Privcap/ Report

Includes a bonus interview with

Edward Conard

Author,
The Upside of Inequality

2016 Fundraising Roundup

Year in Review

Featured Topics

Sold Out: Brand Name Fund Allocations
A VC Fundraising Boom
Is the Fund-of-Funds Business Stagnant?

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About This Report

This publication is a companion to Privcap's Fundraising Roundup, a quarterly video program on the latest trends in private equity fundraising.

About the Experts

Alan Pardee is a managing partner and co-founder of Mercury Capital Advisors, among the world's elite institutional capital-raising and investment-advisory enterprises. Pardee was previously a managing director and chief operating officer of Merrill Lynch Private Equity Funds Group.

Learn more about **Mercury here.**

Click to watch the full program

Leopold Peavy joined Preqin in 2012, and is head of investor products at Preqin. In this role, he oversees all commercial elements of Preqin's investor-focused suite of products and manages various other strategic initiatives and partnerships. He is also responsible for publications and research reports for LPs/investors in alternative assets, and for developing and promoting new products for this client group.

Learn more about **Preqin here.**

David Snow is CEO and co-founder of Privcap Media, the leading channel for thought leadership in private capital investment.

www.privcap.com

Sold Out: Brand Name Fund Allocations

Privcap: Leo, can you give us an overview of private equity fundraising in 2016, and where you think it will rank compared to recent years?

Leopold Peavy, Preqin: We keep growing and we keep getting stronger, in terms of an industry and actual total capital closed. And while we're not at 2007 and 2008 levels yet, it looks that we're incrementally getting there every single year. And there is an incredibly high demand for private equity across all institutional investors. We have about 59 percent of all active institutional investors looking to allocate to private equity or actively allocating to the asset class.

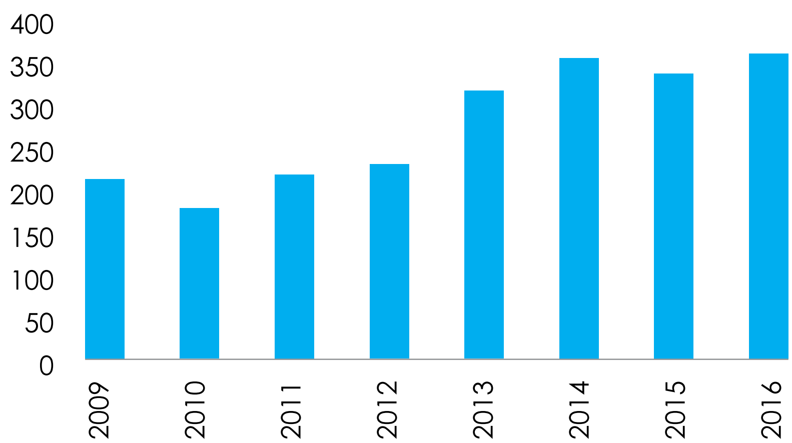
Alan, as you look at the list of the largest fundraises in 2016, it's remarkable that almost all of them are brand name firms that have been in the market for a long time. They have seemingly had little problem raising their follow-on funds. What's behind that trend?

Alan Pardee, Mercury: LPs have very few other places that they can go in terms of investing capital and getting attractive rates of return. But at the same time, everybody's a little bit nervous. Is this a top? Will the market suddenly change? Is there an external shock that could change the way people think about this asset class and all asset classes, whether liquid, public, private, what have you?

There's a lot of capital available in our marketplace, but there's an old saying—nobody gets fired for buying IBM. Nobody gets fired for investing in Blackstone. So there is a certain wave of embracing the established manager that is a change from where we were in say 2013 or 2014, when newer managers were thriving.

2016: A Post-Recession High

Total PE Capital Raised, by Year ($B)



Source: Preqin

Mature Firms Ruled

Largest PE Funds Raised in 2016

Fund	Fund Size ($M)
Advent Global Private Equity VIII	13,000 USD
Ardian Secondary Fund VII	10,800 USD
TPG Partners VII	10,500 USD
Green Equity Investors VII	9,600 USD
Apax IX	9,000 USD
Permira VI	7,500 EUR
Ares Corporate Opportunities Fund V	7,850 USD
Cinven VI	7,000 EUR
Thoma Bravo Fund XII	7,604 USD
BDT Capital Partners Fund II	6,206 USD

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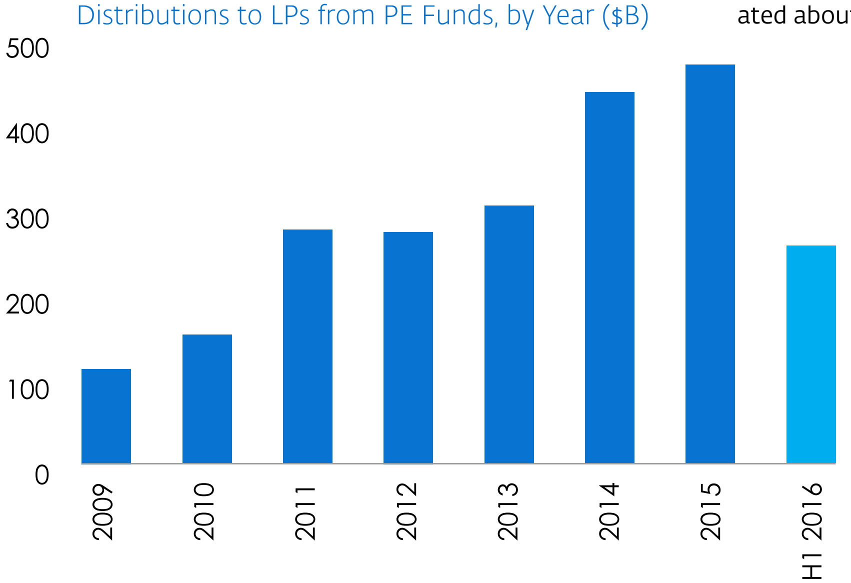
It must be a challenge for investors, especially investors that are newer to the asset class, that have a significant amount of capital that they want to put to work in private equity. So how do you put capital to work responsibly when these highly sought after, seasoned managers have limited availability?

Pardee: LPs are finding themselves having to be far more proactive than they were in the downturn, for sure, but even in the last upturn. They are proactively going to general partners to find out what funds they want to invest in, doing the diligence early. They are getting a relationship going with a general partner that might be an established fund manager that may not be as big as some of the biggest funds, but has a strong track record, differentiated deal flow, and activity.

Peavy: Speaking with several LPs who have quite large private equity portfolios and are connected throughout the industry, they still aren't able to get into many of the top funds due to the phenomenon of "one and done" funds. So they have about a month to get into the data room, and then those funds close quickly and they're not able to invest again, potentially, for another three or four years, until that manager has another fundraise. So it's all about timing, building relationships, and being proactive.

A Cash-Back Windfall

Distributions to LPs from PE Funds, by Year ($B)



Source: Preqin

LPs are going to get more than $500B in capital distributions back from their private equity funds. Capital distributions are great—that's what the whole industry is about. And yet, what do you do with this capital?

Peavy: There [are] thousands of LPs now investing actively in the asset class, and they're not just accessing private equity through fund-of-funds or through an outside consultant. They have actual investment teams. It's a reality that now that they have the resources, they can seek out and perform the due diligence on managers.

Pardee: When you only have a finite set of places where the capital can go and there is a demand crunch at the top where the most popular things might be, one's going to end up having to make some incremental decisions that add a new manager, a new strategy, a new geography, a new asset class. And we're beginning to see some of those smaller numbers start to swell again in certain LPs' holdings.

Peavy: The LPs have more choices than ever, yet nearly half of LPs—when compared to even 2015—say it's more difficult than ever to find attractive new fund opportunities. So it's very interesting that there is a ton of supply, but the demand is only to really a certain segment of the top managers.

Pardee: So it's an attractive time to be a successful manager of almost any fund as long as you have had a good track record, a good history, and a good return profile, and something differentiated about what you're doing.

A VC Fundraising Boom

Privcap: In 2016, venture capital firms worldwide raised the largest amount of capital since 2000. What is driving this level of interest?

Pardee: At some level, it's jealousy—the herd of unicorns that have come into the public markets means that somebody who is a venture capitalist did well in those companies. And the idea of an LP wanting to find their way into those early—and frequently, if they can—is part of what's driving this interest in VC. That said, it's not as though venture capital fundraising is easy. The numbers are bigger, and that's obviously translating to a demand in the marketplace.

But the VC funds that have performed best, really, are a small handful. If you start taking apart the performance data, you find yourself seeing a much smaller subsection of firms at the top of the VC world than you might find within the private equity or real estate world.

And in fact, there's even more capital in the VC market than the fundraising numbers indicate, right? Where are these other sources of capital coming from?

Peavy: Some are coming from corporate VC arms; they're coming from LPs such as sovereign wealth funds and family offices looking to invest in direct companies themselves. And when you're looking at investors—like family offices, in particular—they're interested in doing niche things. They're looking at expanding their current family wealth and being able to do something that could potentially last.

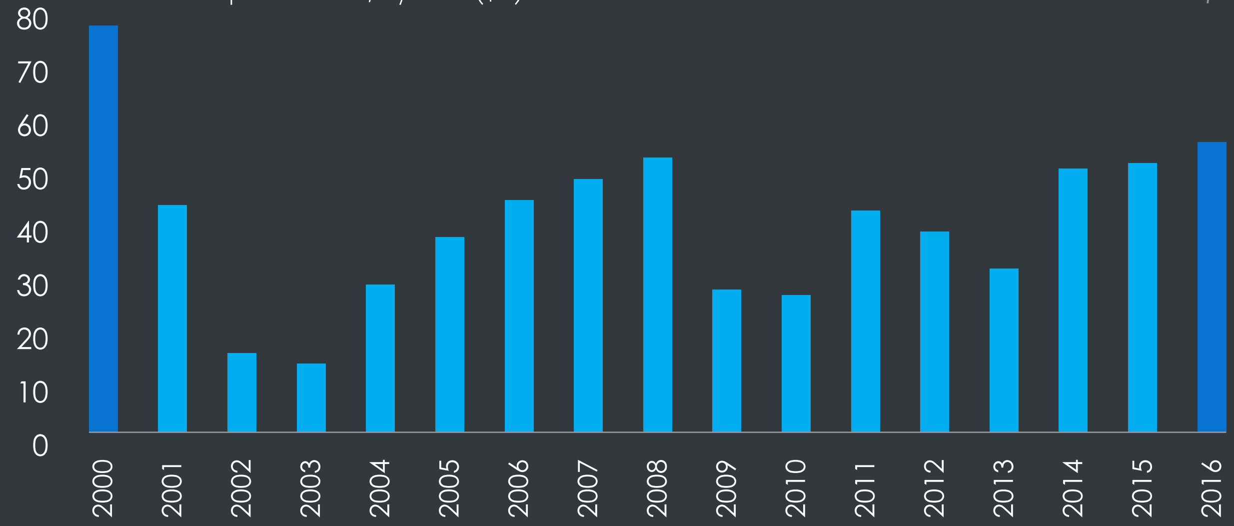
Some of these successful unicorn companies are being started with very small amounts of capital, which suggests that it's really about who you know. Is it true that sinking $100 or $10M into a relatively large VC fund isn't necessarily the path to making those outsized returns?

Pardee: That's absolutely true, and that goes to the point of the concentration of return at the top of the VC asset class. Whether one wants to count it as a half a dozen firms or 10 firms, there's a list of firms that we could rattle off that do have persistence as it relates to being able to generate strong IRRs and multiples. Ending up in the other selection of firms [means] being a participant in the venture capital asset class, but [with] not quite the same return outcome.

VC Haul Strengthens

Total VC Capital Raised, by Year ($B)

Source: Preqin



Is the Fund-of-Funds Business Stagnant?

Privcap: The recent statistics from Preqin suggest that something's wrong with the fund-of-funds business model—or at least with the demand that investors have for fund-of-funds. In 2016, fund-of-funds around the world didn't even crack $20B in fundraising. That's roughly where they were back in 2000. What happened?

Pardee: Being a fund-of-funds manager means being in a business that's become tough over the last several years. Like many asset classes, there are a lot of choices that are available, and people have to make some tough decisions. What you see, primarily, as it relates to fund-of-funds, is that there's been a rationalization of who are the strong and who are the weak in this marketplace.

There [are] certain persistently successful managers that have done well and continue to grow. And there are a lot of people that are [going] by the wayside, at this point. A number of funds that had been strong performers, had been decent-sized names and firms, seem to have withered.

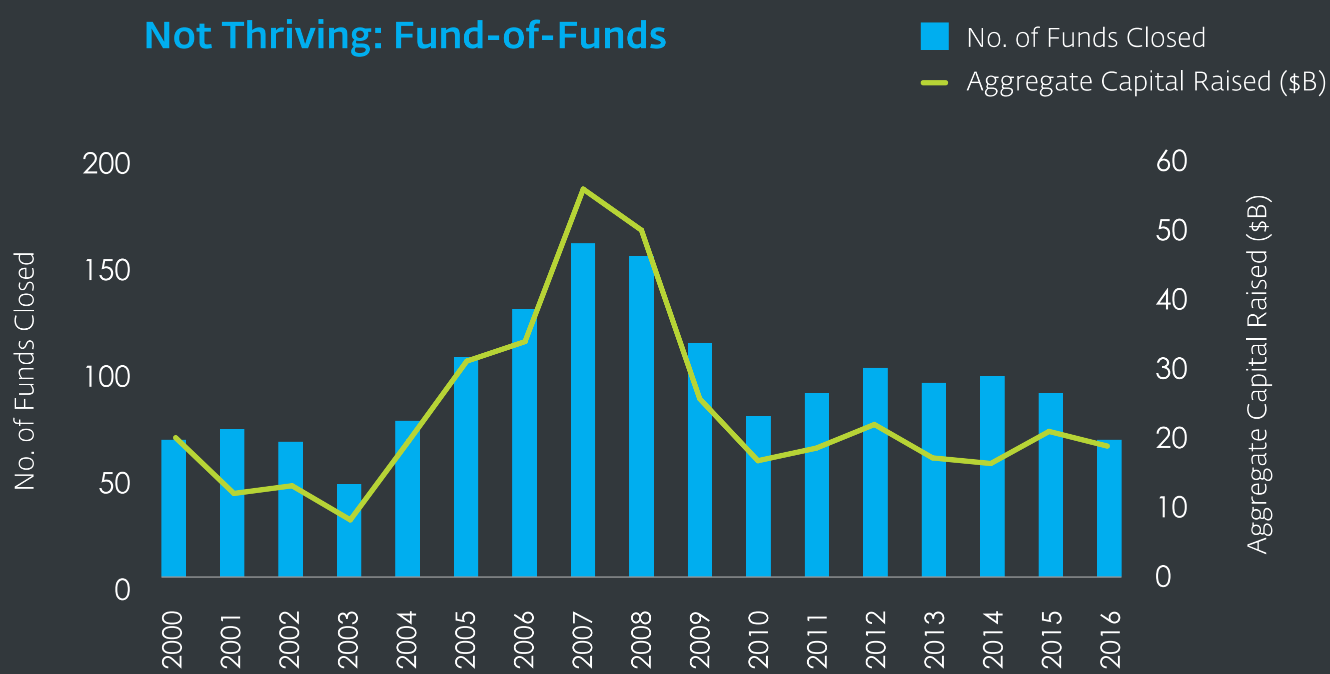
Peavy: Those fund-to-funds that have been established are always going to survive, because they're always innovating and they're always coming up with services to provide [to] investors, whether it be having an expertise in a certain geography or a certain strategy. Because … many of these key investors are nonprofit entities. So they are not able to hire the in-house staff necessary to go scour the world for investments in an emerging market that potentially may be hot in five years.

One of the biggest fundraises last year was a $10B secondaries vehicle from Ardian. Have secondaries vehicles risen in popularity?

Pardee: The secondaries business has been a real buzz business for fundraising, and an attractive one in terms of rates of return and multiples for a while. There are some very sizable funds that have been raised in the last while, because the secondary funds have managed to innovate the type of transaction they're in, with the GP-led restructurings and other forms of investment that they've been active in, of late, that have produced some attractive rates of return.

Peavy: As these investors become more proactive and more sophisticated, they're not going to be able to continue these relationships with less-innovative existing fund-of-funds where they're being charged double-layer fees, when there is a record 3,000 funds in market that they can invest into directly. ■

Not Thriving: Fund-of-Funds



Source: Preqin

POWER HOUSES

OF PRIVATE EQUITY:

Edward Conard

Insights from the world's leading investors and dealmakers

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Edward Conard
Author,
The Upside of Inequality

Michael Ricciardi
CEO, Managing Partner & Co-founder,
Mercury Capital Advisors

Michael Ricciardi of Mercury Capital interviewed author Edward Conard about economic red flags the private equity industry should look for in coming years

Michael Ricciardi, Mercury: What would constitute, for you, a red flag as we move forward over the next several years?

Edward Conard: To think that we're going to cut taxes without cutting spending—and [that] somehow that's the magic elixir that's going to increase growth. You ultimately have to cut government spending, otherwise you're just distorting.

And I think one of two things can happen. I can either come and tax you, or I can say, "I'm going to lower your taxes, but then I need to borrow from you. Oh, by the way, when I have to pay you back in the future, I'm going to increase your taxes to pay you back." So when did you really pay the taxes? You paid the taxes today. Or I can borrow it from the Chinese. But I have to run a trade deficit to do that. And if I run a trade deficit, there's a guy in Michigan or somewhere who's going to lose his job over it. I don't think that's a prescription for great growth. It might help rich guys. I'm not sure it helps workers. ■