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Privcap/ Report

IR IN THE TIME OF CORONA

An expert discussion focused on the LP/GP communication dynamic when everyone is forced to stay home

Experts

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IR in the Time of Corona

David Snow, Privcap: Michael, why don't we start with you, since you are in touch with so many GPs. Amid this COVID-19 crisis, what are you seeing by way of AGMs getting postponed or cancelled?

Michael Elio, StepStone: We have slowly seen these events get canceled over time and, quite frankly, they have to be canceled. Because, depending on their jurisdiction, you can't have more than 10 or so people together. And, quite frankly, nobody can travel anyway. So, we have seen things being canceled or rescheduled into the fall. What we're seeing is a domino effect of events tripping all over each other in the fall because there were pretty regular events. Others are shifting to something that we're doing right now – more of a webinar delivery platform – and trying to stick to their dates and compressing it down to get the information out to their LPs.

Mona Marquardt, InRider Partners: We really think best practice is sticking to the date that you already had set, even if it's in the next couple of months. One, it is already on your investors' calendars. And as [Mike] mentioned, we can't have everything compressed into the autumn. But also, maintaining the schedule that you put out there in this environment, where everyone is so stressed and so worried, builds some sense of stability, builds trust. We are anticipating that the first AGMs that are delivered virtually – whether they're teleconferences or video conferences – are going to be pretty rudimentary, pretty basic. People are just looking to get information out there. But LPs are going to get accustomed to this format and we'll see some GPs starting to deliver pretty refined virtual AGMs.

So, there is a need to think forward about how you're going to convert to a much more compressed timeframe, shifting to an agenda that's appropriate for a virtual setting and even changing the way your content looks. You're going to need to shake up what's on the screen so you don't have people zoning out and going to get coffee and walk the dog in the middle of your AGM.

Snow: Gary, you're probably very much in touch with your LPs right now. What's the general mood?

Gary Sernovitz, Lime Rock Partners: First, people are being human and probably comparing this to, depending on your age, the two prior or similar-ish events of a lifetime: the Great Financial Crisis and 9/11. Right now, we are solely in the mode of getting the facts and getting your bearings. Investors are asking about capital call pace, trying to get an early handle on valuations and really in fact-gathering mode.

I get a sense, anecdotally, that the Great Financial Crisis kind of helped people prepare for this mentally. There doesn't seem to be the rumor mill around LPs asking if people are defaulting. Maybe

The Experts

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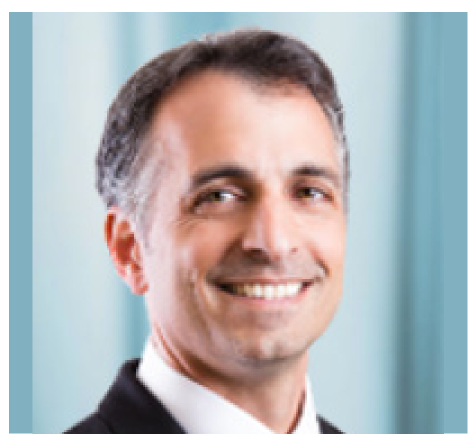

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it's a benefit of having 12-year bull-market gains on their balance sheets, but on a human level, they're adjusting.

Snow: Here's a question from the audience: will LPs feel that a virtual AGM is suitable?

Elio: To Gary's point, LPs are starved for information and data. Luckily, I think the LPs are well-suited to this unfortunate event. Those that have gone through it 12 years ago know the questions to ask and how quickly to start asking them. So, when are you going to call capital? What does your deal flow look like? Tell us about your portfolio and valuations. Those questions have already started bombarding IR folks all around the world.

Question from the audience: Will LPs really want to sit through a three- to four-hour online presentation?

Mona Marquardt, InRider Partners: It definitely has to be a shorter event. The few that have taken place so far have been more in the two-and-a-half-hour range. You're compressing a lot and you're probably not going to have your portfolio company CEOs speaking if they're in the middle of crisis management.

It's really important to make sure that the technology is tight and your presentations are tight and visually differentiated from each other so that people are engaged. Also it is important to try to engage your audience if the platform allows them to ask questions. You can certainly solicit questions or even put a poll out there at the beginning of each presentation, so there's something to keep them feeling like they're in the room even though they're all at different locations.

So, I think a virtual AGM is suitable for now. I don't think it's a permanent replacement because people need to meet the people they're giving money to. I think it will hold us over through this time of need, but we will have to go back to the standard way of doing things eventually.

Marquardt: Agreed. It's absolutely acceptable now, and LPs are understanding of whatever format can be put out there for the time being. They don't even need to see the presenters on the screen, provided they can see the presentation. There are even questions around end-of-the-year AGMs. If we do see a resurgence in cases after the summer, we'll need to be in virtual mode throughout all of 2020. LPs, particularly those in less central locations, are going to want this option in future years as those folks have very small teams and limited travel budgets. But we anticipate that GPs are going to try to move back to in-person meetings as soon as possible.

Snow: Mike, Gary made an interesting point about how the Great Financial Crisis may have prepared many LPs for this moment. In general, do you think many LPs are better prepared for this than GPs?

Elio: I'm pretty proud of the LPs this time around. If you recall what happened in the last boom time – 2006, 2007 – distributions were coming through and a lot of commitments were made. They were like freshmen with their first credit cards. So, commitment pacing went through the roof in '06 and '07 and just died afterwards. We had the denominator effect, we had a lot of different issues impacting LPs. This time around, a lot of LPs actually have an allocation to cash. They're prepared, they knew exactly what to do to see what their liabilities were and what their pacing is. And, quite frankly, the CIOs and the heads of PE really want to stick to their pacing through this downturn to make sure that they don't miss out on some of the good opportunities that are coming up. That said, this all will depend on how long this lasts. If this is a three- to six-month issue, that's one thing. If this is an 18-month issue, I think we'll have bigger issues going on.

Snow: We had one question about whether this event is live or pre-recorded. It's live, but that is an important point, because you can arrange virtual meetings where a big chunk is prerecorded and then there's a portion where LPs can ask questions live.

Moving on to valuations. Gary, what is the right way to convey portfolio valuations in an environment with huge swings like right now?

Sernovitz: It's a huge issue internally and externally. We're already getting communication from our LPs about what other GPs are already telling them about where they expect things to be. We got one on Wednesday and they said they expect things to be down about 15% in the energy sector. One of my colleagues said, "Is that an April Fools' joke?" [Laughs] "Did they invest in Zoom, toilet paper and gummy bears in their energy portfolio?"

We are going to be very, very transparent and methodological with folks. Clearly, every LP understands two things. One, private market transactions that happened in the last five years are not relevant in this market. There is no newly established private market transaction in this market. Two, in a crisis like this, pub-

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lic market valuations are hard to fathom. I used to be a sell-side equity research analyst. Stocks fall faster than the estimates from the analysts, who are waiting for company guidance. My advice would be use this first-quarter letter [to LPs] to broadly about how you're approaching valuations this quarter. Show some humility. We're all in this together. There are no perfect and absolute objective answers in a market like this. Just make it so people can easily follow what you're doing instead of mumbling about discounted cash-flow, where no one has any transparency into inputs.

Elio: We've probably had 300 one-on-one calls with GPs in the last three weeks, and they've fallen into different categories. First, the GP reached out and said, "Look, we're still here. We're working from home. We hope everything's all right. We hope everyone's well." The second round of communication was more on categorizing their portfolio companies: "Here's the red, yellow, green, here are the issues that we think may be a problem, the dynamic is changing every day, but we'll stay in communication with you."

The third is to Gary's point on valuations: "Here's where we think things will come out for 3/31, because at this point, 12/31 doesn't matter." LPs are looking at 9/30 and they're saying, "Oh my God, where are we going to be on 3/31?"

At StepStone, we actually created a coded dashboard where we can map out all the portfolio companies of an LP to see where those valuations will end up on 3/31. We're estimating anywhere from a 15% to 17% drop in NAV from 9/30 to 3/31. GPs need to communicate, because you can't just take a broad-brush approach.

I will say LPs this time have a different strategic asset allocation, so they don't have quite that broad public market exposure. So the denominator effect, even though it is hitting them, is not as bad as it was the last time around.

Snow: Let's move on to fundraising, because we are getting a lot of questions about it from the audience. Mona, what is your prediction for the impact to 2020 fundraising from COVID-19, and what and GPs do to keep ties with LPs in these uncertain times?

Marquardt: As Michael was saying, LPs by and large are looking to stay as much on plan as they can, given many unknowns. We have heard that a meaningful percentage are looking to reduce the amount of capital that is put out. By what amount is unclear. It seems like things are going to be fairly quiet right now, especially as many institutional investors are resetting to working from home. They probably have other delays that are wholly unrelated to their fundraising diligence process.

There is the question of when is it no longer inappropriate or when is it no longer tacky to try to contact a new investor? Investors do seem like they're most interested in maintaining relationships with existing GPs. That's where their dollars are most likely to go and those are the calls they're most likely to be taking.

For funds that are already in process, where you've established dialogue, that can continue. Probably the first outreach at this point is a general check-in, not really pushing any information about the fund. You want to demonstrate you're concerned about them first and [ask] "Is this a good time to talk?"

For new relationships, that is tougher. If you're using a placement agent, that can be really valuable because they will have existing, personal relationships.

Question from the audience:
How are secondary transactions being affected by the crisis?

Michael Elio: Secondary transactions need to be priced on something. And 9/30 transactions are no longer relevant. 12/31 valuations are, though also no longer relevant. I think the market is effectively on hold, until we can get some clarity on what the future looks like and what some of these valuations look like.

Gary Sernovitz: If someone calls you up and says, "We wanted to launch a secondary transaction," my thought is: "Poor, poor man." That's it. It's obviously not a good time in any context of any asset. I would try to discourage them, if they were friends.

Sernovitz: This is not a time where the phone rings and it's going to be good news. I just talked to one of the largest Canadian plans yesterday and they said, "All we're doing right now is re-ups and looking at the portfolio, not even thinking about anything else."

The second challenge is how people think about various sub-sectors. I was talking to one LP and she said she wanted exposure to a new sector, to buy things at the bottom. And that tends not to be done in a five-year draw-down with illiquid fund. It's better in credit. It's better in the public markets.

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Snow: Mike, what is the right way to ask people for money in these trying times?

Elio: I think existing relationships will still be able to raise money. ODD has been done on those organizations and there's already a GP-LP relationship in place. We've actually seen some GPs in this market move up some of their closes. Closes that were scheduled for April are still going on as planned. We can thank the governor of California for waving the Brown Act because, now, all the California plans can actually meet over the phone and continue their business. But I will say that business is still focused on all of the existing things that were in the pipeline. I think LPs are saving that little bit to be, to Gary's point, opportunistic. Of course, we tell our clients that if you think there's an opportunity now, you probably should've committed last year, so you're too late, you missed it.

Many of our clients have had springing relationships on the credit side. Their focus has shifted over there. So, I think fundraising will be tougher this year, less for the established names and established relationships. First-time funds will be hard. You can get the story out there, but it will be very hard for you to make a connection with an LP over the phone. And, quite frankly, I don't know anyone who's really written a check to a first-time manager without having met them in person. I think communication and education can happen, but until meetings can happen in person, those funds will probably have to wait until the beginning of Q3 to start fundraising.

Sernovitz: Five years from now, LPs will remember a judgment they made on your character as an individual and as a manager. That will be remembered the next time you ask people for money, more so than any individual factual data point. These are good people that are in the foxhole with us in this crisis versus.

Snow: Mona, what is the worst way to share bad news?

Marquardt: The worst way to share bad news would be to not preview it at all, and to share it via an email after it's a done deal basically. So, don't do that. Previewing what you know, when you know it and being very clear about what you know and what you don't know. I would say the Governor Cuomo approach is one to be emulated. Don't be overly optimistic. Be focused on the facts that you have. ■