FUNDRAISING

Anatomy of a fundraise

Institutional investors may be increasing their allocations to private equity, but GPs still need to take a thoughtful and strategic approach to the fundraising market, say FIRSTavenue executives Michael Henningsen and Colin Dinneen

Although fundraising cooled somewhat in 2018, there's no doubt LP appetite for private equity remains strong: according to *PEI's LP Perspectives* survey, which gathered views from more than 100 institutional investors, one-third plan to increase their allocation to private equity in 2019.

Yet successful fundraising still requires a great deal of thought, preparation and resources. Michael Henningsen, partner and co-head of FIRSTavenue's Asia business, and Colin Dineen, managing director in its US operations, discuss key trends and what it takes to raise capital successfully in today's market.

Henningsen: *LPs are becoming more discerning on ESG, issuing specific questionnaires to GPs*

Dinneen: *firms need to think 12-18 months out of a fund launch to ensure existing LPs know their plans*

Q How would you characterise the fundraising environments in your respective regions in 2019?

Michael Henningsen: There is still a lot of liquidity in the Asian market and there is continued strong interest among LPs for private equity and alternatives more generally. We've had a busy start to the year. However, we are seeing some uncertainty creep in as LPs take into consideration a more mixed macro-economic environment, political tensions and trade talks. These concerns are starting to feed into LP underwriting and they are factors that we need to be aware of for the next 12 months.

Colin Dinneen: We're also seeing continued interest in North American private equity. The concerns Michael just mentioned are on the horizon for LPs, but they haven't had a meaningful impact on the overall fundraising market to this point. LPs are watching how Brexit will unfold and the ongoing US-China trade talks are very much top of mind. Yet it has been such a robust market over the past five years, and we are not seeing indications of this slowing.

Q What's the fund pipeline looking like?

CD: We've seen a proliferation of funds coming to market in the US and a tremendous amount of capital pursuing private equity. Time to market between funds has shortened and funds are raising larger pools of capital. A key trend is first-time funds competing with established managers for capital, but these first-time funds have different characteristics from what we've seen before. They are often raising $1 billion-plus funds and they don't look or feel like first-time funds because they are often managed by teams who have worked together, are established fiduciaries of LP capital and have a strong track record.

MH: We're not seeing the same strong trend of 'established' new managers in Asia as in the US. Here, first-time managers are more usually a couple of partners spinning out or are formed by people stepping out of corporate M&A or business development roles. This year we believe we'll see fewer large funds coming from the Asian market because last year was such a busy year for such funds here, especially in the context of the pan-Asia and China segments. You will see funds from a broader mix of regions, such as Japan, Korea, India and South-East Asia.

Q What's your advice for funds looking to raise over the coming 12-24 months?

CD: I'd start by emphasising that, even though there is a large volume of LP capital going into private equity, it can still be difficult to raise capital. Funds need to take a thoughtful approach towards timing and positioning. They need to consider fundraising at least 12 months and probably 18 months ahead of launch, not just to ensure they are prepared, but also to ensure their existing LPs know of their plans. Today's LPs plan far ahead and successful firms are making sure they are on current and potential investors' calendars.

MH: LPs are becoming fully allocated for the year earlier and earlier – they are also being increasingly aggressive about planning their pipeline so they can start their due diligence early and be in a position to get into over-subscribed funds. Finally, LPs are concentrating their relationships with fewer managers, so it can be very difficult to get new funds into LP portfolios.

Q You mentioned timing, Colin. How should GPs manage that?

CD: It can be a fine balance. If a fund has had some significant early distributions, and there is high visibility on the portfolio's liquidity, LPs may look favourably on an early fundraise – they are particularly interested in DPI. GPs are in a tough spot in the current market. With increased valuations, they need additional capital in their pocket so they can budget for add-on acquisitions, for example.

MH: We've seen some funds trying to go out too early – they haven't fully invested their previous fund before launching a new fundraise. LPs are very sensitive to this, but it's not always the fund's fault. The competitive nature of the deal market has sometimes meant a deal a firm has expected to do hasn't gone ahead, for example.

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>
> **Colin Dinneen**

Q How should first-time funds approach the market?

CD: It is a good time to raise capital, but all funds, and in particular first-time funds, need to be very thoughtful about how they do it. They need to have already built a team and possibly have co-investment opportunities already in the pipeline or have already done deals ahead of fundraising.

Q What can potentially go wrong in today's market?

MH: We sometimes see GPs get lulled into a false sense of security – they have had strong LP support in the past and so assume this will be the case on the next fundraise. Yet LPs won't always re-up and that can stall the process. That can happen for reasons well beyond a GP's control, such as an LP reducing its number of relationships, or it just can't invest at that time – that's why it's so important to talk to LPs ahead of launch. If that happens, the GP needs to find a new set of LPs – for the best managers, that just means a longer process than planned.

CD: The good news is there are new LPs coming into private equity, from markets such as Japan. Unlike the more mature LPs that are trimming their relationships, these investors are under-allocated and so can represent a deep new pool of capital.

Q What role does communication play in today's market?

CD: LPs are increasingly sophisticated and want to understand what a GP really thinks about their portfolio, timings and expectations. They don't want salesmanship – LPs are highly familiar with the ups and downs of private equity now and so don't want to hear tightly controlled messages. GPs need to listen to what LPs are saying and the two sides need to work together – that can only happen through direct conversations.

Q How important has ESG become for LPs when it comes to fund selection?

MH: ESG is rising in importance, particularly when we talk to consultants working on behalf of LPs that have a position on this. For these LPs, ESG has become a material driver for their decision to invest, alongside financial returns. I think this will increase further as a consideration – we've already come a long way. Where conversations used to centre around whether a GP has ESG policies, LPs now have specific ESG questionnaires to ascertain how firms account for ESG and what aspects they measure. LPs want to see case studies of where they have or haven't done deals because of ESG concerns.

CD: Europe has definitely been ahead of the ESG curve – European LPs have been pushing the agenda and driving the larger GPs in particular to raise standards and formalise policies. I think Michael's point about consultants is particularly pertinent, given the consolidation we've seen in that part of the market. A smaller number of consultants hold the purse strings for an increasingly larger share of LP commitments, which means GPs need to spend time understanding what consultants are looking for – and the fact is they tend to be much more demanding across the whole spectrum of fund selection criteria. ■

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