Privcap/ Report

Q3 2017

SPOTLIGHT

Outlook for European LPs

How investors in private equity's second-largest market view the regional opportunity

With Experts From:

Cambridge Associates

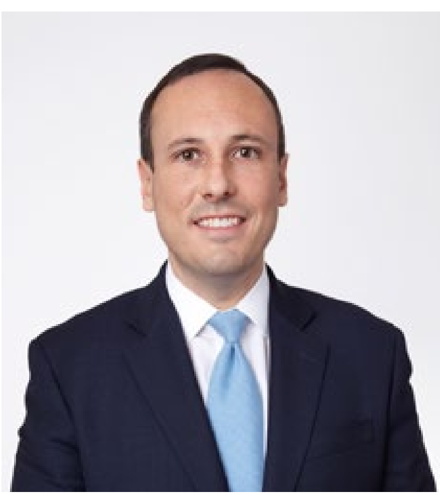
Coller Capital

MVision

Picking Spots in Europe

Political uncertainty is not deterring investors from finding pockets of growth opportunity across Europe

Vicky Williams
Managing Director,
Cambridge Associates



Eric Foran
Principal,
Coller Capital

Investors crave security, and the world of 2017 is providing very little of it. But private equity trends remain positive despite some monumental disruptions, and European investors are finding some bright spots in the region as Europe adjust to the looming impact of Brexit and the general uncertainty following the U.S. presidential election that put Donald Trump in office.

Limited partners in private equity funds are today more attuned to hazards that may become apparent as 2017 progresses. At London-headquartered Coller Capital, a recent survey of LPs showed economic protectionism ranked high on a list of risks to private equity returns.

“We found that 60 percent of our LP respondents saw protectionism as a risk going forward,” says Eric Foran, a principal in the firm’s New York office. But political risks are hardly the top threat to private equity returns. Instead, underperformance in Europe is usually due to the same mistakes made by U.S. GPs. Vicky Williams, a managing director in Cambridge Associates’ London office, says that valuations, debt multiples, and returns on the Continent have not shown much divergence from the North American market. “In Europe, it looks just as expensive as the U.S., particularly on the upper end of the market,” she says, citing an average 6X EBIDTA multiple on debt. “But in the lower midmarket, debt multiples are much lower, much more reasonable.”

“An overwhelming majority of LPs are concerned generally about prices and valuation,” Foran says. “I don’t think that has a particular focus for Europe, North America, or Asia.”

Williams notes that certain European submarkets are more active than others. Private equity investment in Germany has been robust, with deal counts in the Germany-Austria-Switzerland region far outpacing the broader European region. Significant deals, including Apollo Global Management’s mid-June $336 million purchase of private bank Oldenburgische Landesbank from insurer Allianz, continue to keep activity there going at roughly four times the pace of Europe as a whole.

Williams points to growing international interest in the European activity, with increased investment from Asia-Pacific and

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Middle Eastern investors. That increase in capital means all that capital will have to be put to work, and Europe offers plenty of interesting opportunities. Williams notes, for example, that Barcelona has over the past several years grown as an investment destination. German e-commerce opportunities have also drawn significant venture interest, she says.

Even in London, the nerve center of the United Kingdom's divorce from the European Union, companies like Betfair are among the ranks for venture-backed companies that have thrived. Williams notes that Dublin-based King.com, Helsinki's Super Cell, and former Stockholm startup Spotify have all realized robust returns for investors. "People are aware that in the last 10 years, there's been a real growth of European marquee companies being created through venture and private equity investment," she says.

The German-speaking countries' uptick in deal counts points up a trend Williams has seen in the clients she advises, who've shown increased interest in single-country funds. She says some investors are drawn to managers with specific cultural knowledge and an ability to work in a differentiated deal space, finding local opportunities at competitive valuations. The market may be right for some firms to add value by taking businesses out of complicated family ownership and helping them expand.

"What you see in Europe, obviously versus North America, is rather than one large homogenous market, you've got a series of smaller markets where you need to have local knowledge and local networks in order to operate efficiently and successfully," says Ophir Shmuel, a managing director with MVision. "There are managers who do it very well, but they're the ones with scale who understand and know those markets. They understand the regulations and have the networks in order to achieve their returns there."

More generally across the region, uncertainty remains a significant concern, from the impossibility of predicting Brexit's impact on varied European markets to the impact of election results in the United Kingdom, France, and Germany, as well as currency issues. This is especially relevant for UK businesses with complex European sales and purchasing components, since the as-yet-unknown impact of Brexit means there will be some uncertainty over their pricing power. It could also provide good opportunities for buyers with a clear view on underlying portfolio risks.

> "An overwhelming majority of LPs are concerned generally about prices and valuation."
>
> –Eric Foran, Coller Capital

Williams says the longer-term nature of private equity investments requires extra consideration.

"Some would see currency as a discounting factor now and see an opportunity," she says. "But other investors see uncertainty. It may be a good buying opportunity now, but will that interfere with selling opportunities in the next five to 10 years?"

Foran, at Coller Capital, notes that his firm's recent survey did find one pronounced point of division, which may well have its roots in the comparative politics of Europe and the United States. Investor perspectives on energy plays show a strong regional disparity, with LPs in North America preferring oil and gas investments over renewables, and investors in Europe and Asia-Pacific embracing renewables over hydrocarbons.

"More European and Asia-Pacific investors, about two-thirds, see good opportunities in renewables, while a similar, even slightly higher proportion of North American investors are enthusiastic about oil and gas," he says.

Europe remains an appealing option for LPs, but in uncertain times it's difficult to draw out a unifying theme. Sector plays continue to emerge, and country-specific funds remain active, but Williams cautions against blanket declarations and basing decisions on geographic generalities. "It's really about the quality of the manager, and that makes it a more agnostic decision," she says. "Whether it's investing in a manager in Germany or the U.S., it's really about trusting someone with your money for the next 10 to 12 years. Today, private equity is very much a people business." ■

EUROPE:
Land of Modest Fund Growth

MVision's Mounir Guen explains why the U.S. capital-formation statistics are so far ahead

'Blurry' Growth Ahead for Private Equity

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"U.S. general partners and U.S. investors constitute the majority of the market share globally. The U.S. has the oldest general partners, some of whom are approaching 40, 50 years of history. These are firms with established models of business that are very sophisticated. When you leave the United States, two things happen. One is, the volume of general partners with whom you can invest drops dramatically. Second, the average size of the funds drops quite dramatically as you touch new markets. Europe sits quite closely with the U.S. in terms of GP quality. But what happened in Europe in the last several years is that there's been virtually no new GP names – whilst in the United States, I can point to a number of funds who, in the last five to eight years, came into the market and have literally become dominant presences, increasing their fund sizes from $1 billion to $2.5 billion, $5 billion, and more. The new groups that have been coming out in Europe have usually been in the range of about $300 million to $500 million, of completely different texture. Unlike their U.S. cousins, when they come to raise their next fund, they're not doubling in fund size. They're normally 30 percent larger in fund size. Maybe 50 percent. That affects the top line in terms of the statistics." ■

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Expert View

'Looking Closely'

A veteran fundraiser surveys a sophisticated European LP landscape

Ophir Shmuel
Managing Director,
MVision

The European fundraising market is like the US fundraising market, only less so, according to Ophir Shmuel, a managing director at MVision.

Shmuel points out that 2016 was the strongest fundraising market in Europe since the financial crisis—with sought after GPs hitting their caps very quickly and growth both in terms of funds in the market and fund sizes. Only a comparison to the blinding fervor in the US fundraising market makes Europe look relatively weak.

"I think GPs see the fact that it's a benign fundraising market and they want to take advantage of that right now, before a potential for the window to tighten somewhat," says Shmuel.

Europe is also home to LPs of increasing sophistication, and they want what any sophisticated LPs want: "The investors are still looking for quality managers. They're looking for stories that don't have any issues—no hair on them. Strong track records, strong team, succession managed correctly, and the GP continuing to perform regardless of the markets. And investors are looking far more closely at how GPs produce their returns and how efficient they are in producing their returns. You can have a great gross performance, but you can get killed because you haven't been deploying correctly or the fees eat into the returns." ■