Opalesque
Private Equity Strategies

Issue 16 | July 11, 2014

Welcome to the latest issue of Private Equity Strategies. We hope you are enjoying your summer, and will take us along if you need some beach reading beyond the latest issue of People magazine.

This month we're opening with a brief update on how sovereign wealth funds are planning to increase allocations to private equity, alongside other alternative asset classes and infrastructure. The move is part of a broader secular trend on the part of long-term investors, which have struggled to find places to invest long-term capital.

In our Movers and Shakers column we speak with the founder of Sporting Ranch Capital about their unique assets.

We also cover the notable rise in private equity fundraising and dealflow across all subsectors. Our Insiders View Column further covers new regulatory changes on escrow and distributions – timely information for GPs in this exit environment.

As usual we've also included our monthly Regs Watch and Quick Hits columns for brief updates on regulatory changes as well as new transactions, people moves and events. Please reach out to us if you have story tips or ideas that you'd like to share.

In This Issue

Sovereign Wealth Funds Increase Allocations to Private Equity

Allocating to private equity has been a target rich issue for critics of the industry lately. First the Securities and Exchange Commission (SEC) dropped the fees bombshell this summer, citing issues with fee structures at more than half of private equity firms. Then, rolling pension fund scandals from CalPERs, to North Carolina, through New Jersey, and up to Rhode Island painted an unfortunate picture of the industry. Still, asset flows into private equity are going gangbusters, valuations are rising and M&A activity is white hot. So it appears investors aren't all that concerned. Now, a new report from Invesco shows that sovereign wealth funds are going all-in on private equity.

The Invesco data suggests that sovereigns see allocations to private equity and other alternative asset classes as strategic, rather than tactical allocations that can serve as a bulwark against weak developed markets and shaky global equities. Nearly all of the SWFs in the recent survey say that they plan to increase their allocations to alternatives this year.

"This year we observed similar demand for alternatives in 2013, with 51% increasing new exposure to real estate relative to the portfolio and 29% increasing new exposure to private equity relative to the portfolio on a net respondent view basis. Furthermore, all of the major alternative asset classes (real estate, private equity, infrastructure, hedge funds and commodities) were projected to increase on a net respondent view basis when sovereigns compared their forecasted asset placements for 2014 with their 2013 actuals," the report says.

Infrastructure investments are likely to be big winners as well with allocations rising from an already high 44% to 53% over the next year. SWFs are typically big players in infrastructure investing given their mandates to provide long term value for the state, however, allocations to infrastructure only account for just over 20% of the portfolio in 2012. So, these increases are notable.

Another piece of this puzzle is the shifting view of risk within SWFs. Investment officials at a number of the biggest SWFs are taking a less conservative view of risk, and are willing to consider bigger investments in asset classes like private equity in order to meet portfolio objectives. A similar secular trend can also be observed in pension funds, another group of long-term investors that are facing similar issues of deploying capital for the best return profile.

Report data further shows that sovereigns are going beyond their home-market when looking for alternative investments. Historically, SWFs have kept to their own markets when it comes to investing even in vanilla areas like equities. But, as the global economy becomes more interconnected and state interests extend far beyond borders, the home-court bias is eroding.

"Respondents increasing new assets in emerging markets in 2013 typically referenced a decrease in home-market allocations rather than developed markets. On a net respondent view basis 11% of sovereigns reduced allocations to their home-market in 2013. This trend is important because home-market allocations account for a significant percentage of the total portfolio (42% on average across all sovereign investors in 2013). It suggests that sovereign investors could continue to increase exposure to both emerging and developed markets at the same time if home-market allocations continue to decrease," report authors write.

Ultimately, these trends reflect a broader conversation happening at SWFs, pensions and the world's largest investors - the short term gains in global equities may be great, so too recent realizations in private equity, but the longer term picture is harder to figure out. Investments in alternatives could well become a more mainstream way forward for long-term investors who are willing to trade liquidity for diversity and security.

Movers & Shakers: Sporting Ranch Capital Looks To Phase Two

Sporting Ranch Capital, an alternative investment firm that focuses on buying ranches and ranch land in need of rehabilitation is closing in on its second fund. Sporting Ranch Capital launched its first fund in 2012, buying up sporting ranches and rehabilitating them for purchase. Now the firm is on track to start its second property fund, and is gaining institutional interest.

The fund is backed by Jay Ellis and T. Boone Pickens, both of whom have decades of experience building and maintaining world class sporting ranches. Pickens ranch is known as one of if not the top sporting ranch in the world. The firm buys properties throughout the west including the high plains region, and into the four corners.

“We make sure that all of our ranches are within 30 minutes of medical care and town. The properties have everything you would want out of a sporting ranch including live water, fishing, game, and updated accommodations,” says Ellis.

The first fund included five properties, and closed on $30 million. The second fund is targeting 8-10 properties and $50 million. Ellis partnered with Pickens after covering his directional long/short fund as an analyst at BP Capital.

It takes approximately one year from purchasing a ranch for Ellis and the firm to get things up to snuff for a sale. Sporting ranches differ from other types of ranches in that they are focused on activities like fishing and hunting instead of maintaining cattle or commercial use ranch land.

Prices and frequency of ranch land sales have gone up significantly in the last three years as more individuals wish to own land and investors seek to add real assets to their portfolios. In some cases, buying a ranch just fulfills a dream.

“These are emotional purchases for the individuals that ultimately buy our properties. You have to have want to own a sporting ranch and all that entails, or you’re not going to be a buyer,” Ellis adds. He works with the future owners on issues like working with federal conservation programs and other support programs for land owners and ranchers.

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

As journalists like us 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.

US Supreme Court Expands (and Potentially Limits) the Reach of the Bank Fraud Statute

The US Supreme Court has unanimously held that federal prosecutors can use the federal bank fraud statute, 18 U.S.C. § 1344, against offenders in cases where a bank is not the intended target of a fraud.

SEC Division of Corporation Finance Issues Compliance and Disclosure Interpretations

\On July 3, 2014, the SEC's Division of Corporation Finance issued six new Compliance and Disclosure Interpretations (CDIs) regarding the accredited investor verification process under Regulation D. The new CDIs are summarized in the following alert.

SEC issues broker-dealer no-action letter for M&A brokers

In January 2014 the Securities and Exchange Commission (SEC) issued a no-action letter stating that, under certain circumstances, it will not require a finder, consultant or other intermediary helping to facilitate a private M&A transaction to register with the SEC as a broker-dealer.

New limits imposed on foreign investors seeking to acquire farmland in Quebec

On October 30, 2013, the date of royal assent and entry into force of Bill 4610, it became more difficult for a non-resident to acquire agriculturally zoned land suitable for the cultivation of the soil and the raising of livestock.

Estonia unveils draft law to expand pension fund investment

Estonia's Ministry of Finance has published a draft law intended to provide more investment choice for pension funds and more flexibility to investment funds, and help develop local capital markets.

Holy mackerel – are short-sellers the new caped crusaders in the fight to uphold corporate integrity?'

Has an obscure short- seller called Gotham City Research managed to elevate the reputation of its trade from profiteers of doom to superheroes and saviors of the universe?

Silver Lake to pay $29.5 mln in LBO collusion settlement

Silver Lake Partners LP has agreed to pay $29.5 million to settle a lawsuit that accused several large private equity firms of conspiring not to outbid each other on takeovers prior to the financial crisis. It came one month after Goldman Sachs Group Inc and Bain Capital Partners LLC agreed to pay $67 million and $54 million respectively to settle their portions of the litigation.

90% of PE Managers Expect Business Environment to Improve in India

Most private equity investors believe the ease of doing business in the private equity sector will improve under the Narendra Modi government and that the country's GDP will grow more than 6% this year, says a survey. Around 90% of PE managers who participated in a survey from global consulting firm Bain & Co said ease of doing business will somewhat or significantly improve their ability to operate in sectors of interest, and about 68% said they expected India's GDP will grow more than 6%.

Amazon Hires Goats

Amazon has hired a new round of seasonal employees - goats. The goats work one day a week landscaping and wearing ID badges like other Amazon employees and aren't entitled to any benefits. Sadly, most human employees working in the company's warehouses are rumored to have the same employment agreements.

Insiders View: SEC Provides Guidance to Private Equity on Seller Escrows

By: Stephen M. Quinlivan
Stinson Leonard Street

The SEC has issued guidance to registered private equity advisers regarding escrow arrangements resulting from the sale of a portfolio company. The guidance revolves around a circumstance involving the sale of a portfolio company owned by one or more pooled investment vehicles (typically private equity funds) advised by a registered investment adviser (i.e. a private equity sponsor) and other persons that are not clients of the adviser. As part of the sale or merger, the sellers (including the adviser's pooled investment vehicle client(s) and other non-client owners of the portfolio company) often appoint a "sellers' representative" to act on their behalf with respect to a portion of the sale proceeds held in an escrow following the closing of the sale or merger. The purpose of an escrow is to hold a percentage of sale proceeds to be used in the event of indemnification or an adjustment to the sale price of a portfolio company included in the terms of the purchase or merger agreement between the sellers and buyer. An escrow typically exists for a limited period of time and the funds remaining after such time are distributed on a predetermined formula to the sellers, including the adviser's pooled investment vehicle clients.

The custody rule adopted under the Investment Advisers Act (Rule 206(4)-2) requires a registered investment adviser to maintain funds and securities over which it has custody with a qualified custodian (meaning certain banks, broker dealers and the like) in a separate account for each client in the client's name, or in accounts that contain only the adviser's clients' funds and securities that are maintained in the adviser's name as agent or trustee for the clients. The funds in an escrow often belong to both the adviser's pooled investment vehicle clients and other sellers that are not advisory clients and are typically maintained in the name of the sellers' representative. Under these circumstances, advisers believe that the primary protections of these joint escrows for their clients (and pooled investment vehicle investors) are similar in material respects to separate escrows or escrows with only clients' funds and that creating multiple escrows to fully comply with the custody rule would not significantly change the protections and risks.

The SEC Division of Investment Management stated it would not object if an adviser maintains client funds in an escrow under the above circumstances with other client and non-client assets, provided that:

- the client is a pooled investment vehicle that relies on the "audit provision" and includes the portion of the escrow attributable to the pooled investment vehicle in its financial statements. The "audit provision" requires, among other things, the pooled investment vehicle to be subject to audit at least annually by an independent public accountant registered with, and subject to regular inspection by, the Public Company Accounting Oversight Board, and for the audited financial statements to be distributed to all beneficial owners of the pool within 120 days of the pool's fiscal year-end.

- the escrow is in connection with the sale or merger of a portfolio company owned by the private equity fund (i.e., for indemnification or to adjust the purchase price);

- the escrow contains an amount of money that is agreed upon as part of a bona fide negotiation between the buyer and the sellers;

- the escrow exists for a period of time that is agreed upon as part of a bona fide negotiation between the buyer and the sellers;

- the escrow is maintained at a qualified custodian; and

- the sellers' representative is contractually obligated to promptly distribute the funds remaining in the Escrow at the end of the escrow period on a predetermined formula to the sellers, including the pooled investment vehicle clients.

PE-Backed Buyout Exits Jump in Q2

By: Komfie Manolo

A study by data provider Preqin showed the value of private equity-backed buyout exits in the second quarter of 2014 saw a notable jump up from Q1 2014, with 392 exits valued at $138bn in Q2 2014 compared to 331 exits valued at $90bn in the first quarter. This is the highest quarterly exit value for any quarter in the period since the financial crisis, and the second highest number of exits in the same period, behind Q4 2013 which registered 405 exits.

Christopher Elvin, head of private equity products at Preqin commented, "The growing stability of economies and markets around the world is having a positive impact on the exit environment for the private equity industry. Private equity firms selling their stakes in portfolio companies throughout the second quarter of the year have achieved the highest quarterly value in the post-crisis period."

He continued, "On the flip side, growing markets and higher competition are making it harder for private equity buyers, with deal flow falling over the past two quarters. As economies strengthen further, this should present even greater exit conditions for private equity firms to sell on companies, but may prove problematic for the industry to identify good value investment opportunities, especially in a period of strong fundraising and increasing dry powder levels."

According Preqin, the second quarter of 2014 saw a drop in deal flow, however, with a total of 743 private equity-backed buyout deals announced during the quarter valued at $78bn, compared to 733 deals valued at $82bn in Q1 2014. This represents a 1% rise in the number of deals yet a 5% drop in aggregate deal value.

Another Preqin study found study found that global venture capital investment activity has shown that the average value of Series D and later stage deals that occurred in H1 2014 was $64.1m, a significant increase on the average size of late stage deals done in 2013, which stood at $34.4m. The aggregate value of venture capital deals that took place in Q2 2014 was up 27% on the aggregate value of Q1 2014 deals, yet the number of venture capital financings was 1% lower.

Elvin said, "Companies towards the end of the venture capital financing cycle have received far larger investments on average over the first half of this year compared to recent years. In fact, all venture capital financing stages except growth stage/expansion have seen higher average values in H1 2014, as firms invested over $38bn in companies over the first two quarters of the year. Even though specific countries and regions, such as India, have seen a notable uptick in deals being made, the general trend across the world is that of static numbers of deals taking place over recent quarters."

Quick Hits

Consumer goods maker Unilever Plc said it had sold its Slim-Fast brand to Kainos Capital, a U.S.-based private equity firm focused on the food and consumer sector.

Claudio Siniscalco was named global co-head of co-investments and Jason Sambanju was named director and head of Asia secondaries, both new positions, at Deutsche Asset & Wealth Management

Idinvest Partners, a pan-European private equity firm, has closed its second SME senior debt fund, Idinvest Dette Senior II (IDS II) on E400M.

Castle Harlan has acquired Tensar Corp., an Alpharetta, Ga.–based maker of non-traditional site development solutions for the infrastructure, transportation, and construction markets. The deal was valued at $400 million.

Fieldfisher has bolstered its Paris office with a trio of local lateral hires, including M&A lawyer Pascal Squercioni and tax specialist Antoine Gabizon from UGGC and competition partner Anne-Laure-Hélène des Ylouses from French boutique YGMA, a firm she co-founded in 2004.

Roark Capital Group is at work raising its fourth private equity fund, expected to be at least as large as its $1.5 billion predecessor

The California State Teachers' Retirement System plans to put more emphasis on small and mid-market buyout, debt-related and emerging market funds in its private equity portfolio during the 2015 fiscal year ending June 30

METIS Financial Network has launched an alternative investment marketplace allowing private equity, venture capital and hedge funds to market their offerings to a global network of accredited investors and advisors.

William R. Johnson, former chairman, chief executive officer and president of H.J. Heinz Company Limited has been engaged by Advent as an Operating Partner.

Morgan Stanley said its Asia private equity unit has raised $1.7 billion in its fourth Asia fund as it seeks investment opportunities in China andSouth Korea. The fund, Morgan Stanley Private Equity Asia IV LP, has already made two investments from the new fund, and raised more capital than initially targeted, the Wall Street bank said in a statement on Monday.

Events

Private Equity Investing In For-Profit Educaton Companies

July 24, 2014| New York, NY
Hosted By: Capital Roundtable

PE Investing In Franchise Companies

October 23, 2014- New York, NY
Hosted By: Capital Roundtable

OPALESQUE

PRIVATE EQUITY STRATEGIES

PUBLISHER
Matthias Knab
knab@opalesque.com

EDITOR
Bailey McCann
mccann@opalesque.com

ADVERTISING DIRECTOR
Greg Despoelberch
gdespo@opalesque.com

www.opalesque.com