Privcap/Report

Includes a bonus interview with

Bruce C. Greenwald

of Columbia Business School

Q2 2016 Fundraising Roundup

Private Equity

An in-depth conversation with industry experts

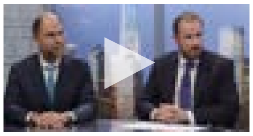
In partnership with

MERCURY iFunds

preqin

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 companion video

Chris Elvin is the head of private equity products at Preqin, the alternative assets industry's leading source of data and intelligence. 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**

A Buyer's Market

Smaller, newer funds must hustle to get committments

David Snow, Privcap: Why is it a buyer's market now for smaller, newer funds?

Alan Pardee, Mercury Capital Advisors: The big megafunds have been getting a lot of the capital, and that's one of the features of our marketplace. Most limited partners are a little bit nervous about the state of the world. They're heading towards the established funds, and that "established fund" definition can be large, but it can also, luckily for the midsized guys, be midsized or small.

Where the challenge really is right now is around the newer funds—the first-time funds, the spinout groups. [In] 2012 to 2014, those guys were very much in favor. Now that the market's a little more worried, they're heading more towards the established firms.

Chris Elvin, Preqin: You look at the number of funds in market, which is now 1,700, and what's interesting is the actual total aggregate target

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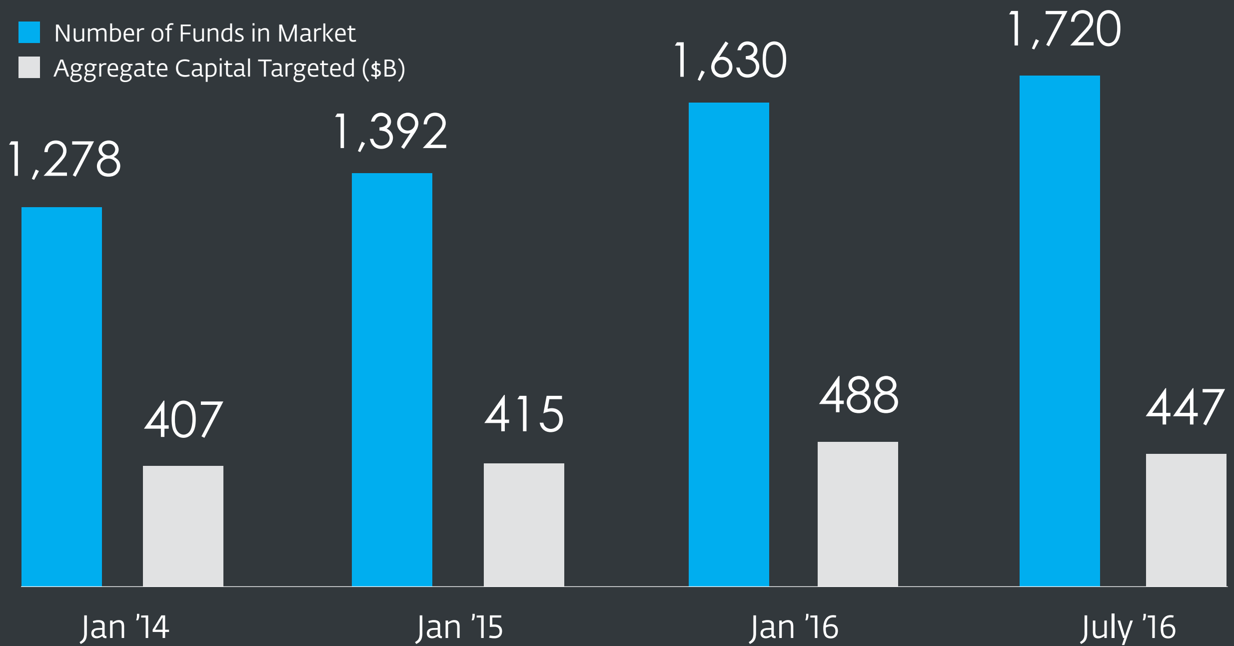
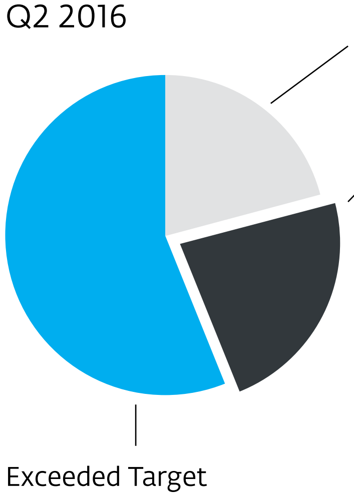
Number of PE Funds in Market, Capital Targeted



Source: Preqin

Most Fund Closes Met or Exceeded Targets
Q2 2016



capital they're seeking is smaller than at the high point of, say, the end of last year. So there's an inference there that the smaller funds make up a larger proportion of the new entrants to the market.

Are these newer funds having to make significant concessions to attract LPs?

Pardee: Absolutely. Currently, I would say it's almost standard practice that as a newer firm is coming into its first closing, it's making some number of concessions to the investors. The typical request is for a discount on [the] management fee. Somebody coming in with 10, 20, 30 percent of the fund, if that is even happening, usually asks for some kind of discount.

Also, to use a U.S. example, taking a European waterfall is another outcome. We try to keep the European waterfalls over there on the other side of the pond, if we can, but it does happen that they come across.

Elvin: We've recently looked at fund terms and conditions for the pool of data that we have, and this year we've seen a movement within the hurdle rates-that level [is] actually increasing. So there's been a trend in terms of GP and LP alignment, [where it's] definitely moving towards the LPs.

There appears to be a growth in what you could call "seeding" organizations. They seed GPs—invest in the management company of a firm that is a private equity firm. Is this a result of the difficulties and risks of spinouts in emerging groups?

Pardee: Now that the attention has gone to the larger, more-established funds, it's a perfect time for the seeder groups to spend time with these newer, emerging managers and give them a hand. ■

More Dry Powder Than Ever

What does it mean for PE investing?

According to Preqin data, since the end of last year, the private equity market has added $73B in uninvested committed capital, sometimes known as dry powder. Chris, what does this indicate?

Elvin: Essentially, it goes hand in hand with the growth of the industry. There are more private-equity-held assets than ever before. We're coming off the back of a robust fundraising period as well. There's more interest in terms of when the pricing will decrease, allowing fund managers to put more of that capital to work. It's sort of a balance of scales.

Are LPs focused on dry powder as a metric, or do they think about other considerations first?

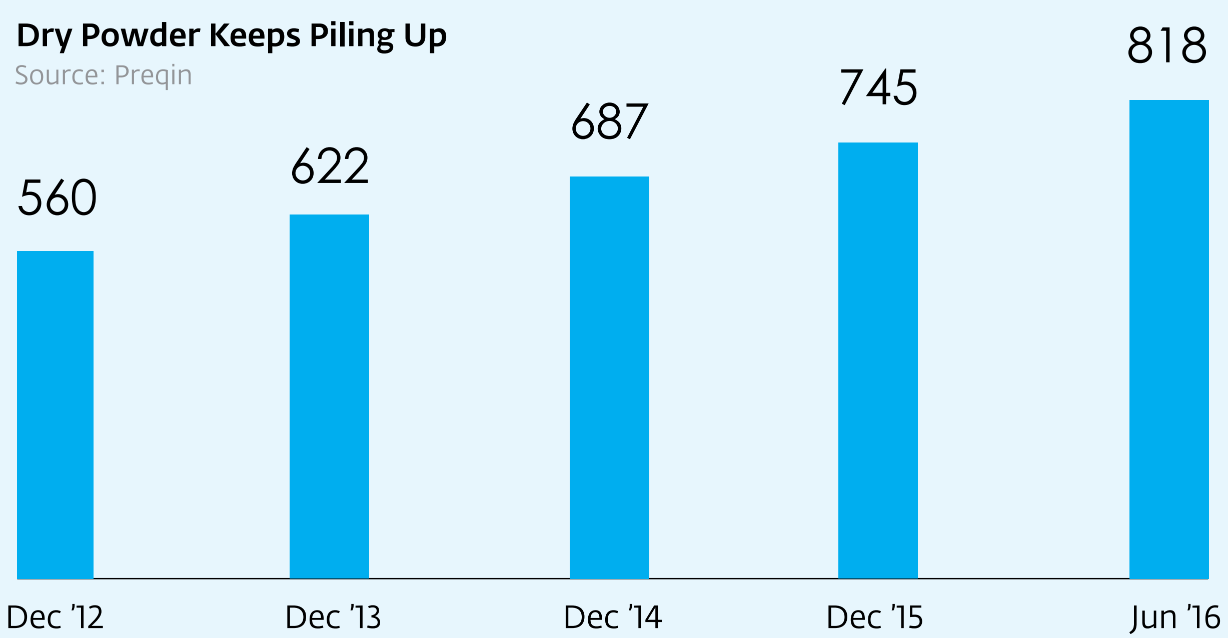
Pardee: Dry powder is really most focused on by the M&A advisor, where they start thinking about the deployment of capital and the deal volume that it needs to meet for it to come out in the next year or two or three. The LP is far more focused on their own budget, their own pacing study, the amount of capital that they have available to deploy into private equity, and what the opportunities are.

So what would it take to start reducing this pile of cash, this dry powder?

Pardee: If we start to see a drop in the entry-level pricing, then that, in turn, will allow them to deploy a lot more of this capital. In Europe we've just seen the repricing. Will we see a repricing in the United States? Time will tell. But we certainly feel like we're closer to the top than to the bottom. ■

Dry Powder Keeps Piling Up

Source: Preqin



Crisis in Europe

How will fundraising hold up?

In the second quarter of 2016, funds targeting Europe raised half as much as funds targeting North America. What is behind this sluggish fundraising pace?

Elvin: North America has been the driver behind the fundraising in this particular quarter, and Europe has been slower. Asia and the rest of the world, they've actually seen more funds close, but less in terms of value. Ultimately, it comes down to the volatility within the markets.

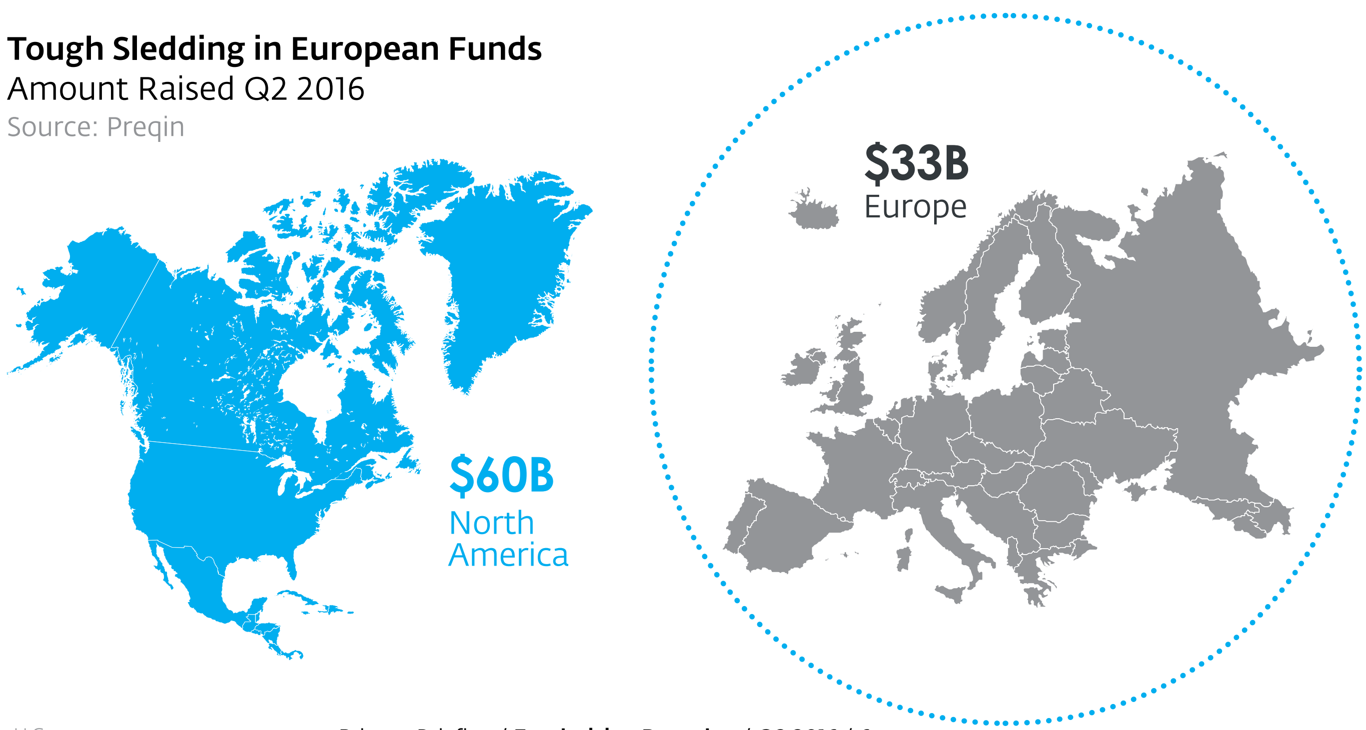
Pardee: The North American funds are doing well today because people believe in what's happening here in the U.S.- and, to a degree, in Canada- in terms of the growth that's still happening. We are the one economy at the moment that feels like it's healthy and doesn't have too-extreme risks.

What long-term impact will Brexit likely have on private equity?

Elvin: We've recently done some surveys of both fund managers and investors to gauge their interest, and there is a mixed bag of results. A very large proportion are simply unsure, at this point, what they are going to do until there is a more definite outline of: Will the U.K. have access to the single market, or won't they? When will the Article 50 vote actually be exercised?

Pardee: If one is taking a 10-year look at the U.K. at any moment in time, one has to come to a belief that it's a growing economy. Thriving industries live there, there's a spirit of innovation. Today might not be the right moment to invest in the U.K., but within the next six months to two years, there is going to be the moment where people will say, "Time to go back in." ■

Tough Sledding in European Funds
Amount Raised Q2 2016
Source: Preqin



Bruce C. Greenwald
Columbia Business School

Michael Ricciardi
Mercury Capital

POWER BROKERS:
Bruce C. Greenwald

Insights from the world's leading investors and dealmakers

Click to watch this video at privcap.com

Mercury Capital's Michael Ricciardi sat down to discuss the state of the financial markets with Bruce Greenwald, the Robert Heilbrunn Professor of Finance and Asset Management and director of the Heilbrunn Center for Graham and Dodd Investing at Columbia Business School.

Michael Ricciardi, Mercury Capital Partners: Carl Icahn has said that what's going on right now is a replication of what took place in 2007 and 2008. And, in fact, the market is about to go off a cliff and that people are going to find themselves in dramatically worse shape. Do you agree?

Bruce Greenwald, Columbia Business School: No. First, the valuations are actually not as rich as they were in 2007. Second, for example, in 2007 you could buy credit default swaps on Dubai sovereign debt, the riskiest region in the world, for 4 basis points—that craziness is not in the market.

The real issue is the earnings power of these companies. As a share of total U.S. income, corporate profits, which pre-1990 were about 8.5 percent, are now around 13.5 percent to 14 percent. If that increase in profits is sustainable, and it's likely to continue, then we may have a flat market for a while. We may not have the kind of increase in prices that we've had, but we're probably not going to see the kind of crash we saw in 2008, 2009. And I think that profits are going to stay where they are. ■