Private Equity: 2014 in Review - Moose Guen, CEO, MVision

What key trends have you seen in the private equity fundraising market in 2014?

In the history of private equity, there have only been a handful of years in which distributions from general partners have exceeded drawdowns. In part, this has been due to the nature of the way the asset class developed, as investors have notched up their allocations regularly. But in 2014, the amount of capital returned far exceeded the level of drawdowns. The result of this is there is a very strong need to put capital to work, and in very large numbers.

For larger investors, they have to be able to cover that gap and have created an orientation toward co-investments and direct investments, because it is one of the very few ways they can put capital to work and be able to have the allocation they need. What we have also seen in 2014, especially at the end of the year, is the emergence of special products, which are the result of growing appetite for co-investments from these larger investors. So we are seeing more separate account management and we are seeing special long-term product creation.

The other trend that is taking place is that the US marketplace has been very much the main focus. It has really been an area where the investors have spent a huge amount of time and it has also been a very profitable area, one that has generated superb returns.

Europe has not been centre stage. It really hasn't been since the financial crisis and the European crisis. Saying that, in early 2014, there was a little flurry of activity in Spain; Italy was a bit limited; France is still not an area of strong focus from investors; Germany is still being sought after; and the Netherlands and Sweden are always popular, even though I think as we approach 2015 there are slightly different views on the Northern markets. And the UK has very little product at the moment, so the product that does come out is generally well received as it has the characteristics of long-term performance.

As developed economies regain traction, do you see emerging markets losing ground in securing private equity capital commitments?

We are in an interesting situation. Basically, the average investor on a global basis is committing between 0 and 3% in non-US, non-Europe funds, but that is moving to 10%. And the vast majority of that 10% will be in Asia. China is a must have and still is with every single investor. With India, investors are showing interest, but they are still trying to get their heads around it – the country is 60 years old and private equity is 12 years old, so it is moving into its next cycle. But if you look at it from a macro-perspective, that country simply cannot be ignored.

The big pan-Asian funds had all gone through fundraising in 2013. There is a bit of activity that took place in 2014, but statistically you will probably find that the numbers are down. However, if you look at the actual orientation of the dollars that would like to be deployed on a global basis, there is quite a significant amount pointing towards Asia.

If we look at Latin America, the Mexican government has changed its tax regime which quietened down the market a bit. This did have certain impacts on performance, earnings and revenues. It will take about a year or so for this to work through the system, and there will be some activity again. In terms of Brazil and the recent government changes, there is a little bit of a slower movement. In the earlier part of 2014 there was quite heavy activity when a couple of names came through that were kind of iconic to the market. From the first part of 2014 to the second part, it is a very different picture. There is always quite select interest on the west coast of Latin America. So what some of the investors look at is the ability to cover this through some of the pan-regionals so that they can get some form of coverage. We see that with the pan-regionals being able to raise in 2014, but not being able to significantly increase their fund sizes.

Africa is a bit more of a new environment, and it is really the frontier-orientated investors that are involved in it. The Gulf region has a few good players of which one of the predominant names, Gulf Capital, has recently closed in 2014 which will help the region. Russia, which historically has and continues to have one of the top performing emerging market GPs, is a region that I think can be considered as on hold at the moment.

How has the fundraising environment changed in the last 12 months for both private equity fund managers and investors?

The investors are looking for fewer relationships and a more concentrated portfolio. So regarding the selection process, the filters are quite rigid. But if you are a fund manager in the right place at the right time, you could find yourself in a very comfortable position.

What you have got is movement here and there, but there are not necessarily large funds, or a group of large funds, coming through. When I go back to the initial point of the need for capital to find a home, because of the unusual nature of 2014, there are not enough great products to be able to capture it. That raises some very interesting dynamics in terms of what can happen and what will happen. Part of it will then push the alternative asset class into other areas like credit, infrastructure, real assets, real estate – because the capital needs to be deployed.

What factors do you see as having the most influence on private equity fund managers' ability to secure capital commitments?

I think one is showing returns that can generate 2x net cash invested, or the potential of them. Second is showing a preservation of capital, and third a popularity of support. Because you have to remember that tailwinds do not drive alpha. If alpha, or perceived alpha, is recognized, and if investors believe that a certain name is presentable and meets those criteria, they will like it and they will chase it.

Have you seen any attractive areas of investment emerge as countries

around the world build innovation and develop expertise as you predicted last year?

I think Asia is moving in leaps and bounds. Latin America has had geopolitical changes that it has had to work through. But the general texture of the private equity community is very sophisticated, and all of these changes and challenges have resulted in much stronger and better firms. I think the result of this is a much more robust asset class. In the very short term, given the unusual dynamic of the 2014 cash flows, we have a special situation to work through.

What are the challenges facing placement agents that operate across different geographies?

On a legal point, we have to be very cognizant of regulations across the world. The AIFMD in particular has kicked in, and we are following the regulatory processes that need to be followed, and working with legal counsel and our clients. From that perspective placement agents need to adapt. From another perspective, while perceived great funds are scarce, there is a real run to try to capture those. Performance is an important element in selection. If a GP is not showing consistent returns, or one of the funds is an underperformer, the fundraise will take time and one needs to prepare for that.

How important is the length of time that private equity funds spend on the road?

It is all smoke and mirrors. Everyone is perpetually marketing right now. The timing of a fundraise is by no means an indicator of performance, and future performance. I have known situations where the most challenged fundraisers are taking almost two years, but the general partner is currently producing an 8x multiple with their portfolio. One has to really grasp the DNA and the dynamics of the underlying manager to make decisions. One of the concerns I have is that the diligence process is so extensive these days, and somewhere in there we have to remember that the questions asked will not give us the decisions. Decisions can be made quite quickly – whether something fits or will perform or not – but the question then is do we have the right paper trail support.

What is the outlook for first-time funds coming to market in 2015? How do you advise those that may not have an established track record or established base of investors?

The important thing for first-time funds is that they come to market with deal flow. One of the key aspects that investors are looking for is active GPs. One of the big points in 2014 was the net return vs the gross return, and investors focus on net returns now, which are always a product of activity. The more active the GP, the more the net and the gross spread is small. When you have a first-time fund, what you need to focus on is the ability to show a pipeline that you can execute. What we see a lot of time with first-time funds in today's market is the GPs putting together deals and then working with potential investors in a kind of deal-warehousing relationship. As such, they can get to know each other and demonstrate how the group works.

Saying that, there are also scenarios where there is a spin-out team, which has been extremely popular, particularly in the US. With spin-outs, the investors are looking for something new, and they are quite positive towards a particular team. They will then run with it and support them.

What is your opinion of the current alignment of interests between GPs and LPs?

Over the last year there has not been that much of a change. The investors are still strong. One of the things going into 2015 is that we might find ourselves with a lot of capital looking to go into certain funds. That will cause a difference in alignment, with greater power in the GPs' hands. That is something that is definitely on the horizon.

What are your predictions for the private equity industry in 2015?

I think the return profile will continue to be quite robust going into 2015. I do not necessarily think we will find all the products we are looking for. So again, as the amount of capital grows and the exits continue to be strong, we will find quite a fair amount of activity. On a fundraising scale, it could be all over the place; it is all dependent on who is in the market.

I think the industry is getting very sophisticated, on a global basis. The GPs know what they need to do for their investor base, but the investor base does have different agendas and will vary accordingly. This is something we just have to be cognizant of. I also think there are certain markets that should have more popularity than they have at the moment, but time will be our friend with that one.