OPALESQUE
PRIVATE EQUITY
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In This Issue

Welcome to the latest issue of Private Equity Strategies. In this issue we will touch on some niche areas could be standout segments for the industry. Emerging markets GP Abraaj Group has launched a new energy investment arm focused on renewable energy in emerging markets. An expanded Regs Watch features a contribution from Dechert that explores how the SEC is looking at private equity. In addition we offer our regular updates on a full scope of new guidelines, court rulings and items of note for private equity compliance teams.

Movers and Shakers looks at middle market lender Franklin Square which had a banner year in 2015 and has made a new high profile hire. In the Data Snapshot, we look at Bain & Company's new report on exit activity as well as research from Pantheon that suggests that quartile rankings are more important than some might think. Finally, we want to draw your attention to the new Opalesque Marketplace:

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Abraaj Group Launches Energy Investment Arm

Bailey McCann
Private Equity Strategies

The Abraaj Group, an investor operating in global growth markets, is creating a new project development arm to further extend its investment capabilities energy infrastructure space. The group will focus on finding and developing energy assets in developing economies throughout the world.

The move may seem counterintuitive but, the firm says they are looking to the future of energy as well as new energy markets worldwide.

"Abraaj's ambition is to effectively manage capital across a number of energy sub-sectors," Sev Vettivetpillai, Partner and Global Head of Abraaj's Thematic Fund Business tells Private Equity Strategies. "We will be looking specifically at renewable energy sources including geothermal, wind and solar."

The firm has already started making investments in this theme and Vettivetpillai says they have been able to find suitable assets while still avoiding the commodities rout which is impacting petrostates. In October of last year, Abraaj announced a partnership with the Aditya Birla Group to build a gigawatt scale renewable energy platform focused on developing solar power plants in India.

In addition to renewables, the group will also be considering midstream and downstream opportunities in distribution, management and storage. "We aren't interested in taking commodity risk," Vettivetpillai says.

According to Vettivetpillai, there is a pent-up demand in emerging markets for viable energy delivery, however, many of these projects require greenfields style development which can make it difficult for private equity or other would-be investors. He adds that even when projects get to a possible financial close, often the way energy developers structure transactions can make it difficult to satisfy both debt and equity investors. To that end, Abraaj plans to get involved early on by working with partner firm Themis to lead or partner with other project developers in order to bring projects from concept to bankability.

Abraaj acquired Themis in 2013 to support this new energy investment theme. The company has energy infrastructure projects under development in excess of 1,300 megawatts and has advised several African governments and lending institutions on energy and civil infrastructure related projects.

Tas Anvaripour will join Abraaj as a Partner in the energy infrastructure team, following her previous roles as Chief Executive Officer of Africa 50 and Chairperson of Themis. Marc Mandaba, Founder of Themis and former private infrastructure investment officer at the African Development Bank, will join Abraaj as Managing Director and Head of Themis.

Vettivetpillai says the bulk of the investment projects Abraaj will be pursuing will be in Africa. "There are opportunities all over the world that we will look at, but Africa has significant infrastructure demands and we have the expertise on the team," he adds.

In total, the energy investment thematic group has a staff of 14, but may expand over time.

According to Vettivetpillai, Abraaj plans to break up the traditional investment holding company model in order to offer investment opportunities throughout the process including development, financial close, and at the yieldco stage. "We have found that there are different groups of investors who are interested in different phases of each project, so we want to provide those options," he said.

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Regs Watch: Lessons for PE Managers from the SEC's Ongoing Scrutiny of Private Equity Funds

by Carl A. de Brito, David A. Vaughan,
James E.B. Bobseine, and Gary E. Brooks - Dechert LLP

A large number of private equity managers were required to register for the first time with the U.S. Securities and Exchange Commission (SEC) pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act (Act). Since the Act's enactment in 2010, there has been a significant increase in SEC scrutiny of private equity managers – primarily through investigations and civil enforcement actions initiated by the SEC's Division of Enforcement, as well as the Presence Examination Initiative (Initiative) conducted by the Office of Compliance Inspections and Examinations (OCIE). The SEC's enforcement activities in this area accelerated in 2014 and 2015. Given the scope of the deficiencies cited by the SEC Staff following the Initiative, it seems clear that the bar has been raised in this area.

Private equity managers seeking to comply with their regulatory obligations can learn from the activities of OCIE and the Enforcement Division. Specifically, private equity fund fees and expenses have come under substantial regulatory scrutiny as the SEC Staff has observed what it believes are allegedly improper practices regarding (i) the level of disclosure with respect to such fees and expenses; and (ii) whether such fees and expenses are being fairly allocated among fund managers, funds, and other parallel investment vehicles and investors, as well as co-investors. And, an important take-away from recent enforcement actions is the possibility that the SEC may find that full and fair disclosure can cure, or at least mitigate, otherwise problematic fee and expense practices.

Background and Legal Framework

Prior to the enactment of the Act, many advisers to private funds were exempt from SEC registration as investment advisers pursuant to former Section 203(b)(3) of the Investment Advisers Act of 1940 (Advisers Act). Title IV of the Act eliminated the exemption previously provided by Section 203(b)(3) – as a result, many previously unregistered advisers to private funds were required to register with the SEC and became subject to its regulatory oversight.

The Presence Examination Initiative – instituted in 2012 and involving examination of more than 150 private equity firms – was meant to provide the SEC with a better understanding of the unique issues and risks surrounding the newly-registered advisers to private funds. Through the Initiative, OCIE has identified several "key risk areas," including improper expenses, hidden fees, issues in the marketing and valuation of private equity funds and co-investment policies and practices. SEC enforcement actions in 2014 and 2015 have made clear that the Enforcement Division is following through on OCIE's identification of risk areas by targeting what it views as "improper expenses" and "hidden fees." During the last year, the Enforcement Division has continued to publicly state that it intends to bring enforcement actions against private equity firms, and that those actions will relate to "undisclosed and misallocated fees and expenses as well as conflicts of interest."{1}

Unlike the regulation of registered investment companies, the federal securities laws do not substantively regulate the fees and expenses charged by private fund advisers, with the exception of restrictions on charging carried interest to investors who do not meet certain high net worth tests.{2} However, the U.S. Supreme Court has interpreted Section 206 of the Advisers Act to impose a fiduciary duty on investment advisers,{3} and by rule, investment advisers to private funds must make full and fair disclosure to investors and prospective investors.4 As such, investment advisers have a duty to eliminate – or, at a minimum, disclose – conflicts of interest. This legal framework means that, theoretically, a private equity manager registered as an investment adviser could charge any fee or expense to a fund (if investors agreed), so long as this is clearly and adequately disclosed to investors. As a corollary, when an adviser exercises discretion in the absence of disclosure, the adviser risks the Staff applying its own standards of whether this result was "fair." Recent activities of the Enforcement Division and OCIE highlight this.

Division of Enforcement – Activities and Lessons for Managers

Managers Must Implement, and Regularly Review, a Written Compliance Policy regarding Fee Disclosure

An SEC settlement from June 2015 stands for the proposition that private equity managers registered as investment advisers must implement compliance policies and procedures to make certain that fees are fully and fairly disclosed. Further, following implementation, the adviser must review, at least annually, the adequacy of those policies and procedures. This case also underscores the SEC's interest in ensuring that expense allocations are in fact fairly disclosed.

In this settled enforcement action {5} against a private equity manager, the SEC alleged that broken deal expenses were borne by flagship funds and not by co-investors, in the absence of explicit disclosure in the limited partnership agreements or related disclosures that the manager would not allocate broken deal expenses to co-investors. The SEC also alleged that the manager had failed to adopt and implement a written compliance policy or procedure governing its fund expense allocation practices until 2011. The SEC asserted that the manager had violated: its fiduciary duty by failing to provide an express disclosure regarding the broken deal expenses; and Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder, by failing to adopt and implement written policies and procedures reasonably designed to prevent violation of the Advisers Act and the rules thereunder. {6}Without admitting or denying the SEC's allegations, the manager agreed to settle with disgorgement and penalties.

Managers Must Disclose to Investors and Any Advisory Board Potential Conflicts of Interest Related to the Manager's Allocation of Fees and Expenses

A late-2015 settled enforcement action highlights the need for private equity managers registered as investment advisers to be particularly careful when entering into arrangements with affiliates or when receiving payments from portfolio companies. In this November action, the SEC alleged that the firm had failed to fully disclose certain conflicts of interest to a private equity fund client and failed to fully disclose to investors information relating to payments made to an affiliate for consulting services. As a result of these alleged failures, the SEC found that the firm and certain of its officers had violated Section 206(2)7 and Section 206(4) of the Advisers Act, and Rule 206(4)-8 thereunder.{8}

This SEC cease-and-desist order{9} was issued against a private equity firm and investment adviser registered under the Advisers Act, as well as two principals, a former principal, and the dual-hatted chief compliance officer and chief financial officer. While neither admitting nor denying the SEC's findings, the firm, two principals and a former principal agreed to settle with disgorgement and fines.

Managers Must Adequately Disclose Situations where a Potential Conflict of Interest may Give Rise to a Fee Disparity, and Provide Adequate Disclosure of Monitoring Fee Practices

The outcome of an October 2015 settled enforcement action suggests that, at least in some cases, the SEC will not simply accept that an adviser has made some relevant disclosures, but rather will carefully scrutinize whether (in the view of the SEC Staff) such disclosures were adequate.

In this cease-and-desist order{10} against three private equity fund advisers, the SEC alleged that the advisers made inadequate disclosures regarding their monitoring fee practices and discounts received by the advisers from outside legal counsel while the funds paid higher rates. The SEC indicated that, although the advisers had disclosed they might receive monitoring fees from portfolio companies held by their advised funds, the advisers did not adequately disclose their practices regarding the acceleration of such fees for the remaining term of the agreements upon sale of the companies, or that the terms of the agreements exceeded the advisers' typical portfolio company holding period. According to the SEC, the payments to the advisers had the effect of reducing the value of the portfolio companies prior to sale, to the detriment of the funds and their investors. The SEC also alleged that the advisers had failed to adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act. Without admitting or denying the SEC's allegations, the advisers agreed to settle with disgorgement and penalties.

OCIE Presence Examination Initiative – Results and Lessons for Managers

Just as private equity managers can draw lessons from recent actions initiated by the SEC's Division of Enforcement, the publicly disclosed results of OCIE's Initiative can instruct managers as to what the SEC Staff believes are key issues and risks confronting the private equity industry.

In summarizing the results of the Initiative, SEC Chair Mary Jo White provided a fairly comprehensive roadmap when she stated "Some of the common deficiencies from the examinations of these advisers ... included: misallocating fees and expenses; charging improper fees to portfolio companies or the funds they manage; disclosing fee monitoring inadequately; and using bogus service providers to charge false fees …"{11} Former OCIE Director Andrew Bowden echoed Chair White's observation, when he indicated that the most frequently cited deficiencies in adviser examinations have involved inadequate policies and procedures or inadequate disclosures as to the treatment and allocation of fees and expenses.{12} In his remarks, Mr. Bowden noted the extent of such deficiencies, stating "When we have examined how fees and expenses are handled by [private equity fund] advisers, we have identified what we believe are violations of law or material weaknesses in controls over 50% of the time."

The published results of OCIE's Initiative highlighted a number of problem areas, of which two are of particular interest to private equity managers. First, OCIE Staff expressed its belief that too many fundamental fund documents (e.g., limited partnership agreements and operating agreements) contain vague language relating to the treatment or allocation of fees and expenses. According to OCIE, the use of such imprecise language fails to provide investors and potential investors with enough information to adequately assess the fees and expenses they can expect to be charged under such documents. In the SEC Staff's view, this impression also has the potential to provide managers with overly broad authorization to charge fees and expense to funds. Second, OCIE identified a list of "common" private equity practices that, if engaged in by a manager, should be accompanied by a close look at how the fees and expenses are being allocated and treated, including: (1) use of consultants (also known as operating partners); (2) inadequate disclosure of fees and expenses; (3) imposition of hidden fees (such as monitoring, administrative and transaction fees); and (4) imposition of break-up fees and broken-deal expenses.

In response to the OCIE's focus on these fee and expense issues, private equity managers should ensure that written policies and procedures are implemented to cover the treatment and allocation of fees and expenses, and that these policies and procedures should be regularly reviewed in light of the SEC's continuing activities and evolving guidance. Managers may also wish to assess their disclosure pertaining to fees and expenses charged to the funds they manage – whether such disclosure is provided directly to investors, or contained in fund organizational and offering materials and other pertinent fund documents. Further, managers might compare their fee and expense disclosures to those contained in the Fee Reporting Template developed by the Institutional Limited Partners Association (ILPA, a non-governmental advocacy organization for the interests of institutional limited partners).{13} According to the ILPA, the template, which was launched in January 2016, "marks the industry's first attempt to unify and codify the presentation of fees, expenses and carried interest information by fund managers to Limited Partners" – as such, it may serve as a useful resource.

It should be noted that OCIE has also been focusing on co-investment policies and practices of private equity sponsors and disclosure thereof to investors – particularly where investors in a fund are not aware that other investors are negotiating priority co-investment rights. Providing private equity investors with the opportunity to co-invest with a fund in which they are limited partners is an attractive opportunity for investors to gain additional exposure to fund investments at a lower cost than charged by the fund to its fund investors. In this regard, Marc Wyatt, Acting Director of OCIE, pointed out that co-investment opportunities have a very real tangible economic value, but can also be a source of various conflicts of interest, and he suggested that private equity fund sponsors increase transparency as to the allocation of co-investment opportunities among existing investors. He noted that many in the industry have responded to the OCIE focus on co-investor allocation by disclosing less, rather than more, to avoid accountability to investors. In response to that observation, Mr. Wyatt expressed the view that investors deserve to know where they stand in the co-investment priority stack, and that sharing a robust and detailed co-investment allocation policy with all investors is the best way to avoid risk.

Footnotes

1) See, for example, Private Equity: A Look Back and a Glimpse Ahead, Marc Wyatt, Acting Director, Office of Compliance Inspections and Examinations (May 13, 2015).

2) Section 205(a)(1) of the Advisers Act prohibits (with some exceptions) an investment advisory contract from providing for adviser compensation based upon a share of capital gains on, or capital appreciation of, a client's funds. As a result, private equity managers registered as investment advisers may not charge carried interest to investors who do not meet certain high net worth tests (with certain exceptions set forth in the SEC rules).

3) Securities and Exchange Comm'n v. Capital Gains Research Bureau, Inc., et al., 375 U.S. 180, 191 (1963) ("The Investment Advisers Act of 1940 ... reflects a congressional recognition 'of the delicate fiduciary nature of an investment advisory relationship,' as well as a congressional intent to eliminate, or at least to expose, all conflicts of interest which might incline an investment adviser – consciously or unconsciously – to render advice which was not disinterested") (internal citations omitted).

4) Rule 206(4)-8 under the Advisers Act.

5) I.A. Release No. 4131 (June 29, 2015).

6) Under Rule 206(4)-7 of the Advisers Act, an investment advisor must: (i) adopt and implement written policies and procedures reasonably designed to prevent violation of the Advisers Act and the rules thereunder; (ii) review, at least annually, the adequacy of the policies and procedures established pursuant to such Rule and the effectiveness of their implementation; and (iii) designate an individual responsible for administering the policies and procedures.

7) Section 206(2) of the Advisers Act prohibits investment advisers from directly or indirectly engaging in "any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client."

8) Section 206(4) and Rule 206(4)-8 prohibit investment advisers from (1) making false or misleading statements to investors or prospective investors in private equity and hedge funds and other pooled investment vehicles they advise, or (2) otherwise defrauding those investors.

9) I.A. Release No. 4253 (Nov. 3, 2015).

10) I.A. Release No. 4219 (Oct. 7, 2015).

11) SEC Chair Mary Jo White, testimony before the Committee on Financial Services of the U.S. House of Representatives regarding the SEC's Fiscal Year 2015 Budget Request (Apr. 29, 2014).

12) Andrew J. Bowden, Former Director, Office of Compliance Inspections and Examinations, U.S. Securities and Exchange Commission, Spreading Sunshine in Private Equity (May 6, 2014).

13) ILPA Guidance (Jan. 29, 2016).

Regs Watch: Brief Updates on Changes in Regulation for Private Equity

As journalists like me and lawyers have written ad nauseum, new and ever more regulations are in the pipeline for private equity and alternatives as a whole. Here we will hit on some of the cases of note and provide links to new guidance over the past month.

Private equity: Small Business, Enterprise and Employment Act commencement regulations (No. 4)

The regulations bring into force certain provisions of the Small Business, Enterprise and Employment Act 2015 (the "Act") with varying effective dates. Read more from Cummings Law.

JOBS Act Exemptions are Expensive & Burdensome but Loopholes Exist

Crowdfund Insider reports that firms that are interested in crowdfunding, may find some loopholes in the law that work to their advantage. This is particularly true for Regulation A+ which can remove some of the reporting and monitoring requirements laid out in the JOBS Act. Read more.

Attention Start-Ups! Possible Revisions to "Accredited Investor"

On December 18, 2015, the staff of the U.S. Securities and Exchange Commission (the "Commission") issued its report reviewing the definition of "accredited investor" under Rule 501 of Regulation D to the Securities Act of 1933. The recommendations presented in the report could have significant implications for start-up or small businesses looking to raise capital or for private equity and other venture funds engaging in fund-raising. Read more.

Acquisitions by Non-EU Buyers of German Targets May Require Special Regulatory Review or Approval

Little known German regulations that apply to non-EU buyers who are acquiring German companies, may prove to be a surprise and could potentially be an unforeseen roadblock to a timely and successful closing. Read more.

How Elite Law Firms Cash In As PE Funds Go Big

The bevy of billion-dollar funds has many law firms salivating at the prospect of landing such a client, but experts say only a select few firms are up to the task. Read more.

Post-Brexit Regulatory Landscape - Radical Departure or Business as Usual?

This article outlines possible changes to the UK financial services regulatory landscape in the event of the UK voting to leave the European Union (EU) on 23 June 2016. We consider a number of key issues posed by Brexit to a cross-section of financial services institutions. Read more.

Bermuda: Amended Law Appealing To Private Equity Funds

Recent amendments to partnership legislation in Bermuda, effective in December 2015 (Amendments), allow for greater flexibility in how partnerships conduct business, thereby further strengthening the appeal of Bermuda partnerships for use in private equity fund structures. Read more.

PE Investment in China Recovers

Investments made by venture capital and private equity funds in China recovered in March, lifted by a robust momentum in the service industry, according to a report from Beijing-based Zero2IPO Research Center.

The number of settled deals rose 120.9 percent from a month earlier to 338 last month.

Singapore Finance Minister Encourages Local Businesses to Tap Private Equity

Singapore Finance Minister Heng Swee Keat says small and medium sized businesses in the country should look to private equity in addition to government schemes to help fund and grow their businesses. "Make the best use of the expertise of our private equity players, who can connect you to markets and partners, and to access technology," he recently told the Straits Times.

The Finance Minister voiced his support for private equity while speaking at the opening of green restroom specialist Rigel Technology's new global headquarters at Changi Business Park on Friday (April 8).

Movers & Shakers: Franklin Square Adds New Role After Banner Year

by Bailey McCann
Private Equity Strategies

2015 was a record year for Franklin Square - its BDC direct lending platform committed over $1.9 billion to private deals in the fourth quarter of 2015, and more than $5.6 billion for the full year 2015. The $5.6 billion in new private deals in 2015 represents Franklin Square's highest annual total on record and an increase of more than $400 million from 2014. The Pennsylvania-based company which is partnered with GSO Capital Partners, provides a range of alternatives and business development companies (BDCs).

Alongside lending and private deals, new directly originated deals during the quarter for Franklin Square included the addition of six new portfolio companies and 10 new commitments to existing portfolio companies. Those deals were completed with 46 portfolio companies headquartered in 22 different U.S. states.

Sean Coleman, Chief Credit Officer of Franklin Square, tells Private Equity Strategies that despite a volatile year for capital markets in 2015, Franklin Square was able to maintain its record pace by leveraging the scale of its direct lending platform and its relationships through GSO. "The relationship with Blackstone/GSO gives our companies access to their group purchasing program, which is a benefit unique to our platform and a real differentiator for us," he explains. "This program allows our companies to realize significant savings and efficiencies that would not otherwise be available to them."

Franklin Square's activity also stands out against other BDCs in the market, which have had difficulty maintaining share price and investor confidence. The number of BDCs has increased significantly over the years - but most are currently trading at a discount to NAV. Coleman says that may be due to a larger cyclical credit trend, though, rather than fundamental problems with BDCs as a vehicle. "Many people think we are nearing the end of the credit cycle and anticipate a higher level of defaults," he explains. "So some investors are penalizing the BDC sector ahead of potential NAV declines. However, many of the larger-scale firms, such as ourselves, trade at or above NAV due to scale and strong deal-sourcing capabilities."

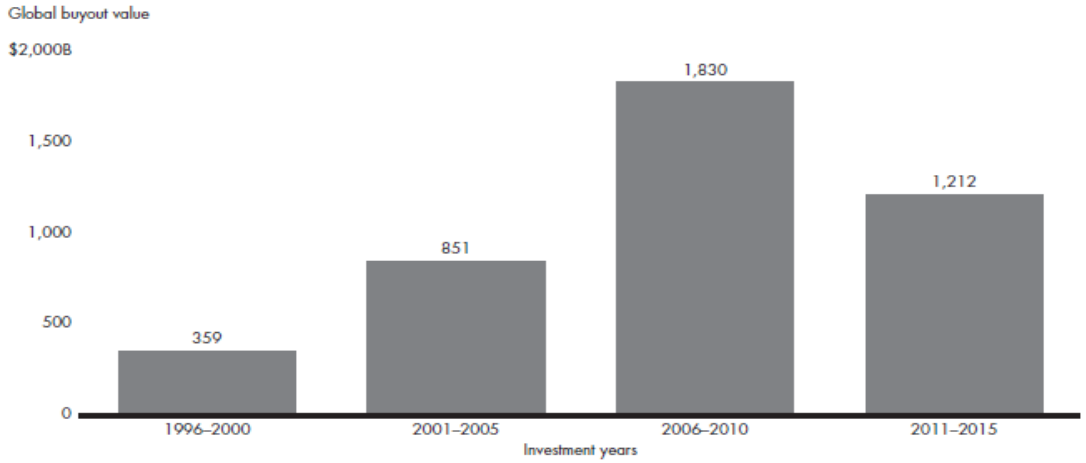
Even if investors may have worries about a decline in value over the next year, Coleman seems cautiously optimistic. The firm is continuing to launch new BDCs and doesn't plan to slow down originations. In January, Franklin Square launched its newest BDC - FS Investment Corporation IV (FSIC IV), expanding the scale of its direct lending platform. And in February, the firm hired Lewis Katz to act as Chief Business Development Officer - a newly created role. Katz joined the firm from Blackboard Advisors, a management consulting firm he founded, where he advised financial services companies on asset management and long-term strategy.

Coleman adds that as the market's largest provider of BDC Capital, he sees middle market demand remaining strong and says that it will be able to avoid some of the bubbly behavior of other parts of the credit market. "For 2016, we think the US economy will continue to muddle through. A slow growth US economy is beneficial to credit - not too hot, not too cold. Weak global growth, the strong dollar and commodity price volatility will likely continue to be headwinds for multinationals but are less of a concern to us given that we are focused on middle market credits," he says.

Data Snapshot: Bain & Company: Exits Slow But Investors Are Still Positive About PE

Bain and Company have released their annual private equity report, which shows that while the overall performance of private equity continues to remain higher than that of the public equities markets, exit activity is likely to slow down over the near term. Data in the report shows that 2015 was very nearly an all-time high for the industry with $422 billion in realizations and 1,166 deals reported at year-end. But, GPs are finding it harder to deploy capital into fresh deals which will mean fewer exits in a couple of years.

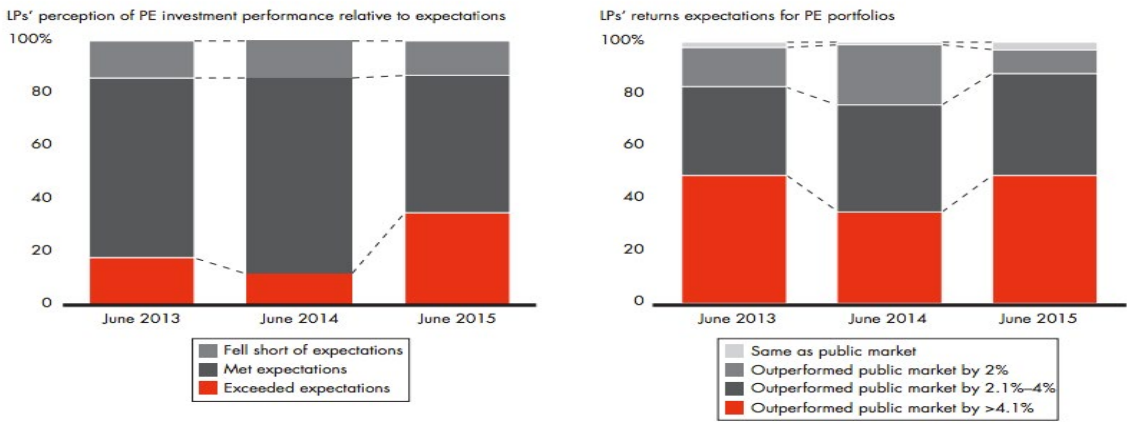
Slower Investment Activity Over The Past Five Years Will Feed Through To Fewer Exits In The Years Ahead



Notes: Bankruptcies excluded; IPO value represents offer amount and not market value of company
Source: Dealogic

Even with lower exit activity, LPs are still happy with overall performance in private equity. According to the report, a recent poll by Preqin showed that in 2014 just 12% of surveyed LPs reported that PE had exceeded their expectations. But by 2015, 35% of LPs said that PE had exceeded expectations, nearly triple the number who said PE had fallen short.

Figure 1.30: LPs' satisfaction with and expectations for PE returns improved markedly



Source: Preqin

Study: Carried Interest & The Persistence of Quartile Rankings

It seems like every GP will tell you they are in the top quartile of something. However, new research from Pantheon shows that quartile rankings may matter more than previously thought. The conclusions from the study may be relevant for PE professionals seeking to manage old portfolios, or for LPs seeking to actively manage their portfolios at an earlier stage or on a more tactical basis.

According to the study, when it comes to examining new funds, final fund quartile performance rankings appear to emerge relatively early. By year five, top quartile buyout funds in the data already had less than a 13 percent probability of generating final performance that was below the median. It is also equally difficult for GPs who underperform early to jump up in quartile rankings, even if they luck out with a handful of good bets near the end of a funds lifecycle.

"We were surprised to see how early the final destiny of a private equity fund was established," report author Dr. Ian Roberts of Pantheon told Private Equity Strategies. "Good GPs are able to create a lot of value really rapidly, and the data bears that out for investors."

Pantheon collected data on 522 U.S. and European buyout and venture funds from Preqin with vintage years ranging from 1992 to 2004 in order to see how this all works. Roberts said they started in 1992 to ensure there was enough observation among vintage years in each quartile in order to make the study statistically relevant. The report shows that venture capital funds have it even harder when it comes to jumping quartiles - a finding which underlines the need for strong manager selection, especially within venture.

That's not to say, however, that a fund that does well in the first five years will continue to do as well over its whole lifecycle. Roberts writes: "even if a top quartile fund remained top quartile, it may have underperformed (in terms of its incremental IRR performance from that point in time onwards) lower quartile funds – at least, lower quartile funds that successfully improved their final performance ranking." This is an important point for secondary investors trying to assess how a given stake might work out if an investor is coming into a fund after the five-year mark.

The paper also looks at how carry can explain mature fund performance. Roberts looked at whether the prospect of receiving carry motivates a GP to outperform in the future. Funds were classified as being in carry if its observed IRR was greater than or equal to 8% at any particular point in time. Based on historical performance over the study period, there does appear to be a pattern of incremental outperformance by funds in carry compared to funds of the same age but not yet in carry.

Roberts concludes that carry does appear to be an effective motivational tool for GPs - at least relative to those who GPs who were underperforming. This is also an important finding for secondary investors, particularly for funds that are in years seven to nine of their lifecycle. At that point, if a fund is in carry investors are likely to see much stronger performance over those that have not yet crossed the carry threshold.

"Ultimately, what we wanted to do with this was not just to provide answers to a hypothesis," Dr. Roberts says. "But we want to give a better toolbox to LPs and secondary investors who may be trying to get a sense of fund performance over time. That information can be hard to come by." The full paper can be accessed here.

Barrel Aged...Drones?

by Bailey McCann
Private Equity Strategies

The makers of Remy Martin are getting into the commercial drone business. Andromede, a holding company of the Heriard Dubreuil family, the largest investor in Remy Cointreau SA, recently led a significant investment round into Delair-Tech, a drone maker.

Founded in 2011 by four engineers, the Toulouse start-up makes a commercial drone that is capable of flying long distances without a pilot and taking images throughout the flight. Toulouse is one of the leading international research centers for the use of satellite data. The $14.5 million round may not sound like a big number compared to venture investments in the US, but it is significant for Europe and Benjamin Benharrosh, marketing director at Delair-Tech says it will help the company expand internationally.

Benharrosh says the company is looking to open a US office as well as one in Australia. The company is already certified to fly its drones out-of-sight in France. Large industrial groups which rely on Delair-Tech include rail infrastructures, electrics, petroleum, highways, mining, and agriculture. Benharrosh explains that these industries use the drones to monitor track conditions, manage assets and check sites remotely.

During flight, the drone takes thousands of images along its prescribed route. Once it returns, the images are removed from the onboard camera and processed. Delair-Tech has developed specific expertise for each type of industry it works with and has designed solutions to enable the acquisition, manipulation, and analysis of data by combining multiple sources of geographic information from its sensors, alongside other systems developed by the aeronautics and aerospace industries. In the future, Benharrosh envisions a model where the image processing is handled on board and in real time.

The company has also launched Delair Services, a sort of "try before you buy" option for users. The turkey solution will have Delair fly its own drone and do the image processing as a service rather than requiring a potential client to buy a drone and do it on their own.

So why are the makers of Remy Martin interested? Bloomberg suggests that the company's expertise in agriculture may be a boon to the makers of wine and spirits, which rely heavily on the health of their crops.

Quick Hits

Fund News: Kayne NewRoad Ventures Fund II LP, has $90 million in commitments to invest in early-stage technology-enabled businesses. The fund is a venture between Kayne Anderson Capital Advisors and NewRoad Capital Partners.

Fund News: DFW Capital Partners, a Teaneck, N.J.-based private equity firm focused on lower middle-market services companies, has closed its fifth fund on $360 million.

Sold: Leeds Equity Partners will sell Evanta, a Portland, Ore.-based provider of executive leadership development and collaborative exchange programs, to CEB for $275 million in an all cash transaction.

Exits: Tower Three Partners has sold The Paslin Company, a Warren, Mich.-based a robotics integrator for the automotive market, to Zhejiang Wanfeng Technology Development Co.

Fund News: JLL Partners, a New York-based private equity firm, has closed its seventh fund with $1 billion in capital commitments.

People: David Blittner has joined Ropes & Gray as a New York-based partner in the law firm's private equity practice.

Valuations: Ant Financial, the finance affiliate of Alibaba Group, has increased the amount of funding it is raising to $3.5 billion, according to Bloomberg.

Fund News: H.I.G. Capital has closed a new private equity fund focused on Brazil and Latin America with $740 million in capital commitments.

Fund News: HarbourVest Partners has closed a new Canadian venture capital fund-of-funds with C$375 million in capital commitments.

Fund News: Aquiline Capital Partners, a New York-based private equity firm has closed its third fund with more than $1.1 billion in capital commitments.

Events

Best Practices for PE Operating Partners in Overseeing Portfolio Companies

May 12, 2016 | New York
Hosted By: Capital Roundtable

SuperReturn Boston

June 6 - 7 2016 | Boston

Private Equity Investing in Distressed Middle-Market Companies

April 14, 2016 - New York, NY
Hosted By: Capital Roundtable

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