The dash for cash

With so many large and upper mid-market European funds embarking on the fund raising trail this year, investors look set to be spoilt for choice about where to commit their buyout allocations. But will they get into the funds they want, asks *Vicky Meek*?

The current fund raising market is a bit like the old adage about waiting for a bus: you wait for ages and then several come along all at once. "Last year was pretty poor for fund raising," says Rhonda Ryan of Insight Investments. "We just didn't see many groups that were of the quality we're looking for. This year, they're all coming out together."

Of course, it depends on your view as an investor as to what constitutes quality. But for limited partners looking for larger European buyout funds and those at the higher end of the mid-market, 2005 is set to be a bumper year. Most of the brand names of private equity will be out. The roll-call of well known and established firms currently in the market or in pre-marketing phase includes Advent International, Apax Partners, BC Partners, Bridgepoint, CVC Capital Partners, Candover, Cinven, Electra Partners Europe, HgCapital… the list goes on.

All this is great news for LPs. For a few years now, the European buyout market overall has outperformed its US counterpart. And investors have not been slow to pick up on this point. Most European and US LPs were looking to increase their allocations to this area, according to a 2003 study published by research house AltAssets. Its popularity appears to have endured: a recent Coller Capital survey of LPs across the world found that European buyouts ranked as the most attractive segment of the private equity universe. Great news, too, for European buyout fund general partners seeking fresh capital.

So there's demand from LPs and supply from the GPs – all seems well and good. Yet, as ever, the real picture is a little more complicated than that. The widespread notion that LPs are going to have a busy time of it this year because of the sheer weight of money being sought is a little misleading. Most of the fund raising activity will be clustered at the higher end of the buyout spectrum. "The funds out this year will include a concentration of the large pan-Europeans and large US players," says Mounir Guen of placement agent MVision. "There is limited fund raising activity below this level, in the Continental European country-specific funds, for example. As a result, I don't think investors will find themselves as busy as many people are suggesting. It looks set to be a record year, but only because there will be a concentration of large funds coming out at the same time."

The fact that so many funds are coming to market at the same time would suggest that investors will get their pick of the crop. But the difficulty is that firms will be seeking to limit the size of their latest funds in response to LP pressure to place hard caps on the amount they raise. There is no doubt that many of the European firms will be seeking to increase their fund size compared to their previous offerings – but not by much. "If firms are faced with high demand from LPs, some might be tempted to increase their fund size," says Chris Davison, associate director at research and placement firm Almeida Capital. "But I'm not sure many will go higher than 10% to 15% above their last fund. There's more of a sense of discipline in the market now than there was a few years ago." Guen agrees: "European funds won't be looking to raise much more than their previous funds. Many of them are finding their sweet spot and consolidating this. US funds, however, will be looking to break records and raise larger funds."

LPs looking to commit to the very large funds are unlikely to experience problems gaining access. And, indeed, many in the market believe that the glut of mega-funds may mean that some firms don't raise capital as quickly as they are anticipating. "There will be so many large funds out in the market that some may struggle to reach their targets as quickly as they had hoped," says Guen. "Some will have to work across two vintage years as their significant investors scale back the individual investments they can make in this vintage year to be able to commit to more groups."

Some funds may struggle even in spite of increased interest in European buyouts among the large US institutions that are willing and able to write big cheques. "Some larger funds may find it harder to reach their target than they hope," explains Ralph Aerni of SCM. "US appetite for the European funds is likely to be huge, but I think there is an issue that is emerging. A lot of the large US groups have been expanding their European bases by opening new offices around the continent and hiring new people. My feeling is that LPs may target the US GPs with a good European presence in preference to some of the European groups because they have a global reach. This could be a key differentiator, if not in this fund raising round, then certainly next time."

Yet further down the scale, it could be that LPs start finding it difficult to get into the funds they want as US institutions start targeting the mid-market. As Davison says: "Access hasn't been a problem in Europe historically, but it could become one this year." It's a view many in the market share, including Aerni. "Access could become an issue for the mid-market groups," he says. "There is a strong US appetite for these funds, and many will get around half of their capital from US investors. That obviously limits the amount available for European investors. Existing LPs probably won't have problems getting the

Who will take the lead?

allocation they want, but new investors to the funds may struggle."

It's not just competition from US LPs and hard caps that are causing this new phenomenon. There are a couple of other factors. The first is the increasing maturity of the industry and the increasing ability of LPs to compare and contrast the performance of funds in similar markets. "The issue of access to certain funds is the result of an increasing transparency in the market," says Aerni. "Everyone now knows who the best performers are and they all want to be there. Some LPs are going to be disappointed." This is helped along by the fact that so many funds will be out at the same time. Ryan is one investor who is seeking to make the most of this. "From an LPs' perspective, it's very helpful that so many funds are coming out together," she says. "It means that we get an insight into a wide variety of firms' performance and can benchmark more accurately to help ensure we choose the best funds in the market."

The other factor is that, as firms have become more sophisticated in their approach to fund raising, they have a clearer idea of potential appetite for their fund. They know if LPs are going to be clamouring to get in and adjust their process accordingly. "There are a number of GPs that are playing hard to get," says Davison. Indeed, LPs report that one or two firms now have a waiting list for investors. Either that, or they are not wasting shoe leather by traipsing around the world seeking commitments, but simply holding investor dinners or sending out faxes prompting LPs to invest. It's uncertain whether these attempts to make their funds appear "exclusive" will result in rapid and successful fund raisings, but it's clear some firms believe LP appetite for their offerings is at an all-time high.

But if access to certain funds does become an issue, as many believe it will, what does that mean for those left out in the cold? Where will they be investing their money? There's a clear understanding among LPs now that it does not make sense to deploy capital in funds that they do not believe are going to be the top performers. Many will therefore look elsewhere. "If some of the larger LPs can't commit to the funds that they want, they'll simply cut their European allocations," says Philip Bassett, who leads the investor relations team at Permira. "I spoke to one US investor recently who said that if he couldn't get into the three European funds he wanted to, then he just wouldn't invest."

Others may take the view that there are alternative opportunities to be had. "LPs have traditionally been momentum investors," says Christophe de Dardel at Unigestion. "They have looked at past performance and committed to groups that have demonstrated an ability to invest well and return capital. There's nothing wrong with that. But I think that, as the market matures and investors become more sophisticated, they will become more forward-looking. They may start allocating more to emerging groups, for example." In the near term, however, he says that there are other opportunities in the market this year that investors could look at. "There will be a handful of French funds and one or two Spanish funds out that we'll be following with interest."

One thing does seem certain, however. We're unlikely to see much of the capital that can't get into the most popular funds being diverted to European venture capital. We may see a gentle recovery in fund raising in this area of the market, according to Davison, as some of the better known names come out and exit conditions improve. But for most LPs, European VC leaves them cold. De Dardel's view is far from unusual: "We've seen some first closes over the last few months and that is a good thing. But I can't see there being a renewed enthusiasm for European VC because nothing has really changed since the crash. There is a market for it, but we all know how it stands in comparison to the US."