suspects, there has been a shake-up in the top 10 this year. TPG has slipped from fourth to 10th, mostly due to a tightening in methodology, which excludes funds managed by the firm's credit arm that had previously been included. On the back of its €10.75 billion eighth flagship fundraise, EQT has stormed up the list from 31st

to seventh, the highest the Stockholm-headquartered firm has ever been ranked. It should come as no surprise that Apollo Global Management's record-breaking Fund IX, which closed last year just shy of \$25 billion, also propelled the firm up the ranking, landing it in fourth position.

This year saw a massive leap for Menlo Park-based Silver Lake, which closed the largest-ever tech-focused fund on \$15 billion last year and moved up from 23rd to ninth. CVC also came roaring back this year, having closed the largest-ever euro-denominated fund on €15.5 billion in 2017.

In the first golden age of private equity fundraising in 2008, firms raised \$433 billion and Carlyle reigned supreme as leader of the PEI 50. In 2018 the make-up of the PEI 300 may look slightly different, but King Carlyle is back on top, and with last year's fundraising total \$22 billion shy of that 2008 record, it's safe to say the private equity gold rush is back. ■

PERFORMANCE

A better PEI 300

Analysis by tech company Bison shows this year's returns are rising, writes **Marine Cole**

This year's *PEI 300* firms are better performers than last year's ranking, according to data provided by private equity technology group Bison.

The top 300 private equity firms by amount of capital raised in the past five years generated, on average, a net internal rate of return since inception of 13.72 percent. This is up from last year's *PEI 300*, which generated 12.9 percent. The top 300 firms from 2016 had a 13.3 percent return.

The performance of *PEI 300* firms is also getting closer to that of *PEI 10* firms, which generated 13.61 percent, showing that being a top fundraiser doesn't automatically translate into better returns.

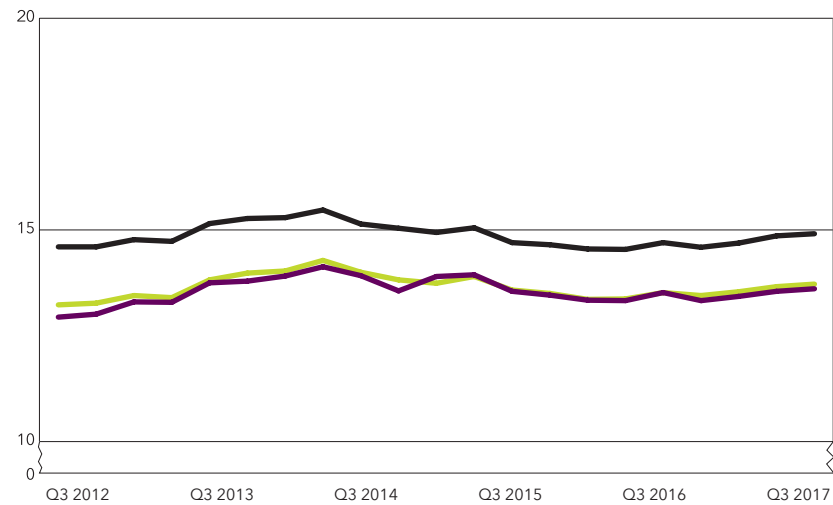
However, *PEI 50* firms remain the top performers of the group, returning 14.91 percent, 80 basis points higher than returns from last year's *PEI 50*.

While absolute returns are on the rise, the extra return investors receive from firms in the ranking over public markets, as shown by Bison's PME Alpha, is going down.

The top 50 firms generated 8 percent over public markets, compared with 9.6 percent last year, but still above the 6.8 percent achieved in 2016. *PEI 300* firms overperformed the public markets by 6.63 percent, which is down from 7.8 percent in last year's ranking. ■

NIFTY FIFTY

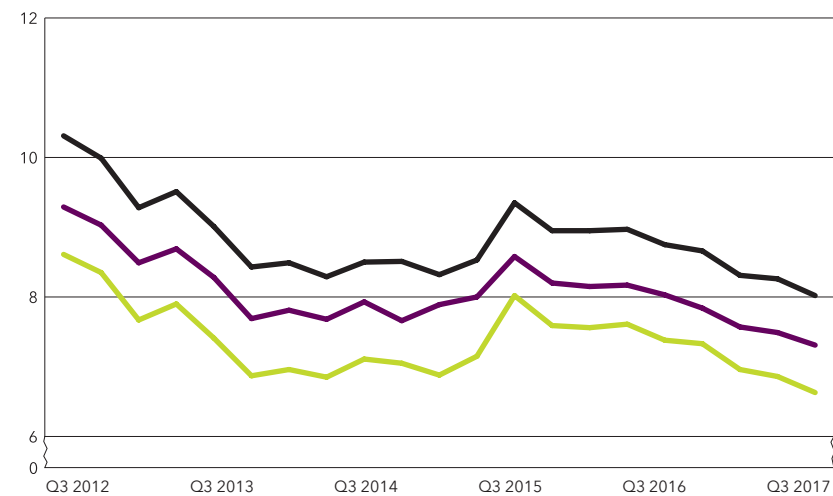
Net IRRs of the different layers of the *PEI 300* show the best performers coming from those outside the top 10 firms



Source: Bison

RELATIVE DECLINE

How this year's *PEI 300* firms compare with public markets over time



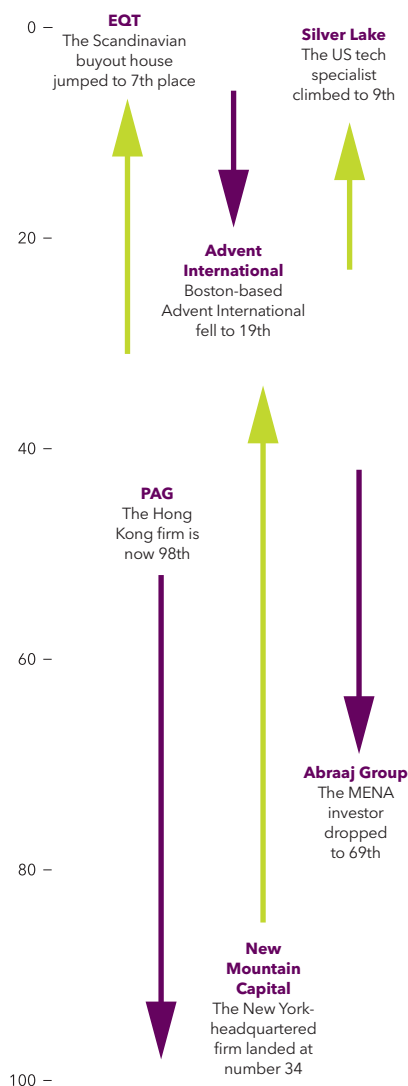
Source: Bison

RISERS AND FALLERS

All change at the top

Three firms broke into the top 10 after leapfrogging a host of blue-chip players. Alex Lynn reports

RISERS AND FALLERS



Source: Private Equity International

Private equity continued its march towards pre-crisis levels of fundraising in 2017. With this heady environment driving some monstrous fundraises, it's little surprise to see a flurry of dramatic shifts in the *PEI 300*.

Some of the most notable jumps occurred in the usually predictable top 10. Scandinavian buyout house EQT's mammoth €10.8 billion haul for Fund VIII in February saw it jump 24 places to seventh with \$4.2 billion raised over the past five years. CVC's €15.5 billion raise for Fund VII pushed the firm to fifth in the ranking, up five places from 2017, while US tech specialist Silver Lake also climbed 14 positions to reach ninth place after collecting \$15 billion for Fund V in April 2017.

The top 100 saw New York-headquartered New Mountain Capital rise 51 positions to 34th after raising \$6.2 billion for its fifth flagship in September to bring its five-year total to \$10.3 billion. The firm narrowly beat France's PAI Partners, which climbed from 75 to 35 after closing Fund VIII on €5 billion in March. Hong Kong's pan-Asia buyout and growth investor Affinity Equity Partners climbed 38 places to 36th.

Several London firms also made impressive leaps: Equistone climbed 39 places to 45th, with \$7.6 billion raised over the past five years. Vitruvian rose 122 places and now sits in 86th with \$4.4 billion raised, while European mid-market firm TDR Capital reached 47th, up from 128th last year, after securing €3.5 billion for its fourth flagship last year.

Buy-and-build specialist Waterland rose 97 places to 89th, with \$4.1 billion raised over a five-year period. The Dutch firm made headlines in August after holding a first and final close on €2 billion for its seventh fund less than two months after launch.

AND SOME GO DOWN

Of course, not every firm rose up the ranking. Boston-headquartered Advent International fell 13 places to 19th due to its \$10 billion 2012-vintage falling out of the required time period. Leonard Green & Partners – partially acquired by Blackstone in 2017 – fell to 38th place, down from 17th the previous year. Embattled MENA investor Abraaj Group, which has recently undergone a leadership change and corporate restructuring amid an LP investigation into misuse of funds, dropped 27 places to 69th.

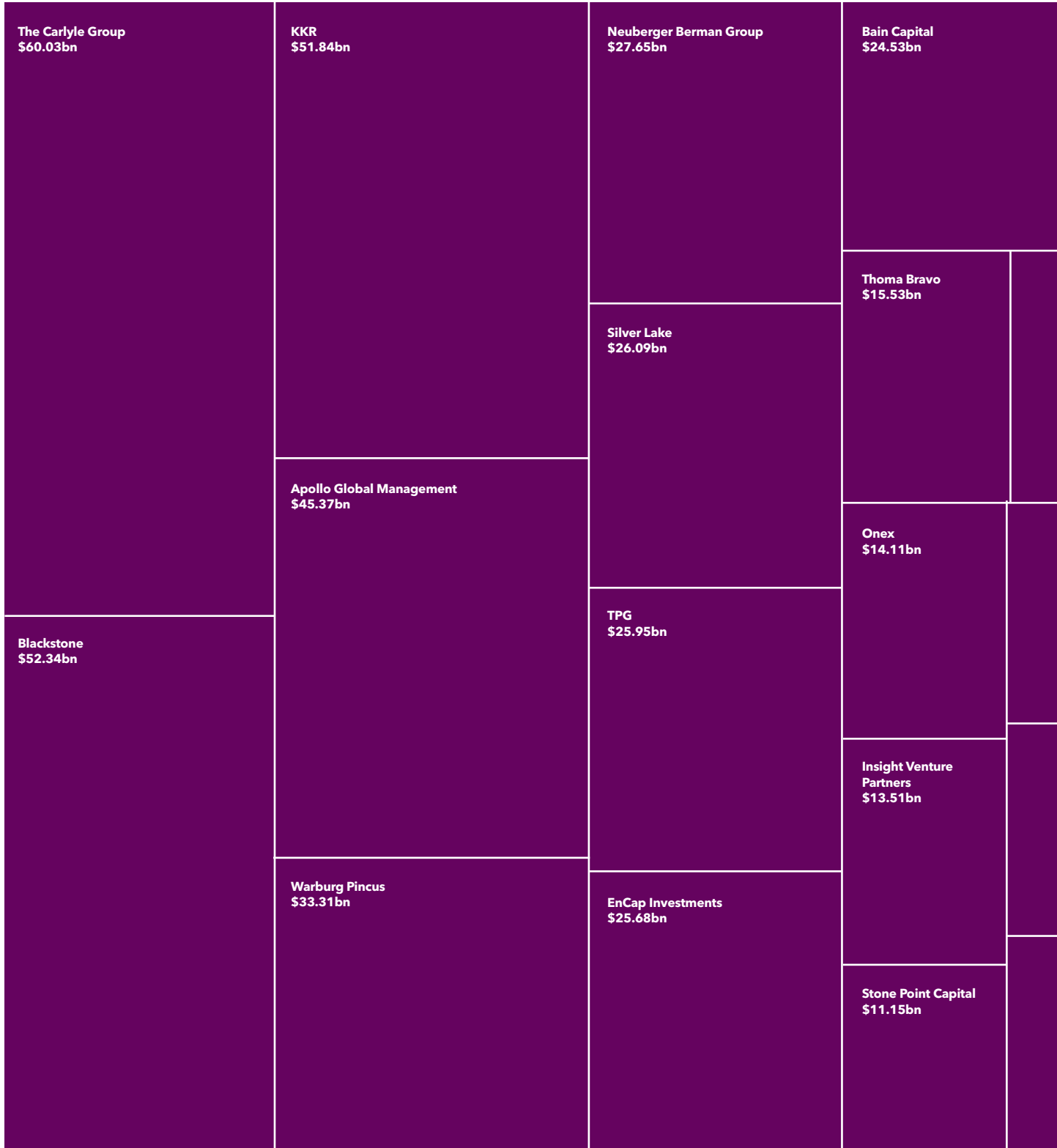
Hong Kong's PAG is now 98th after placing 52nd last year. It raised \$3.6 billion over five years. New York's Rhône Group – partially acquired by French private equity house Eurazeo in November – fell 39 places to 122nd in the rankings.

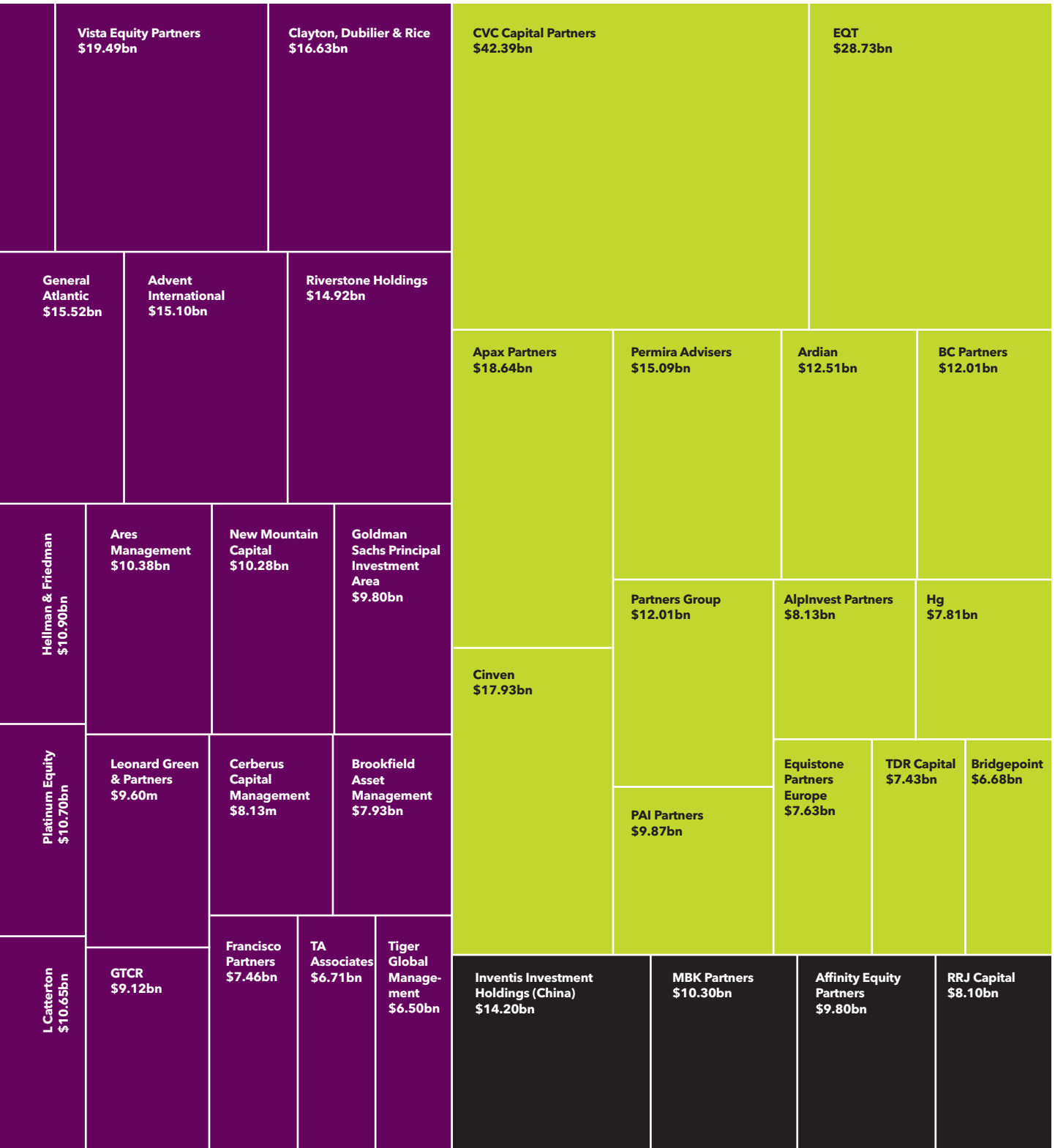
Energy firms were among this year's biggest climbers. Houston-based Post Oak Energy rose a whopping 319 places to 171st on the list. The firm – which makes equity investments in the upstream sector of North American oil and gas – closed its fourth flagship fund at its \$600 million hard-cap in November. Boston's Old Ironsides Energy rose 313 places to 176th after collecting \$300 million for the 2017-vintage Old Ironsides Energy III.

China had some notable declines. China Development Bank – whose 18 billion yuan (\$2.9 billion; €2.3 billion) 2012-vintage CDB Development Fund fell outside the *PEI 300* calculation period – dropped from the list after placing 124th last year. China International Capital Corporation, previously 212th, also fell out of the ranking. But some Chinese firms did well: buyout GP Hopu Investment Management has raised at least \$2 billion for its 2017-vintage Master Fund III, climbing 154 places to 115th in the process. ■

Sizing up the top 50

■ North America ■ Europe ■ Asia-Pacific





11-50

2018 Rank	2017 Rank	Firm	PEI 300 Five-Year Fundraising Total (\$m)	Headquarters
11	▼ 8	EnCap Investments	25,684.50	Houston
12	▼ 11	Bain Capital	24,527.25	Boston
13	◀▶ 13	Vista Equity Partners	19,490.00	San Francisco
14	◀▶ 14	Apax Partners	18,636.50	London
15	▲ 16	Cinven	17,932.60	London
16	▼ 15	Clayton, Dubilier & Rice	16,633.00	New York
17	▼ 12	Thoma Bravo	15,529.27	Chicago
18	▲ 28	General Atlantic	15,517.00	New York
19	▼ 6	Advent International	15,100.00	Boston
20	◀▶ 20	Permira Advisers	15,093.54	London
21	◀▶ 21	Riverstone Holdings	14,918.51	New York
22	▲ 36	Inventis Investment Holdings (China) Ltd	14,200.00	Shanghai
23	▲ 47	Onex	14,105.70	Toronto
24	▲ 40	Insight Venture Partners	13,510.38	New York
25	▼ 24	Ardian	12,506.48	Paris
26	▼ 19	BC Partners	12,012.88	London
27	▲ 33	Partners Group	12,012.00	Zug
28	▼ 27	Stone Point Capital	11,151.29	Greenwich
29	▼ 25	Hellman & Friedman	10,900.00	San Francisco
30	▼ 29	Platinum Equity	10,700.00	Beverly Hills
31	▲ 32	L Catterton	10,654.05	Greenwich
32	▼ 18	Ares Management	10,377.50	Los Angeles
33	▼ 26	MBK Partners	10,298.31	Seoul
34	▲ 85	New Mountain Capital	10,282.80	New York
35	▲ 75	PAI Partners	9,873.65	Paris
36	▲ 74	Affinity Equity Partners	9,800.00	Hong Kong
37	▼ 22	Goldman Sachs Principal Investment Area	9,800.00	New York
38	▼ 17	Leonard Green & Partners	9,600.00	Los Angeles
39	▲ 73	GTCR	9,124.23	Chicago
40	▲ 43	Cerberus Capital Management	8,129.00	New York
41	▲ 46	AlpInvest Partners	8,126.59	Amsterdam
42	▼ 39	RRJ Capital	8,100.00	Hong Kong
43	▼ 34	Brookfield Asset Management	7,928.00	Toronto
44	▲ 45	Hg	7,805.51	London
45	▲ 84	Equistone Partners Europe	7,627.83	London
46	▲ 101	Francisco Partners	7,460.00	San Francisco
47	▲ 128	TDR Capital	7,434.92	London
48	◀▶ 48	TA Associates	6,705.05	Boston
49	▼ 44	Bridgepoint	6,679.92	London
50	▼ 41	Tiger Global Management	6,500.00	New York

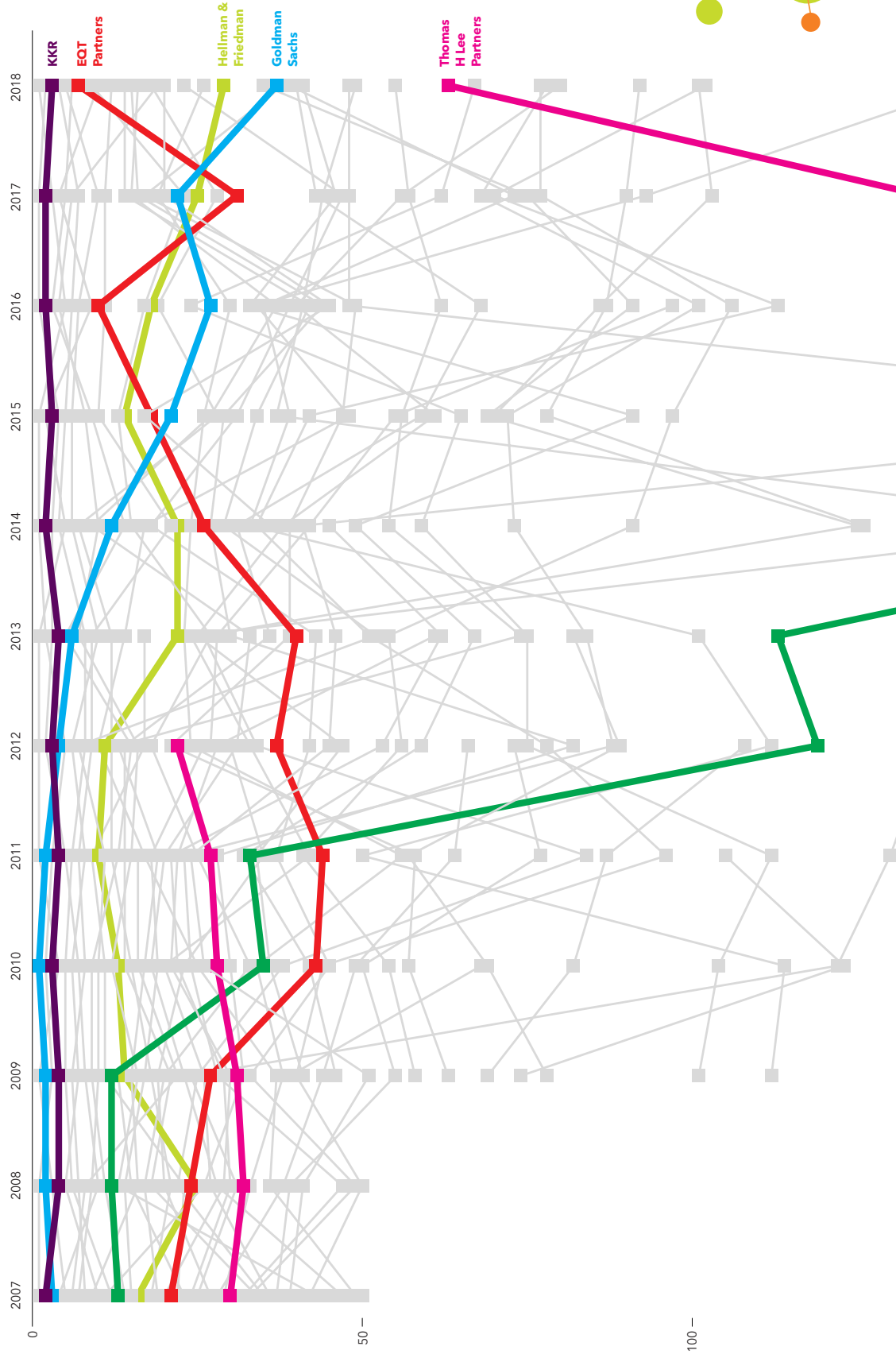
51-100

❖ Not present in 2017 PEI 300

2018 Rank	2017 Rank	Firm	PEI 300 Five-Year Fundraising Total (\$m)	Headquarters
51	▲ 58	New Enterprise Associates	6,450.00	Chevy Chase
52	▼ 50	BDT Capital Partners	6,200.00	Chicago
53	▼ 51	Centerbridge Partners	6,166.00	New York
54	▲ 122	Genstar Capital	6,050.00	San Francisco
55	▲ 57	Providence Equity Partners	6,030.00	Providence
56	▼ 55	AEA Investors	6,000.80	New York
57	▲ 60	Investindustrial	5,890.96	London
58	▼ 53	Veritas Capital	5,865.00	New York
59	▲ 81	HarbourVest Partners	5,836.55	Boston
60	▲ 63	Castlelake	5,792.00	Minneapolis
61	▼ 59	Marlin Equity Partners	5,769.91	Hermosa Beach
62	▲ 65	Morgan Stanley Investment Management	5,616.75	New York
63	▲ 135	Thomas H. Lee Partners	5,607.00	Boston
64	❖ N/A	ArcLight Capital Partners	5,580.00	Boston
65	▼ 88	Baring Private Equity Asia	5,537.00	Hong Kong
66	▼ 61	Accel	5,525.00	Palo Alto
67	▼ 62	Berkshire Partners	5,500.00	Boston
68	▲ 107	The Jordan Company	5,500.00	New York
69	▼ 42	The Abraaj Group	5,426.24	Dubai
70	▼ 30	NGP Energy Capital Management	5,425.90	Irving
71	▲ 151	Olympus Partners	5,340.00	Stamford
72	▲ 99	Triton Partners	5,103.43	St. Helier
73	▼ 37	American Securities	5,000.00	New York
74	▲ 158	GI Partners	4,968.10	San Francisco
75	▼ 66	Pamplona Capital Management	4,945.83	London
76	▲ 82	IK Investment Partners	4,852.70	London
77	◁▷ 77	Summit Partners	4,852.09	Boston
78	▼ 68	Madison Dearborn Partners	4,776.10	Chicago
79	▼ 72	TCV	4,730.00	Palo Alto
80	▼ 56	Nordic Capital	4,729.27	Stockholm
81	▼ 80	Sequoia Capital	4,622.01	Menlo Park
82	▼ 67	H.I.G. Capital	4,587.08	Miami
83	▲ 113	Kelso & Company	4,560.00	New York
84	▲ 185	Charlesbank Capital Partners	4,500.00	Boston
85	▼ 79	Quantum Energy Partners	4,465.35	Houston
86	▲ 208	Vitruvian Partners	4,384.00	London
87	▲ 154	Patria Investments	4,377.59	São Paulo
88	▼ 78	CITIC Private Equity Funds Management	4,300.69	Beijing
89	▲ 186	Waterland Private Equity Investments	4,085.25	Bussum
90	▼ 64	Kayne Anderson Capital Advisors	4,025.00	Los Angeles
91	▲ 92	ACON Investments	3,994.21	Washington DC
92	▼ 90	CCMP Capital	3,951.00	New York
93	▲ 145	Norwest Venture Partners	3,900.00	Palo Alto
94	▼ 91	Kohlberg & Company	3,800.00	Mount Kisco
95	▲ 114	The Riverside Company	3,750.71	New York
96	◁▷ 96	CDH Investments	3,688.92	Hong Kong
97	▲ 201	CITIC Capital	3,656.65	Hong Kong
98	▼ 52	PAG	3,600.00	Hong Kong
99	▼ 98	KPS Capital Partners	3,570.00	New York
100	▲ 118	KSL Capital Partners	3,552.48	Denver

A decade of change

PEI charts the progress of the 50 firms that appeared in our inaugural ranking in 2007. Some are still riding high today, while others have been lost in private equity history



150 —

Private Equity International published its inaugural general partner ranking, the PEI 50 in 2007, aiming to create “a useful point of reference in a changing and expanding industry.”

The industry, and the ranking, have certainly changed since then. In 2009 we expanded to 300 firms, and today our research and analytics team applies the rigorous methodology to more than 500 firms globally to come up with the definitive ranking the industry has come to rely on.

A quick scan down the original PEI 50 list gives a clear picture of how different the private equity world was back then. Yes, Carlyle was at the top of the list, but at that time the firm had “no plans” to go public and a five-year fundraising total of \$32.5 billion. Today, it’s quite a different beast (see p. 32).

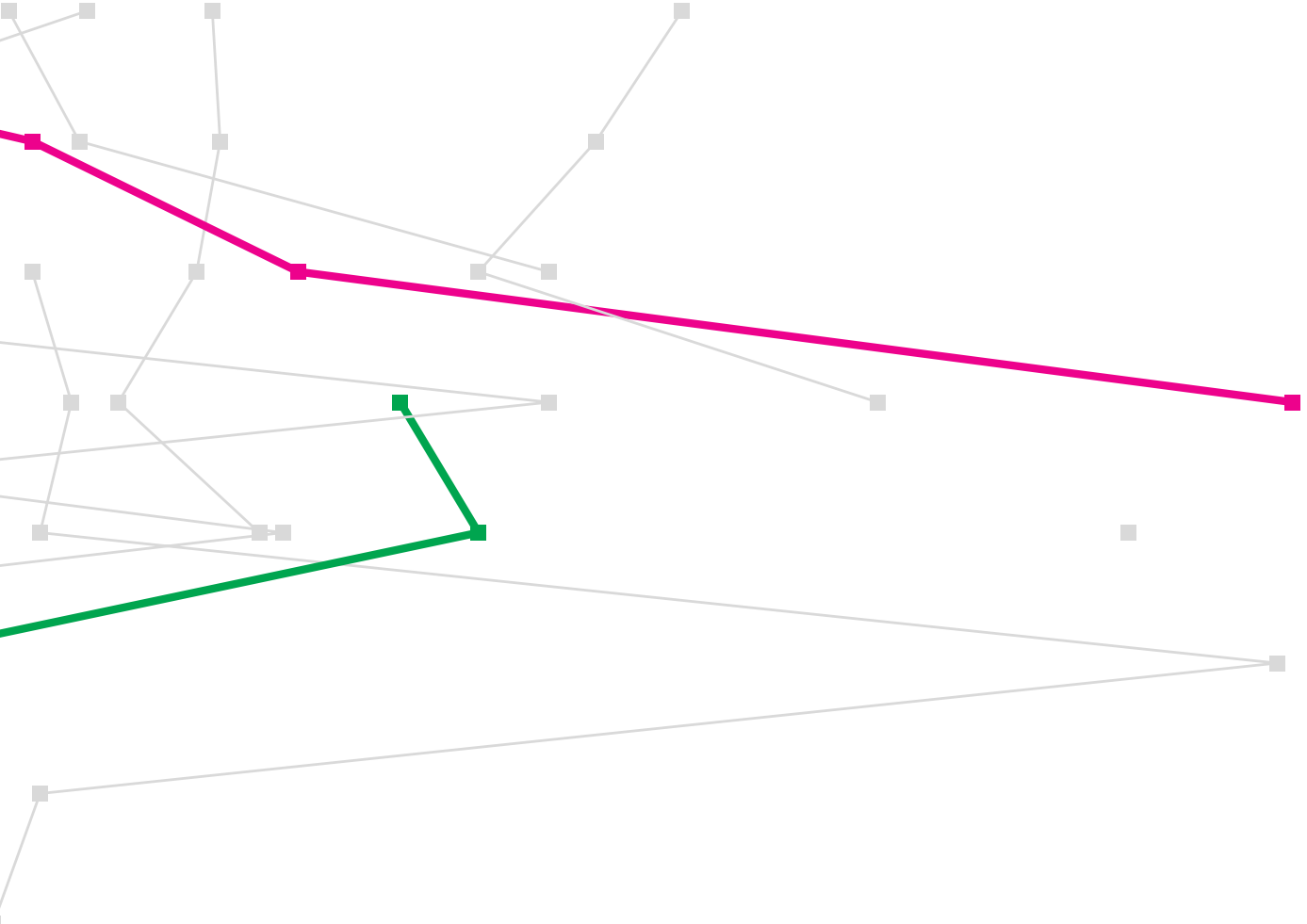
A significant slice of those riding high in 2007 can no longer be found in the PEI 300 for various reasons, including Terra Firma Capital Partners, Candover and Doughty Hanson. Some, like Goldman Sachs, Providence Equity Partners and Charterhouse Capital Partners have slid down the ranking. But some, like Advent International and Silver Lake, have surged ahead.

Each annual list offers a snapshot of a particular point in time, with each of the challenges and hurdles the industry has faced over the last 12 years reflected in the ebbs and flows of the ranking. A useful reference point indeed.

continue on the next page

300 —

3i Group



Continued from p. 47

THE EVERGREENS

About a fifth of the firms have charted a steady course through the years, perhaps none more so than **KKR**. In the original *PEI 50* the firm ranked second, and it has never slipped below fourth, showing that operating multiple fund families within private equity helps to smooth the way. This year the firm comes in third just \$500 million behind second-place Blackstone.

THE DEPARTED

The private equity landscape has changed, if not drastically then certainly noticeably since 2007, thanks in large part to the global financial crisis. Some firms took hits during that period from which they were unable to recover. Others dramatically shifted the way they operate. One such firm is **3i Group**, which was 13th on our 2007 list. The listed company had always made hefty contributions to its limited partnerships, but in 2013 shifted entirely away from raising third-party capital for private equity investments, instead relying wholly on its balance sheet. Its last third-party fund was the 2006-vintage €5 billion Eurofund V, and as such the firm no longer appears in the *PEI 300* ranking.

THE COMEBACK KINGS

The last decade has been a rollercoaster for financial markets, and private equity has been no exception. Some firms have ridden that rollercoaster better than others. **Thomas H Lee Partners** was riding high in 2007 in 30th place with a five-year fundraising total of \$7.5 billion. But after three consecutive years of climbing, in 2013 it plummeted out of the ranking as it took more time to come back to market with a successor to its \$10.1 billion sixth fund. In 2015 it crept back in at 296th and has been climbing in leaps and bounds ever since, landing at 63rd this year.

THE SHRINKING VIOLETS

To stay atop the *PEI 300*, it is not enough to just raise capital in a consistent way. This

is evident in the handful of firms that have slipped down the ranking despite their fundraising totals staying steady. One such firm is Hellman & Friedman; debuting at 16 in 2007 with a five-year fundraising total of \$12 billion, the following year the same total only granted the firm 25th place. This year it's in at 29 with \$10.9 billion.

THE SURGERS

It goes without saying that it's much easier to slide down the *PEI 300* than it is to climb up. But a small handful of firms have plotted determined ascents over the last decade, among them Advent International, Clayton, Dubilier & Rice and **EQT Partners**. From 21st place in 2007 with a five-year fundraising total of just over \$10 billion, EQT has since launched several new product lines within private equity and snuck into the top 10 for the first time in 2016. It's shot up to seventh place this year on the back of its €10.75 billion eighth flagship fundraise.

THE SLIDERS

For around a quarter of firms in the original list, the first few years were their highpoint before sliding down through subsequent rankings. On the eve of the global financial crisis, **Goldman Sachs** raised one of the largest funds the private equity world had ever seen, the \$20.3 billion GS Capital Partners VI, which included \$9 billion contributed by the firm and its employees. It took almost a decade to come back with a follow-up buyout fund, the \$7 billion West Street Capital Partners VII. In the intervening years a lot changed for Goldman and its banking peers, many of whom chose to spin out their private equity teams. The impact of the Volcker rule, part of the Dodd-Frank Act passed in 2010, can be seen in the decision not to name the fund after the parent bank and in the amount of capital Goldman itself was able to commit to the fund. From top of the list in 2010, Goldman now sits in 37th place. ■

FUNDS OF FIRMS

Who owns whom?

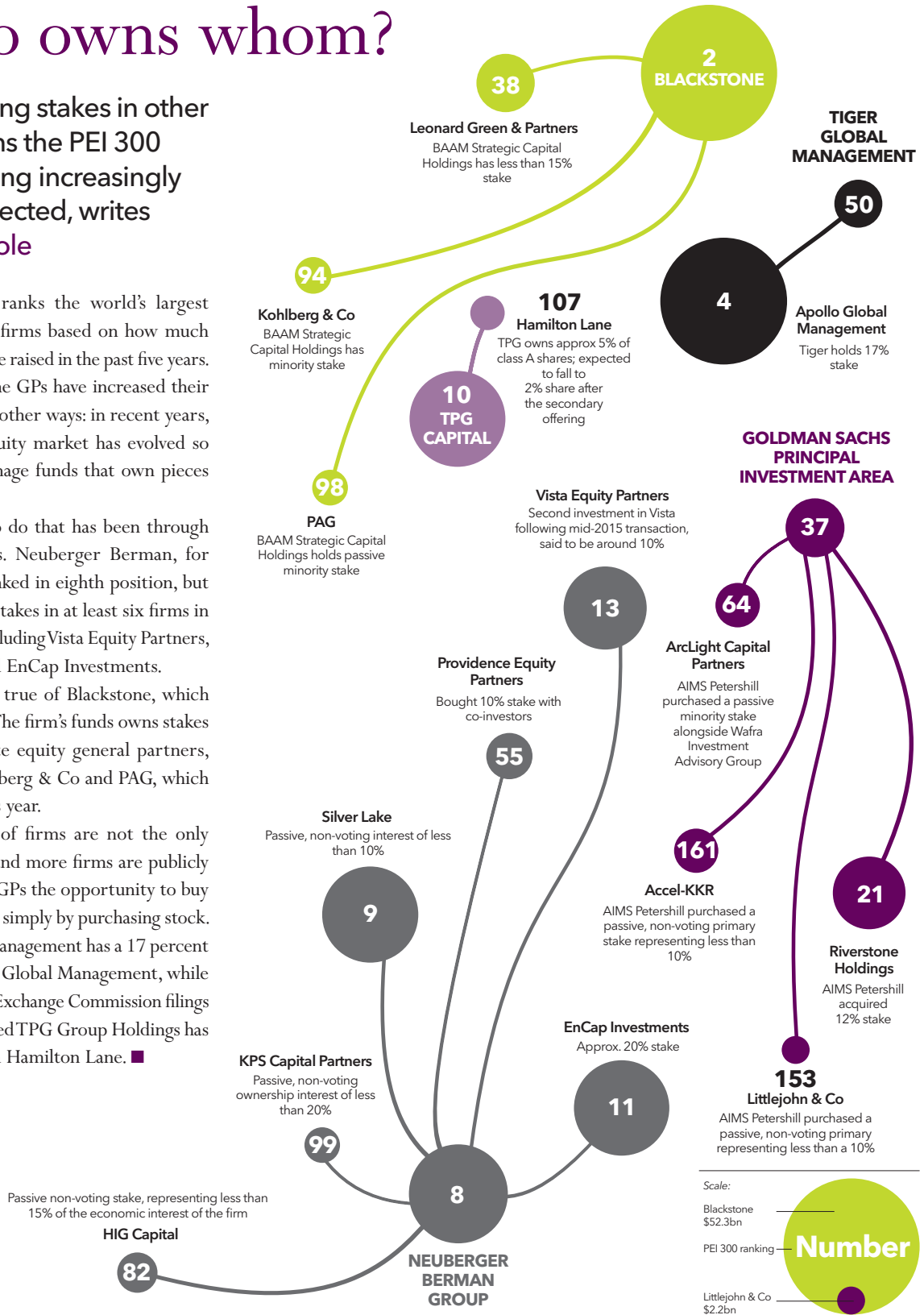
Firms taking stakes in other GPs means the PEI 300 is becoming increasingly interconnected, writes **Marine Cole**

The PEI 300 ranks the world's largest private equity firms based on how much money they have raised in the past five years. But some of the GPs have increased their importance in other ways: in recent years, the private equity market has evolved so firms now manage funds that own pieces of their peers.

One way to do that has been through funds of firms. Neuberger Berman, for example, is ranked in eighth position, but its funds hold stakes in at least six firms in the ranking, including Vista Equity Partners, Silver Lake and EnCap Investments.

This is also true of Blackstone, which ranks second. The firm's funds owns stakes in three private equity general partners, including Kohlberg & Co and PAG, which it acquired this year.

And funds of firms are not the only option. More and more firms are publicly traded, giving GPs the opportunity to buy into their rivals simply by purchasing stock. Tiger Global Management has a 17 percent stake in Apollo Global Management, while Securities and Exchange Commission filings recently revealed TPG Group Holdings has a small stake in Hamilton Lane. ■



PEI 300: 101-150

❖ Not present in 2017 PEI 300

2018 Rank	2017 Rank	Firm	PEI 300 Five-Year Fundraising Total (\$m)	Headquarters
101	▲ 103	First Reserve	3,537.00	Greenwich
102	▼ 70	Welsh, Carson, Anderson & Stowe	3,532.02	New York
103	▼ 100	TowerBrook Capital Partners	3,500.00	New York
104	▲ 239	Sentinel Capital Partners	3,450.00	New York
105	▼ 86	Lightspeed Venture Partners	3,405.60	Menlo Park
106	▼ 104	IDG Capital Partners	3,382.81	New York
107	▲ 136	Hamilton Lane	3,341.94	Bala Cynwyd
108	▼ 87	Roark Capital Group	3,258.40	Atlanta
109	▼ 106	Crestview Partners	3,255.86	New York
110	▲ 176	Oak Hill Capital Partners	3,246.93	New York
111	❖ N/A	Andreessen Horowitz	3,236.70	Menlo Park
112	▼ 105	HGGC	3,174.00	Palo Alto
113	▼ 111	Court Square	3,173.00	New York
114	▲ 269	Hopu Investment Management	3,100.00	Beijing
115	▲ 119	Hony Capital	3,024.24	Beijing
116	▼ 115	Montagu Private Equity	3,020.73	London
117	▲ 149	OrbiMed Advisors	2,913.00	New York
118	▲ 146	IVP	2,900.00	Menlo Park
119	▲ 127	Great Hill Partners	2,878.84	Boston
120	▲ 216	ICONIQ Capital	2,878.34	San Francisco
121	▼ 83	Rhône Group	2,855.97	New York
122	▲ 133	Digital Sky Technologies	2,820.00	Moscow
123	▼ 112	IFC Asset Management Company	2,790.66	Washington DC
124	▼ 69	Audax Group	2,782.00	Boston
125	▲ 132	Hahn & Co.	2,742.80	Seoul
126	▲ 253	Foundry Group	2,720.00	Boulder
127	▲ 134	Altor Equity Partners	2,630.55	Stockholm
128	▼ 109	Kleiner Perkins Caufield & Byers	2,600.00	Menlo Park
129	▲ 137	Trilantic Capital Partners North America	2,578.38	New York
130	▲ 155	WL Ross & Co.	2,562.50	New York
131	▲ 140	The Catalyst Capital Group	2,540.00	Toronto
132	▲ 141	Charterhouse Capital Partners	2,535.80	London
133	▼ 97	Sycamore Partners	2,500.00	New York
134	▼ 131	TSG Consumer Partners	2,500.00	San Francisco
135	▲ 143	Inflexion Private Equity	2,457.37	London
136	▲ 288	Spectrum Equity	2,452.00	Boston
137	▲ 144	Pine Brook	2,440.00	New York
138	▲ 147	Primavera Capital Group	2,428.31	Beijing
139	▲ 217	Quadrant Private Equity	2,391.90	Sydney
140	▲ 204	Hermes GPE	2,375.85	London
141	▼ 89	JP Morgan Asset Management	2,363.25	New York
142	▼ 93	Oaktree Capital Management	2,318.29	Los Angeles
143	▲ 150	Astorg Partners	2,315.30	Paris
144	▼ 125	Searchlight Capital Partners	2,309.00	New York
145	▲ 236	Lime Rock Partners	2,291.60	Westport
146	▲ 148	Ridgemont Equity Partners	2,289.56	Charlotte
147	▲ 161	HitecVision	2,274.80	Stavanger
148	▲ 152	Founders Fund	2,270.00	San Francisco
149	▲ 153	GSR Ventures	2,251.51	Beijing
150	▲ 350	Cornell Capital	2,248.00	New York

151-200

❖ Not present in 2017 PEI 300

2018 Rank	2017 Rank	Firm	PEI 300 Five-Year Fundraising Total (\$m)	Headquarters
151	▲ 325	Orchid Asia	2,220.00	Hong Kong
152	▲ 262	Tailwind Capital Partners	2,210.10	New York
153	▲ 156	Littlejohn & Co	2,200.00	New York
154	▼ 126	Arsenal Capital Partners	2,175.00	New York
155	▲ 168	Avista Capital Partners	2,175.00	New York
156	▲ 157	Hillhouse Capital Group	2,125.00	Beijing
157	▼ 102	FountainVest Partners	2,100.00	Hong Kong
158	▲ 159	Sun Capital Partners	2,100.00	Boca Raton
159	▲ 259	JAFCO Co.	2,096.49	Tokyo
160	▼ 130	Siris Capital Group	2,065.70	New York
161	▼ 108	Accel-KKR	2,050.00	Menlo Park
162	▼ 160	Resource Capital Funds	2,040.00	Menlo Park
163	◁▷ 163	Greylock Partners	2,020.00	Menlo Park
164	▲ 165	FFL Partners	2,018.00	San Francisco
165	▲ 166	Odyssey Investment Partners	2,000.00	New York
166	▲ 412	Peak Rock Capital	2,000.00	Austin
167	▲ 173	ABRY Partners	1,985.50	Boston
168	▼ 138	Clearlake Capital Partners	1,980.00	Houston
169	▲ 190	Blue Water Energy	1,971.00	London
170	▲ 347	Pantheon	1,959.10	London
171	▲ 490	Post Oak Energy Capital	1,950.00	Houston
172	▲ 225	Tailwater Capital	1,924.00	Dallas
173	▼ 171	FSN Capital	1,916.50	Oslo
174	▲ 192	Sapphire Ventures	1,900.00	Palo Alto
175	▲ 489	Old Ironsides Energy	1,852.87	Boston
176	▼ 175	American Industrial Partners	1,850.00	New York
177	◁▷ 177	Battery Ventures	1,850.00	Boston
178	▲ 195	BlackRock	1,844.35	New York
179	▲ 419	Brentwood Associates	1,838.00	Los Angeles
180	▼ 110	Yorktown Partners	1,835.80	New York
181	▲ 222	DFJ	1,834.00	Menlo Park
182	▼ 180	Spark Capital	1,829.50	Boston
183	◁▷ 183	Multi Asset Global Investment	1,825.30	Seoul
184	▲ 355	Trive Capital	1,825.00	Dallas
185	▲ 188	Proterra Investment Partners	1,802.32	Minneapolis
186	▼ 184	STIC Investments	1,788.75	Seoul
187	▼ 123	Index Ventures	1,776.11	Geneva
188	▲ 424	Quad-C Management	1,772.50	Charlottesville
189	▼ 164	Deutsche Beteiligungs AG	1,771.92	Frankfurt
190	▼ 170	IMM Private Equity	1,747.06	Seoul
191	▲ 227	White Deer Energy	1,720.00	Houston
192	▼ 139	ARC Financial Corp.	1,710.55	Calgary
193	▲ 367	Vestar Capital Partners	1,684.71	New York
194	▼ 189	Shunwei Capital Partners	1,683.84	Beijing
195	▲ 234	Apax Partners SAS	1,670.01	Paris
196	▲ 484	Horsley Bridge Partners	1,664.00	San Francisco
197	▼ 193	One Equity Partners	1,650.00	New York
198	▼ 194	Actis	1,642.50	London
199	▲ 223	Oakley Capital Private Equity	1,628.73	London
200	▼ 174	Kerogen Capital	1,618.00	Hong Kong

PEI 300: 201-250

❖ Not present in 2017 PEI 300

2018 Rank	2017 Rank	Firm	PEI 300 Five-Year Fundraising Total (\$m)	Headquarters
201	▲ 203	Bessemer Venture Partners	1,600.00	Menlo Park
202	◁▷ 202	Norwest Equity Partners	1,600.00	Minneapolis
203	▲ 205	FTV Capital	1,581.00	San Francisco
204	❖ N/A	Altamont Capital Partners	1,573.00	Palo Alto
205	▲ 376	Tata Capital	1,567.66	Mumbai
206	▲ 210	Pamlico Capital	1,560.00	Charlotte
207	❖ N/A	Huaxing Growth Capital	1,559.19	Beijing
208	▼ 197	Mid Europa Partners	1,557.87	London
209	▲ 211	General Catalyst Partners	1,530.00	Cambridge
210	▼ 200	Qiming Venture Partners	1,529.13	Shanghai
211	▲ 283	GoldPoint Partners	1,525.00	New York
212	▲ 385	NovaQuest Capital Management	1,523.88	Raleigh
213	◁▷ 213	Exponent Private Equity	1,518.03	London
214	▲ 219	HTC Corp.	1,501.69	Taipei
215	▼ 142	Boyu Capital	1,500.00	Hong Kong
216	▼ 214	Lenovo Group	1,500.00	Hong Kong
217	▼ 196	Navis Capital Partners	1,500.00	Kuala Lumpur
218	▼ 207	Pacific Equity Partners	1,496.44	Sydney
219	▲ 233	Morningside Ventures	1,482.05	Shanghai
220	▲ 290	Japan Industrial Solutions	1,478.50	Tokyo
221	▲ 342	Social Capital	1,475.00	Palo Alto
222	▲ 418	Novacap	1,464.50	Longueuil
223	▼ 220	EMR Capital	1,454.95	Melbourne
224	▲ 387	Bernhard Capital Partners	1,450.00	Baton Rouge
225	▼ 218	Torquest Partners	1,442.05	Toronto
226	▼ 221	Nautic Partners	1,430.00	Providence
227	❖ N/A	Vistria Group	1,425.92	Chicago
228	▼ 226	Vector Capital	1,410.00	San Francisco
229	❖ N/A	One Rock Capital Partners	1,395.50	New York
230	▲ 231	Aurora Capital Partners	1,395.02	Los Angeles
231	▲ 252	Partech	1,390.74	Paris
232	▲ 440	Clarus Ventures	1,380.00	Cambridge
233	▼ 228	Multiples Alternate Asset Management	1,375.00	Mumbai
234	▲ 344	Flagship Pioneering	1,370.02	Cambridge
235	▲ 432	VMG Partners	1,361.50	San Francisco
236	▼ 230	Anchor Equity Partners	1,350.00	Hong Kong
237	▲ 255	China Media Capital	1,350.00	Beijing
238	❖ N/A	Perella Weinberg Partners	1,350.00	New York
239	▼ 191	Cathay Capital Private Equity	1,313.27	Paris
240	▼ 224	Freeman Spogli & Co.	1,300.00	Los Angeles
241	▼ 240	Matrix Partners	1,300.00	Cambridge
242	❖ N/A	Siparex Group (Sigefi Private Equity)	1,296.94	Lyon
243	❖ N/A	Chequers Capital	1,291.85	Paris
244	▼ 178	Aquiline Capital Partners	1,290.00	New York
245	❖ N/A	Kedaara Capital	1,290.00	Mumbai
246	▼ 242	Mithril Capital Management	1,280.30	San Francisco
247	▼ 246	Wynnchurch Capital	1,273.22	Rosemount
248	▼ 94	Denham Capital Management	1,271.60	Boston
249	❖ N/A	Adelis Equity Partners	1,271.36	Stockholm
250	▼ 181	Livingbridge	1,265.15	London

251-300

❖ Not present in 2017 PEI 300

2018 Rank	2017 Rank	Firm	PEI 300 Five-Year Fundraising Total (\$m)	Headquarters
251	▲ 364	Edmond de Rothschild Investment Partners	1,255.21	Paris
252	▼ 248	Kinderhook Industries	1,250.00	New York
253	▼ 247	Riverwood Capital	1,250.00	Menlo Park
254	▼ 241	The Sterling Group	1,250.00	Houston
255	❖ N/A	BV Investment Partners	1,237.00	Boston
256	❖ N/A	Atomico	1,230.43	London
257	❖ N/A	Portobello Capital	1,229.57	Madrid
258	▲ 292	Legend Capital	1,222.30	Beijing
259	▼ 169	Energy Spectrum Capital	1,222.00	Dallas
260	▼ 250	Palladium Equity Partners	1,217.85	New York
261	▲ 270	Gilde Buy Out Partners	1,208.29	Utrecht
262	▼ 261	Banyan Capital	1,206.71	Beijing
263	▼ 260	Frazier Healthcare Partners	1,206.00	Seattle
264	▲ 329	FirstMark Capital	1,197.70	New York
265	❖ N/A	Adams Street Partners	1,197.66	Chicago
266	▼ 257	China Everbright Limited	1,196.31	Hong Kong
267	▼ 198	Eagletree Capital	1,190.00	New York
268	▲ 313	Abris Capital Partners	1,184.74	Warsaw
269	▼ 258	ICICI Venture	1,175.00	Mumbai
270	❖ N/A	Core Equity Holdings	1,174.41	Brussels
271	▼ 267	Sterling Partners	1,169.00	Chicago
272	▲ 316	LLR Partners	1,150.00	Philadelphia
273	▼ 256	Sofinnova Ventures	1,150.00	Menlo Park
274	❖ N/A	MidOcean Partners	1,145.00	New York
275	▼ 265	Deutsche Private Equity	1,140.71	Munich
276	▼ 263	Third Rock Ventures	1,132.00	Boston
277	❖ N/A	WestView Capital Partners	1,130.00	Boston
278	▼ 272	Helios Investment Partners	1,128.00	London
279	▲ 452	New Horizon	1,120.00	Hong Kong
280	❖ N/A	TZP Group	1,112.00	New York
281	▼ 182	Lightyear Capital	1,105.00	New York
282	▼ 271	Cortec Group	1,100.00	New York
283	▼ 276	DCM Ventures	1,100.00	Menlo Park
284	▼ 243	Greenbriar Equity Group	1,100.00	Rye
285	▼ 172	Gryphon Investors	1,100.00	San Francisco
286	▲ 426	Menlo Ventures	1,100.00	Menlo Park
287	▼ 273	Northlane Capital Partners	1,100.00	Bethesda
288	❖ N/A	Oak HC/FT Partners	1,100.00	Greenwich
289	❖ N/A	Pearl Energy Investments	1,100.00	Dallas
290	▼ 275	Samsung Electronics	1,100.00	Seoul
291	▼ 249	Thrive Capital	1,100.00	New York
292	▼ 274	YunFeng Capital	1,100.00	Shanghai
293	▼ 277	Castik Capital	1,098.45	Luxembourg
294	▲ 449	CLSA Capital Partners	1,091.00	Hong Kong
295	▲ 439	Frontier Capital	1,090.80	Charlotte
296	▼ 281	Breakthrough Energy	1,080.00	Kirkland
297	❖ N/A	Fondo Italiano di Investimento	1,071.02	Milan
298	▲ 334	Merced Capital	1,068.69	Minnetonka
299	▼ 232	Stripes Group	1,067.00	New York
300	❖ N/A	CreditEase	1,062.20	Beijing

*From left:
Daryl Li, Jeff Keay,
Anthony Shontz,
Scott Humber,
David Schwartz
and Andy Nick*

Keeping LPs centre-stage

Prioritising the needs of LPs is more important than ever in an increasingly complex secondaries market, write **Isobel Markham** and **Marine Cole**

SPONSORED BY: Ardian, Debevoise & Plimpton, Greenhill Cogent, HarbourVest, Landmark Partners and Partners Group

GP-led transactions stole the spotlight in a record-breaking year that saw \$58 billion of secondaries transaction volume. That segment of the market – which has experienced nearly 50 percent annualised growth since 2011 – accounted for around \$14 billion in 2017, according to research by Greenhill Cogent. The advisory firm predicts GP-leds could exceed \$20 billion this year.

It should come as no surprise, then, that the segment was the first topic of conversation around the table at *Private Equity International's* annual secondaries roundtable in Debevoise & Plimpton's New York office in late March.

David Schwartz, who heads up the law firm's fund formation practice, says there has been a rise in interest in these transactions as the market continues to see many more funds that still have significant assets left at the end of their life.

"Depending on the LP base and stage in a GP's fundraising lifecycle, GPs are often very proactive and use a restructuring as a segue into their next fundraise," he says.

In the early days of the GP-led secondaries market, the transactions were typically used by franchises looking to wind down, says Andy Nick, managing director at Greenhill Cogent.

"Now we're seeing those same types of transactions from very alive-and-well GPs that are just using the market as a tool to reduce their administrative burden or wind down a fund that may have been around for 12 or more years. Maybe the investors did very well on it and the GP is on Fund VI, VII, VIII and they're thinking about what to do with Fund III," Nick says. "We're seeing GPs that arguably have greater AUM and probably greater forward prospects than some of the earlier GPs who used the market."

GP-led deals used to take two basic forms: a tender offer, where LPs can opt to liquidate their stakes and the fund structure doesn't change; or a restructuring, where assets are moved out of the fund into a new

vehicle. Today, there are more options on the table, says Anthony Shontz, managing director and co-head of private equity integrated investments for the Americas region at Partners Group.

"More recently we've seen some hybrids such as the strip sales, where you bifurcate the portfolio," he says.

Last year Warburg Pincus sold a roughly \$1.2 billion strip of its Asia portfolio, made up of stakes in 29 companies, into a new vehicle with new terms. Lexington was the majority buyer, joined by Goldman Sachs Asset Management and a few other parties.

Other ways to split the portfolio include by public and private assets, or – particularly in the case of infrastructure – by »

“Previously in a mega-fund, the biggest equity cheque would be \$500 million; nowadays we're seeing investors that can speak for \$750 million or even \$1 billion primary commitments

Daryl Li





» mature or de-risked assets and those that are still development-oriented, Shontz explains.

Some deals have combined GP-led transactions and preferred equity.

“We have worked with GPs to create solutions for all parties involved,” says Scott Humber, a managing director at Landmark.

“In this ‘thought partner’ approach, we have structured transactions that involved a preferred interest in multiple funds. In our experience, we have completed transactions to solve GPs’ desires to take on strategic capital without taking on permanent capital. We have developed defined exit mechanisms, which is important to GPs.”

The majority of GP-led activity has been concentrated in Europe. Data from Greenhill Cogent show transactions in the region accounted for 48 percent of that market last year, compared with 40 percent in North

“ Depending on the LP base and stage in a GP’s fundraising lifecycle, GPs are often very proactive and use a restructuring as a segue into their next fundraising

David Schwartz

America. In a sub-asset class where evolution usually comes from North America – after all, the region accounted for 66 percent of all deals last year – this is surprising

Jeff Keay, a managing director with HarbourVest, suggests several reasons why this has been the case. “I think it’s the appetite

of general partners to explore a transaction that’s not necessarily right up the fairway of what GPs typically do from a fund management standpoint,” he says.

“Part of it may be the profile of the limited partner base of some of the funds where these transactions have taken place; there’s more willingness to manage through the inevitable conflicts that arise.”

Momentum within the region has also played a major role. “European managers have seen their peers pursue those opportunities and that’s lowered the barriers to pursue additional deals. That’s obviously spreading now on a more global basis,” Keay says, adding the balance among geographies is likely to level off this year.

Shontz points out an important structural reason why European GPs are leading this movement: carry. Vehicles with a European-style waterfall don’t take carry until all cost has been returned, whereas those with the American model are taking carry on a deal-by-deal basis. “That creates a real incentive for a GP with a European-style waterfall to accelerate or crystallise the carry through a GP-led transaction.”

WIN-WIN

These transactions can be an attractive tool for GPs and LPs alike. For GPs, providing additional runway for certain assets that have upside potential, as well as realigning and motivating investment teams are two reasons to consider a GP-led transaction, says Humber.

“In a situation where a majority of the carry has been allocated to the more senior partners, some of whom may have taken a step back during the life of the fund, a transaction can serve as an opportunity to establish better alignment and incentives on a go-forward basis for the junior partners who have led the portfolio.”

For LPs, providing a liquidity alternative can be an attractive feature, he adds.

However, all the experts agree the most important thing for ensuring a successful

GP-led transaction is looking after the existing LPs.

“Sometimes there is a monetisation event where carry is distributed to the team, so we are very active and very vocal to protect our investors who are in the fund,” says Daryl Li, a director at Ardian, which also makes primary commitments through its fund of funds programme.

“We will negotiate status quo options, making sure existing investors get to remain in the same terms and conditions they signed up for, or if there’s a big carry event, we want to make sure the key people in the team are incentivised going forward, either through appropriate vesting mechanisms or ensuring they roll an appropriate amount of carry into the new fund.”

Li stresses the need for active communication between the LPs, the GPs and the new investors throughout the process. “GPs

“The reputation you create there has a bigger cost beyond that individual deal”

Jeff Keay

have an objective or several objectives they want to achieve through this transaction, and LPs are usually understanding as long as you have an open line of communication with them. It’s important to establish that and work out a solution for everybody.”

It is typically preferred to offer a status quo option, but it is not always a possibility, says Shontz, for example if the portfolio needs a capital infusion. “Investors may »



MEET THE ROUNDTABLE



DARYL LI
director
ARDIAN

Li works in Ardian’s fund of funds and co-investment teams and is based in New York. The firm has about \$67 billion in assets under management, including \$38 billion in its fund of funds strategy, which targets primary investments and secondaries.



DAVID SCHWARTZ
partner
DEBEVOISE & PLIMPTON

New York-based Schwartz heads the firm’s fund formation practice, representing sponsors of, and institutional investors in, private equity funds. He also regularly represents GPs and LPs in traditional and complex secondaries recapitalisations and restructurings.



ANDY NICK
managing director
GREENHILL COGENT

Nick advises limited partners and general partners on secondaries market transactions and is based in San Francisco. Greenhill Cogent has approximately 35 professionals dedicated to secondaries in five global offices.



JEFF KEAY
managing director
HARBOURVEST

Based in Boston, Keay focuses on global secondaries investments at HarbourVest, which has deployed more than \$60 billion in assets in private equity since inception, including nearly \$20 billion in secondaries since 1986.



SCOTT HUMBER
managing director
LANDMARK PARTNERS

Landmark Partners focuses solely on secondaries in private equity, real estate and real assets with about \$22 billion of invested and committed capital. Humber is based in the Boston office.



ANTHONY SHONTZ
managing director
PARTNERS GROUP

Based in Denver, Shontz is co-head of Partners Group’s integrated investment team in the Americas, which focuses on primary investments, secondaries and co-investments. The firm has \$74 billion in AUM and invests over \$2 billion a year in secondaries.

» be faced with the tough situation: do we put in additional capital or do we keep the status quo and have the companies fail, or do we allow some kind of restructuring?”

However, there are creative ways to approach the problem to find outcomes with which existing LPs are comfortable, says Schwartz.

“Often existing LPs who remain in the restructured fund do not want to commit additional capital,” he says.

“One alternative is to recycle distributions rather than require LPs to make additional capital contributions. The GP can use cash that would have ordinarily been distributed to all of the partners, including the status quo rollover partners, and recycle or reinvest such cash in portfolio investments. There’s a lot of creative ways you can structure to have almost a status quo, and I think having a status quo or an

almost status quo is very important to getting the deal done.”

Shontz points out that most GP-led situations are focused on mature funds, predicting that in the future liquidity offerings may become standard.

“There are discussions taking place with GPs around building automatic liquidity options once a fund reaches a certain age into limited partnership agreements, and it could become a standard feature that at some point in time there is an offer for all LPs to get out if they want to.”

Schwartz says such liquidity provisions are part of the conversation, though he has yet to see them in widespread use.

LONG MEMORIES

While there are several elements HarbourVest focuses on when evaluating a potential GP-led deal, such as asset quality

and manager quality, a major factor is the manager’s approach to the transaction – and their ability to put themselves in their limited partners’ shoes.

“If you approach it from the standpoint of ‘I want to increase my fees, I want to create the opportunity for more carry’ and that’s what drives your decision-making, you’re probably not going to end up with a deal that gets support and it could potentially put you at risk with your LP base.”

Secondaries buyers must bear in mind that some of the existing investors in these funds could be investors in their own funds.

Schwartz mentions a recent deal in which LPs had just 20 days to review a very lengthy disclosure document and decide whether they wanted to roll over into a new vehicle or cash out.

“There was a lot of bad reaction from the LP community,” he says.

“The sponsor and the secondaries players should spend real time communicating with the LP base and bringing them along: meeting with the advisory committee, holding structuring calls with the limited partners and regular process updates, so that when the official offer is made, it’s just part of the process, it’s not ‘this is the first time you’re actually explaining

“There are discussions taking place with GPs around building automatic liquidity options once a fund reaches a certain age into limited partnership agreements

Anthony Shontz



“We’re seeing GPs that arguably have greater AUM and probably greater forward prospects than some of the earlier GPs who used the market

Andy Nick

the deal and you have two weeks to decide.”

Although the deal was ultimately done, the experts agree LPs “don’t forget about being mistreated”. The real success of a GP-led transaction is not on whether the deal gets done but on whether the GP has a successful follow-on fundraising.

“The real cost is not in the uptake – you can drive it ahead and still get a transaction done – but in the next fundraise you will have and the sentiment in the market around how you partner with LPs,” Keay says.

“The reputation you create there has a bigger cost beyond that individual deal.”

MEGA-FUNDS DRIVING MEGA-DEALS

For Li and Ardian, finding situations where the firm has a competitive advantage is paramount. As such, the firm is still focusing primarily on large LP portfolios where its business model gives it an information advantage, and it can react very quickly to speak for the entire portfolio.

Recent mega-fundraisings in the primary market are likely to drive more activity in this market segment, Li says.

“Previously in a mega-fund, the biggest equity cheque would be \$500 million; nowadays we’re seeing investors that can speak for \$750 million or even \$1 billion primary commitments.”



Ardian’s ability to take down large portfolios on its own also helps it to feed its LPs’ desire for co-investment.

“There’s a lot of demand for secondaries co-investment paper and we are mindful of that, and that’s a big part of our investment strategy,” Li says.

“In addition, for the large portfolios there tends to be sizeable GP commitments involved, and GPs are becoming more and more involved controlling the secondaries process.”

Often the secondaries buyer is taking out a fund’s anchor investor. In such situations, Ardian’s strong relationship with GPs through its primary platform, out of which it deploys \$1 billion a year through separately managed accounts, is a competitive advantage.

“That helps us develop very strong relationships with GPs, so then when we

replace anchor investors, they know they can potentially develop a long relationship with Ardian and that we speak for primary capital.”

PILING UP

Nick sees pricing as correlated to the public markets, with pricing as a percentage of net asset value rising as the public markets are rising, taking into account the lag in NAV reporting dates. One factor overarching both the macro environment and the public markets is the effect of leverage and the amount of dry powder in the market.

“There’s less of a capital overhang in the secondaries market than the buyout market, but it’s still more dry powder than we’ve seen historically on average in the market,” Nick says.

“That has been benefiting our clients who have been looking to sell, and even »

“A transaction can serve as an opportunity to establish better alignment and incentives on a go-forward basis for the junior partners who have led the portfolio

Scott Humber

» with the equity markets being a little bit choppy, secondaries pricing has stayed at a high level.”

His firm is seeing more limited partners taking large portfolios to market with the design of only selling a portion of it.

“We have a lot of clients that have a core portfolio that’s the high-conviction ‘we’re going to market because we want to sell this portfolio of assets’. But then alongside that they have an opportunistic portfolio where they understand there’s certain things in high demand on the buy-side, so if they can mix some of the lower-pricing assets that they want to get rid of more with some of the things that the buy-side’s clamouring for, it raises the average price,” he says. A successful deal for such a seller may be offloading 50-60 percent of what they took to market.

In recent years there have been whispers of greater interest from LPs – traditionally sellers on the secondaries market – in becoming buyers. As on the primary side, co-investment opportunities are a good place to start.

Humber estimates there’s around \$100 billion of capacity to buy in the secondaries marketplace, and of that, \$15 billion is estimated to come from non-traditional secondaries buyers, including LPs looking to buy directly.



ENERGY BOOST

Less than 50 percent of the funds sold last year were buyout vehicles, according to Greenhill, showing the role energy, infrastructure and real estate play in the market. Keay identifies energy as one of the larger growth areas in the last year thanks to a large universe of LPs with exposure which are looking to de-risk and an improvement in pricing on the back of greater stability in oil pricing.

“Those assets are still trading at discounts, but I think LPs are looking to de-risk their portfolios given the risk profile,” he says. “It was painful for some LPs when the price of oil bottomed out.”

Ardian has also had an active year in energy and infrastructure secondaries, including picking up a €300 million portfolio of infrastructure LP interests from Italian banking group UniCredit.

Meanwhile, in its dedicated real estate business, Landmark is seeing signs that sellers are more willing to transact.

“Real estate secondaries transaction volume reached about \$6 billion last year, and has grown approximately 25 percent per year since 2008,” says Humber. “We consider dealflow opportunity over the next two to three years and forecast \$15 billion-\$25 billion of aggregate transaction volume.”

Nick points out there was an increase in non-traditional buyers during the last downturn. It is tough for LPs to convince boards and committees to buy into buyout

funds they like and want increased exposure to if the stakes are priced at par or above. However, if pricing dips, there could be a rise in interest from these buyers. ■

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FUND CLOSES

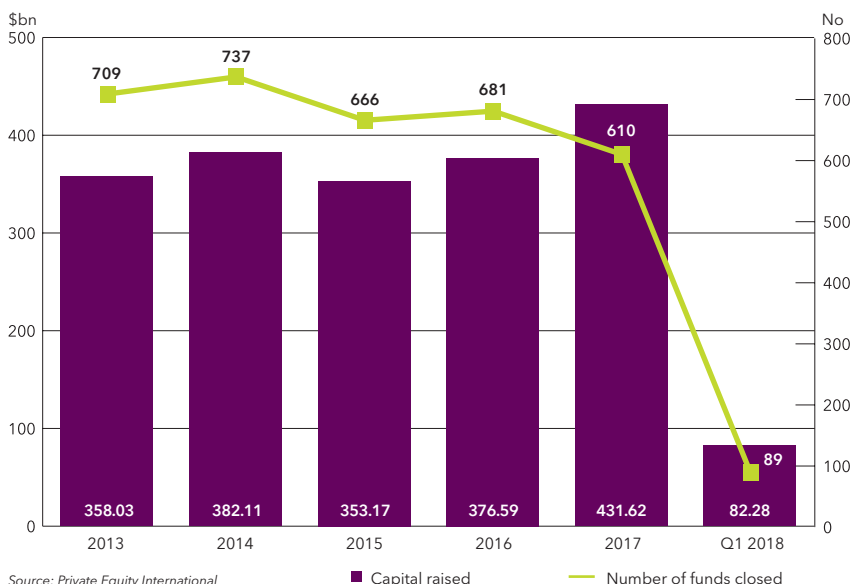
Law of averages

The average fund size reached a 10-year high in the first quarter of 2018, according to PEI data

CAPITAL ON THE RISE

- There were 89 private equity fund closes in Q1 2018, raising an aggregate \$82.3 billion. This equates to an average fund size of \$920 million – larger than any of the previous 10 years. The latest increase is fuelled by buyout and fund of funds vehicles.
- When considering strategies, venture capital saw the most closes with 27, followed by buyout (25) and growth capital (17). Only one vehicle focusing on distressed opportunities closed – Quantum Opportunity Fund II at \$100 million.

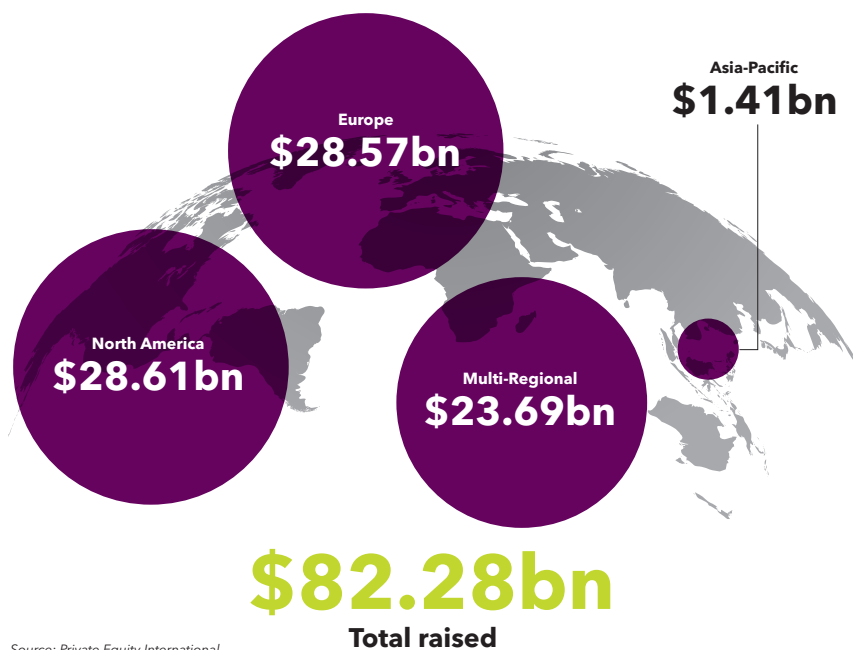
Private equity fundraising, 2008-Q1 18



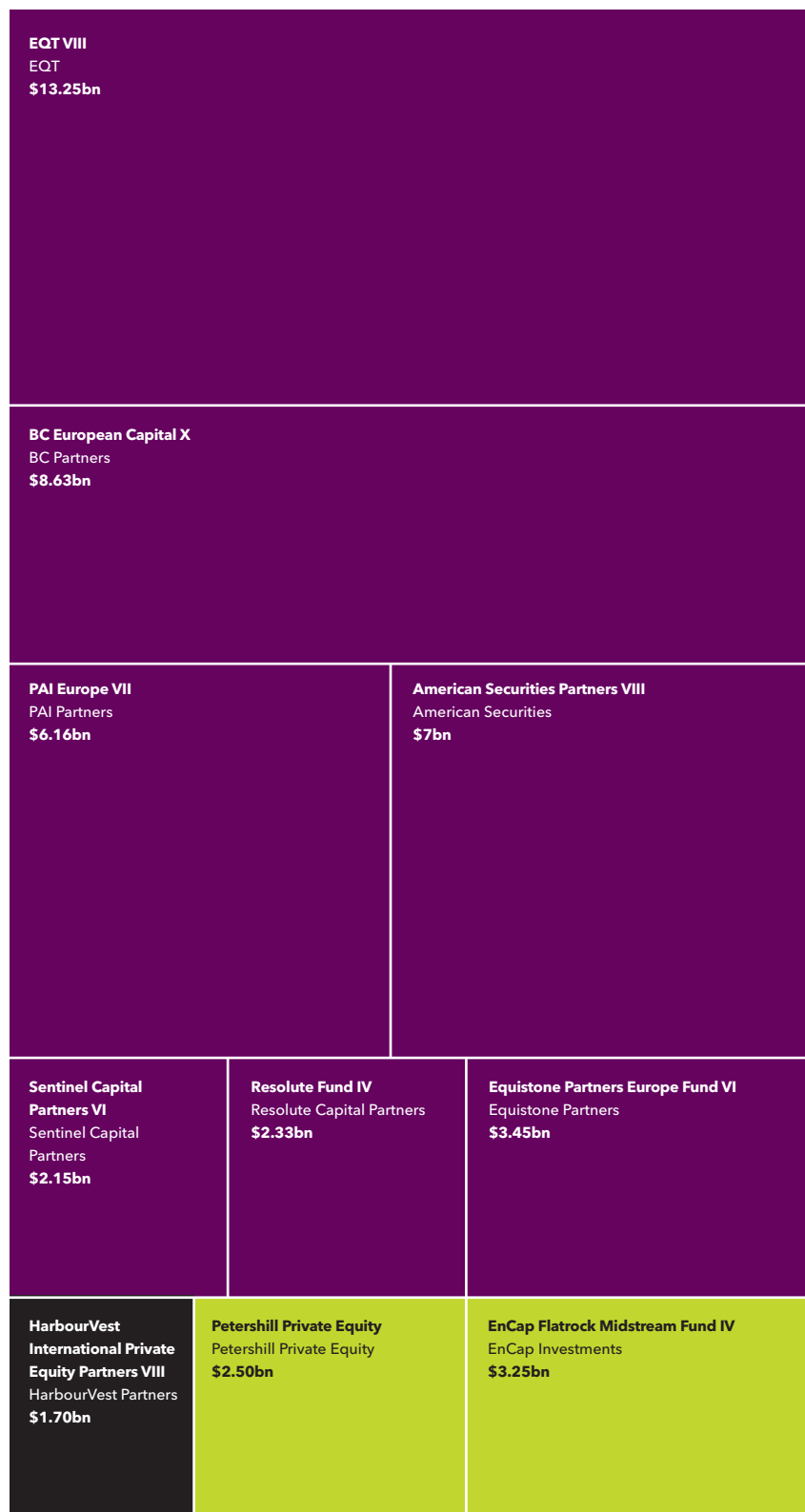
REGIONAL SPLIT

- Capital raised in Q1 2018 by funds targeting solely North American or European opportunities accounted for 70 percent of aggregated commitments (35 percent each). For 2017, 38 percent of capital focused on North America and just 12 percent on Europe.
- There were 21 vehicles targeting multiple regions for investment that held a final close in Q1 2018, accounting for 29 percent of total capital, or \$23.69 billion. The largest of these was the buyout fund BC European Capital X, which invests primarily in Europe and selectively in North America.

Capital raised by geographical focus, Q1 2018



Ten largest funds closed in Q1 2018



89



Funds closed in 2018

\$13.25bn



EQT VIII was the largest fund to close in Q1 2018

70%



Seven out of 10 of the largest funds closing in Q1 2018 were buyout funds

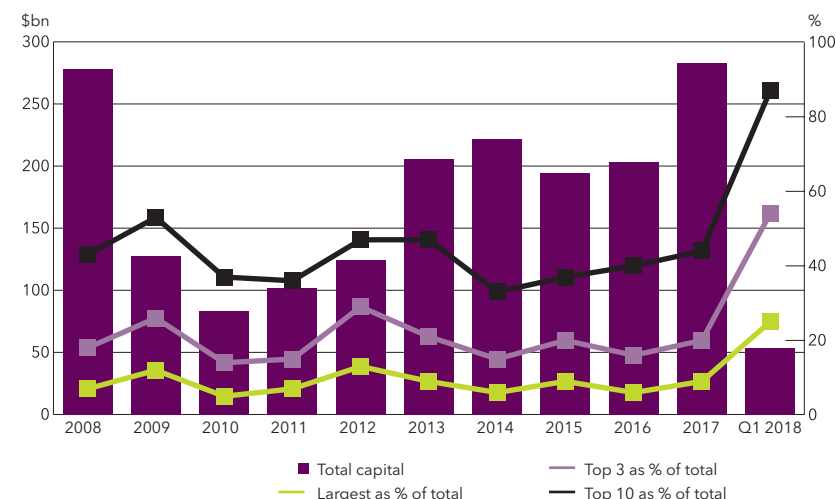
- Buyout
- Growth
- Fund of funds

Source: Private Equity International

BUYOUT BONUS

- Capital raised by buyout funds to March end 2018 totalled \$52.62 billion, with 25 funds raising on average \$2.14 billion. The largest fund to close year-to-date was predictably a buyout opportunity – the European focused EQTVIII – closing at \$13.25 billion.
- For the year to date, the average size of buyout funds has risen 40 percent on 2017. Further, 87 percent of total capital raised year to date has been by the 10 largest vehicles to hold a final close. The expectation is this figure will fall closely in line with 2017’s 44 percent and 2016’s 40 percent as the year progresses.

Capital raised by buyout funds, 2008-Q1 18

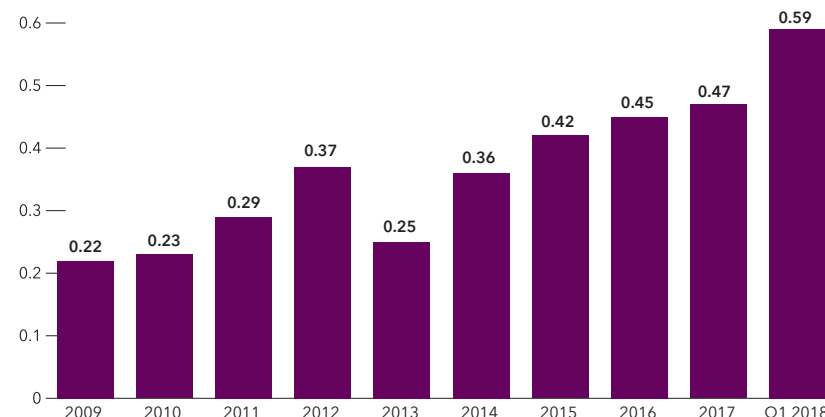


Source: Private Equity International

PASSAGE TO INDIA

- For the year to end-March 2018, \$10.10 billion was raised by 17 growth capital funds holding a final close – an average vehicle size of \$590 million. This average is a 27 percent increase on 2017, and greater in value than any of the previous 10 years.
- A notable growth capital close in 2018 is Sealink Capital I, a \$315 million vehicle formed to invest in Indian growth opportunities, agnostic of sector. It is the only growth fund to close so far in 2018 with a sole focus on the Asia-Pacific market.

Average size of growth fund \$bn



Source: Private Equity International

NINE LIVES

- There were nine secondaries funds holding a final close in Q1 2018 for a total of \$5.86 billion. The largest was Portfolio Advisors Secondary Fund III, closing on \$1.5 billion with an investment focus on Europe and North America. The fund had set a target of \$1 billion.
- The average fund size thus far in 2018 is \$650 million. This is the smallest value since 2011. However, with \$35 billion of targeted secondaries capital in market that is likely to increase considerably.

Five largest secondaries fund closes Q1 2018

FUND NAME	MANAGER	SIZE (\$BN)	REGIONAL FOCUS
Portfolio Advisors Secondary Fund III	Portfolio Advisors	1.50	Multi-Regional
Newbury Equity Partners IV	Newbury Partners	1.41	Multi-Regional
GCM Grosvenor Secondary Opps Fund II	GCM Grosvenor	0.70	North America
Altamar Global Secondaries IX	Altamar Private Equity	0.67	Multi-Regional
PineBridge Secondary Partners IV	PineBridge Investments	0.57	Multi-Regional

Source: Private Equity International

FUNDS IN MARKET BY STRATEGY FOCUS

- Predictably, the majority of capital currently being marketed is seeking commitment to buyout and growth opportunities – totalling 65 percent of total funds in market. These strategies naturally dominate the list of largest funds currently raising, with the biggest being Carlyle Partners VII – the North American buyout vehicle targeting \$15 billion.
- There are, however, considerably sized funds pursuing other strategies currently

Private equity funds in market by strategy, as at 1 April 2018



Source: Private Equity International

in market. Interestingly, the fourth largest ongoing private equity fundraise is for 3G Special Situations Fund V – a vehicle targeting \$10 billion to invest

in distressed or turnaround opportunities. Were the fund to close in 2018, it alone would make it the strongest year for distressed fundraising since 2013.

FUNDS IN MARKET BY GEOGRAPHY

- While 35 percent of funds raised in Q1 2018 had a sole focus on Europe, only 14 percent of capital in market shares this regional preference. The North American opportunity set is the most sought by fund managers, with 42 percent of capital being raised targeted solely at that region. Multi-regional funds account for 24 percent of total fund in market value.
- Only two of the 10 largest funds in market by target size have no plan to

Private equity funds in market by regional focus, as at 1 April 2018



Source: Private Equity International

invest in North American opportunities, whether solely or partly. The China-Russia Investment Corporation Fund, the third largest fund in market, is targeting \$10.84 billion to invest in

both China and Russia. The UK-based fund manager Bridgepoint is raising its sixth vehicle, Bridgepoint Europe VI, focused entirely on European investment opportunities.

FUNDS IN MARKET

Top 10 funds in market

FUND	MANAGER	TARGET SIZE (\$BN)	STRATEGY
Carlyle Partners VII	The Carlyle Group	15.0	Buyout
Lexington Capital Partners IX	Lexington Partners	12.0	Secondaries
China-Russia RMB Investment Cooperation Fund	Russian Direct Investment Fund	10.8	Co-Investment
3G Special Situations Fund V	3G Capital	10.0	Distressed
Coller International Partners VIII	Coller Capital	9.0	Secondaries
Bridgepoint Europe VI	Bridgepoint	6.2	Buyout
Dyal Capital Partners IV	Neuberger Berman Group	6.0	Growth
Energy Capital Partners Fund IV	Energy Capital Partners	6.0	Buyout
Insight Venture Partners X	Insight Venture Partners	5.5	Growth
NGP Natural Resources XII	NGP Energy Capital Management	5.3	Growth

Source: Private Equity International

PERFORMANCE

Better than you think

Removing sampling biases reveals greater parity between US and European venture capital performance than is often expected, according to a report from eFront.

By Alex Lynn

“US venture capital is miles ahead, but Europe? Forget it.”

That was the view of one London-based family office *Private Equity International* spoke to in March. Their less-than-glowing perception of European venture capital is not uncommon, with these funds often compared unfavourably with their US peers, according to the latest FrontLine report from investment software company eFront.

However, traditional methods of comparing the performance of European and US venture funds may not be entirely fair, the report said.

It cited sampling biases such as measuring the performance of euro-dominated vehicles in US dollars and comparing mature US funds that went through particularly favourable conditions in the 1990s with younger European funds that did not.

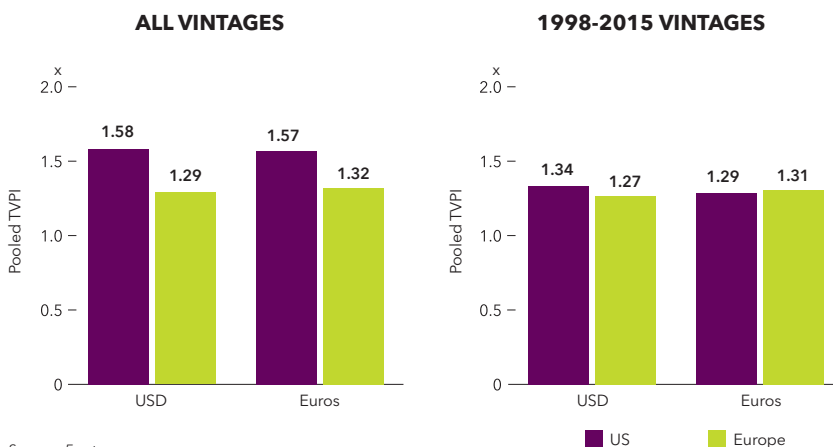
All-time US VC funds, including vintages as old as 1991, generated a 1.58x

“While European VC may lack some of the blockbuster success stories seen across the pond, the performance of venture funds overall has been in line with US performance

Thibaut de Laval

LEVEL PLAYING FIELD

European VC funds performed at a similar level to their US peers when certain sampling biases were removed, according to eFront



Source: eFront

pooled TVPI when measured in dollars, versus 1.29x for European VC, according to the report. The relative performance improved when measuring in euros, with US funds generating a 1.57x TVPI and European funds climbing to 1.32x.

Once sampling bias over maturity is eliminated – by comparing identical vintages from the 1998-2015 period – the performance of US and European funds was broadly similar, delivering a 1.34x and 1.27x pooled TVPI respectively in dollar terms. European funds actually outperformed the US in their home currency, returning a 1.31x pooled TVPI, compared with 1.29x across the pond.

“Sometimes, one measure of performance hides another,” Thibaut de Laval, chief strategy and marketing officer at

eFront, said. “This goes to show that while European VC may lack some of the blockbuster success stories seen across the pond – the likes of Facebook, Airbnb and Uber – the performance of venture funds overall has been very positive, and in line with US performance. Institutional investors who ignore European VC may well be missing out.”

The report coincides with the launch of six new venture capital funds of funds by the European Commission and the European Investment Fund.

The vehicles – first announced in 2015 as part of the Commission’s Capital Markets Union action plan – will contribute €2.1 billion to a selection of VC funds, focused on at least four European countries each. ■

COMPANIES

3G Capital	65	Landmark Partners	54-60
3i Group	46, 48	Leonard Green & Partners	12, 41, 49
Aberdeen Standard Investments	8	Lexington Partners	24, 55
Abraj Group	41	Littlejohn & Co	49
Accel-KKR	49	Makena Capital	28
Adams Street Partners	29	Marblegate	14
Advent International	41, 48	Mars	16
Affinity Equity Partners	41	McKinsey	26
Alaska Permanent Fund	8	Morgan Stanley	34
Alaska Retirement Management Board	8	Murray Devine	29
Alix Partners	12, 14	MVision	20
Apollo Global Management	14, 22, 49	Neuberger Berman	49
Archer Capital	8	New Mexico State Investment Council	26, 68
ArcLight Capital Partners	49	New Mountain Capital	41
Arrian	54-60	NewQuest Capital Partners	24
ATP Private Equity Partners	8	Nomura Securities	14
Bain & Company	6, 38	Nordax Group	24
Bain Capital	12, 35	Nordic Capital	4, 6, 20
BC Partners	62	Oaktree Capital Management	28
Bison	40	Old Ironside Energy	41
Blackstone	6, 18, 34, 48, 49, 68	Ontario Teachers' Pension Plan	22
Bridgepoint	24, 65	Oppenheimerfunds	14
Brigade Capital Management	14	Oxford University Endowment Management	68
British Columbia Investment Management Corporation	8	PAG	41, 49
Cambridge Associates	26	PAI Partners	41
Candover	47	Partners Group	35, 54-60
Campbell Lutyns	4, 20	Policeman's Annuity and Benefit Fund of Chicago	27
Capital Dynamics	16	Portfolio Advisors	64
CB Insights	16	Post Oak Energy	41
CEPRES	12, 30	Providence Equity Partners	47, 49
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THIS MONTH'S COVER

Autobiography
Ivan Csudai

Serigraphy
Year: 2010
Price: €150

Represented by: Michal Cernusak Gallery

ABOUT THE ARTIST

Ivan Csudai is a painter and professor at the Academy of Fine Arts in Bratislava. Born August 18, 1959 in Svodov. Active since 1990, he has held more than 60 solo exhibitions and participated in group exhibitions in his native Slovakia and abroad. In 2004, he represented his country in a trio project at the 26th international biennial in São Paulo, Brazil. He lives in Bratislava.

www.ivancsudai.sk

QUOTABLES

“How is it going six weeks in? Other than hitting the wrong elevator button occasionally, it feels pretty good so far”

Jon Gray, who was promoted to Blackstone’s chief operating officer in February, talks about his new role on the firm’s Q1 earnings call

“Having 5 percent to 7 percent to alternatives is meaningless because of the fees... I don’t have a magic number, but it’s not worth dipping a toe in”

Sandra Robertson, chief investment officer and chief executive of Oxford University Endowment Management, discusses asset allocation at a symposium

“It is imperative the council be able to analyse exactly what we are paying for those investments and to ensure that those costs are accurate and appropriate from a risk/return perspective”

New Mexico State Investment Council hires fund services firm Colmore to validate the fees it pays to GPs

“The superior results of Yale and a number of peers strongly suggest that active management can be a powerful tool for institutions that commit the resources to achieve superior, risk-adjusted investment results”

In its annual report, Yale endowment hits back at remarks by Warren Buffett suggesting endowments should adopt a passive indexing strategy

Businessman, public servant and philanthropist

Peter Peterson is remembered for much more than co-founding Blackstone

Peter Peterson, who died at the end of March at 91, leaves a rich legacy.

His long career in finance needs little introduction, with the founding of Blackstone with chief executive Stephen Schwarzman in 1985 after a decade as chairman of Lehman Brothers.

Early on in the private equity world, he identified the power of relationships and applied it to Blackstone.

“As the world has become more predatory and aggressive, my impression is that the investment banking business has moved from being relationship-oriented to being increasingly transaction-oriented,” Peterson told *The New York Times* in October 1985, when the newspaper wrote about Schwarzman having left Lehman to join the new firm.

Despite making a fortune from private equity, he remained realistic and honest about the industry.

Asked by the *Financial Times* in 2007 why Blackstone did so well, he said: “Dumb luck can play a huge role in life. It is all too easy in the 1990s for people to say I must be a genius investor because I got returns of 30 percent or whatever. If you combine a lot of leverage with a booming stock market, it isn’t all that difficult to make a lot of money, so I don’t think we should get carried away with ourselves, frankly.”

He eventually retired in 2008 about a year after Blackstone went public, turning his initial \$200,000 investment into about \$1.8 billion before taxes and other expenses.

After the IPO, he even expressed support for carried interest to be taxed as income.

“If you’re a hedge fund and a private equity fund and you get carried interest taxed as capital gains, I can’t justify that, because it’s payment for services, and it ought to be taxed



Peterson: identified the power of relationships

as income tax,” he explained to the *The New York Times Magazine*.

Words of remembrance circled on social media after the announcement. “I was deeply saddened to learn of the passing of my friend Pete Peterson,” Schwarzman wrote via Blackstone’s Twitter account. “Pete led an incredible life, leaving a lasting mark on both Blackstone and the broader world. On behalf of the firm and its more than 2,000 employees, we extend our deepest condolences to the Peterson family.”

But he may be remembered most for his quest later in life to increase awareness of the US’s long-term fiscal challenges, denounce the federal deficit and revamp social security, mostly through his foundation, which he started in 2008.

Michael Bloomberg called him one of the great patriots and philanthropists of our time, while Bill Clinton referred to him as a brilliant businessman, principled public servant, great friend and profoundly good man. ■



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