Opalesque
Private Equity Strategies

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In This Issue

Editors Letter

Welcome to the July issue of Private Equity Strategies. Historically, the summer months have been thin for financial news and activity, but not this year. This month we have a power packed issue including news on regulation changes and several notable launches.

In our Dealmakers Q&A section, we open with a discussion of private equity fundraising trends that are driving decisions through the remainder of the year. Veteran placement agents Chris Hastings and Gus Long take a deep dive into where they see opportunities.

Following this theme we speak with Judd Hollas, CEO of EquityNet, a platform for crowdfunding that will move into high gear now that the SEC has finally issued guidance on advertising and crowdfunding allowances included in last year's JOBS Act.

Regs Watch will take us through some other notable regulation changes including delays on FATCA implementation.

In our Movers & Shakers section, we look at the launch of Mission Creek Capital a new distribution management company and speak with Co-Founder and CEO Henri Moudi.

We are looking closely at venture capital this issue with an interview with Hall Capital on investment opportunities in the space. New Ventures our Venture Capital watch column looks at new SEB transaction involving 3D graphics. We follow with the announcement of another technology-focused transaction this time driven by Partners Group.

Finally, as always, Quick Hits highlights new transactions and events to be aware of. Thanks again for your on-going feedback and tips, please keep them coming.

Best,
Bailey McCann
Editor

Bailey McCann
Editor, Private Equity Strategies
mccann@opalesque.com

Dealmakers Q&A: Private Equity Fundraising Isn't Dead Yet

Bailey McCann
Private Equity Strategies

If you read the headlines, private equity fundraising seems mostly dead. However -that's not the case say two dealmakers. Private Equity Strategies spoke with Chris Hastings, Principal at Berchwood Partners, a placement agent and Augustine "Gus" Long, Partner at Stanwich Advisors, an independent, boutique investment bank that focuses exclusively on providing advisory and fundraising services to private equity partnerships globally about trends they see in fundraising right now.

"The market isn't like 2005-06 when the demand and capital were more plentiful, but this is still a healthier market than post the downturn," Long says, noting that there are still opportunities provided real evidence of pedigree and experience are there.

"You're seeing a flight to larger funds, or a flight to quality in a lot of places right now, because there is a perception that with a brand name you'll have less risk. On the smaller side - funds under $2bn - you have a harder time but there is still interest in certain geographies, distressed, energy, real assets, turnarounds," Hastings says.

Both men note that pedigree is important for first time funds. GPs that have many years of experience in all facets of private equity can still raise a fund, but that experience is key. Former CEOs or other new entrants who decide they want to start a fund without a private equity background are going to have a steep uphill climb. "I would invest with a first time fund if the suitable pedigree was there, but I think it is a lot harder, if not impossible, if they are also first time investors without an attributable track record," Long says.

Emerging Markets

Hastings says that if the background is there, demand is strong especially in the middle to small end of the market where financing can be harder to come by. In areas like Latin America, and Africa, funds are also finding opportunities to get into growing economies early on.

"There is interest in Mexico, Colombia, and other Latin American countries. There are also interesting opportunities in Africa, and we are trying to get ahead there, we've sent some people and are working with others on the ground to build relationships and get a sense of the players."

In these areas, fundraising and investing take on some unique nuances that investors should be aware of. Historically, especially in Latin America, privately held companies are loath to allow private equity funds to have controlling stakes, which means funds and investors need to be flexible.

"If you limit yourself to control-only stakes in Mexico or other parts of Latin America you're going to limit the universe of opportunities dramatically. But if you're willing to look at minority stakes with advantageous capital structures or effective control the opportunity set is much larger," Long explains.

Being able to invest more than once is also important. "Particularly with respect to emerging markets, people like to see that they can recycle capital into multiple funds. Given the labor intensive nature of diligencing these opportunities, it is harder to make the case for one time investments," he notes.

US & EU Trends

In developed markets like the US and EU, activity in secondary markets is on the rise, as disrupted cycle funds are more common, but according to Long, fundraising for fresh vintages still hold value.

"It is harder to build a well-diversified portfolio by going only with secondary transactions, but there is a very strong economic case to be made for accessing a fund through the secondary market if the opportunity is there," he says, suggesting that both options can have a place in the portfolio.

New standards like ILPA have also made their way into the market more quietly than some initially expected. "LPs can use ILPA guidelines to get some leverage on fund terms, although that's still going to be more prevalent with LPs who are making the larger commitments. I think the fear that ILPA was just going to be collective bargaining for LPs just hasn't turned out to be true," Long says.

Both men say that overall, firms need to show that they can execute on their core focus area if they want to keep raising money. They note that LPs looking at all parts of the globe are faced with many opportunities, and won't have to rush to get in on good opportunities, instead, they'll be taking a close look at principals and terms when they make decisions.

New Video: Private Equity At Work - Investing in Cyber Security

A new video from the Private Equity Growth Council. Can't see the video? Watch it here.

Crowdfunding and the JOBS Act: The Next Wave In Private Capital Funding

By: Bailey McCann
Private Equity Strategies

Earlier this month, the SEC proposed to lift the 80-year-long ban on general solicitation of accredited investors, pursuant to Title II provisions of last year's JOBS Act. With the new rules, entrepreneurs will now be able to advertise and promote their capital raise activities online (and even offline with billboards and TV ads) to court accredited investors – making the capital raise process somewhat like a new Match.com for businesses and investors. The SEC ban lifting will also affect hedge funds, as Opalesque previously covered, in addition to generating much more deal flow for angel investors.

However, even though there are approximately five million accredited investors in the US, only 10% are actively involved in the investment process. Since businesses will now be able to advertise their capital raises to these investors, this could lead to a boom in driving more accredited investors to participating in the investment process through crowdfunding.

Even before the vote on Title II, some platforms were available for crowdfunding. These first movers now have the outlets in place to build on the next wave ushered in by this vote. EquityNet is one such platform, and has raised more than $200m dollars from accredited investors for entrepreneurs. EquityNet will also be one of the first funding platforms for entrepreneurs to capitalize on the advertising components of the SEC's adoption of Title II as the company has been anticipating this move for some time.

"Companies can now advertise in a much more profound way their need for capital at all stages of their lifecycle," says Judd Hollas, CEO of EquityNet in an interview with Private Equity Strategies. "I think this vote is going to result in more capital being available, and will be most impactful for the individual-to-individual relationship."

The question for many concerned parties is the potential for fraud. Will there be an increase in unscrupulous activity? What experiences do other countries have in dealing with securities-based crowdfunding? It is interesting to note that while the SEC did lift the ad ban, it placed the bar for accredited investor verification higher—eliminating the "self-verification" option. What does that mean -- in practical terms for accredited as well as non-accredited investors?

"I think the fact that entrepreneurs have to verify that investors are accredited is a positive step. Arguably the same questions were raised about companies like eBay or PayPal in the early days, but there have also been a lot of technological advancements driven by those companies. Those technologies and community self-policing will come along here too, some solutions are already in place," he says.

"At EquityNet we've already devised and patented a system of algorithmic verification, similar to what Morningstar did for mutual funds. I think right now, the situation is analogous to the early 1990s when companies like E-Trade started pulling people away from the Merrill Lynches because they lowered the fees and provided the opportunity to be self-directed. Those same people want the opportunity to self-direct private capital investments."

Hollas notes that these allowances could also disrupt current funding cycles throughout the lifecycle of a company. Platforms like SecondMarket could well complement early stage platforms like EquityNet, making the need to go public less urgent.

“This could have a revolutionary impact on the IPO market. Right now, the IPO market very narrowly focused and these platforms provide companies with the opportunity to find equity investments throughout their lifecycle from the private sector, saving a lot of the headache around reporting requirements like Sarbanes-Oxley for companies that go public.”

This could be welcome news for sound private companies that don’t fit the mold VC firms and Angels have come to expect. “I’m not saying all angel investors, VCs and private equity firms are going to go away, but I do think there is a significant market of companies that need funding and can’t always find it. In a lot of ways I think this will create more opportunities downstream for these firms. Ultimately, it is a democratization of financial markets.”

FundaGeek Offers Crowdfunding Consulting Services

A number of niche crowdfunding firms are also getting into the act- FundaGeek operates a specially focused Crowdfunding Portal for researchers that aims to help translate complex science into a form that speaks to a lay audience.

FundaGeek has entered into a strategic partnership with Greer Consulting, a leader in facilitating communication between scientists and lay audiences. Led by Dr. Susanna Greer, Associate Professor with the Georgia State University Department of Biology, Greer Consulting provides services to help design campaign elements that attract more potential supporters.

FundaGeek’s consulting arm plays a complimentary role by advising on pledge amount and reward choice, in selecting the optimum goal amount and campaign period, and how best to promote the project to further potential success including the international distribution of press releases for the project throughout the campaign to targeted media.

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.

FATCA, Derivatives, Glass-Steagall Oh My!

FATCA and Derivatives rules will be delayed as the US tries to finish getting other countries on board. Two US Sentors are also working to revive Glass-Steagall..

Dividend Recaps On Pace For Another Record Year

Law360 says that Dividend Recaps are on pace for another blow out year.

Insurers Could Take Over Public Pension Plans

New legislation sponsored by Orrin Hatch, senior Republican on the Senate Finance Committee, would permit states and cities to voluntarily transfer responsibility and potential liability for defined benefit plans to insurers.

Privacy Attys Capitalize On Creative Fee Arrangements

Alston & Bird LLP recently joined a growing number of firms that offer privacy and data security counseling on an alternative fee basis, an approach that experts say works best if attorneys have a firm grasp of the relatively new practice area and make clear that unintended surprises may cost extra.

Doughty Hanson moves early with AIFMD

Doughty Hanson has become one of the first of Europe's buyout firms to receive regulatory approval under the Alternative Investment Fund Managers Directive.

Very Public New Regulations for a Very Private Industry

Wharton Business School offers a roundup of new regulations impacting private equity in the US and worldwide.

Germany adopts Capital Investment Act (KAGB) to implement the European AIFM Directive

Across Europe, the EU member states are currently amending their national investment laws to transpose the requirements of the AIFMD into national law.

Special report on the regulation of pay in Europe

European lawmakers are busy at work attempting to regulate the pay of those in financial services including private equity firms.

US May Double Leverage Standards For Largest Banks

The US may double capital requirements for the nation's largest banks. The move would likely force them to halt dividend payment to investors and tighten lending practices even more. If the measure goes forward, PE firms may find new opportunities in private lending.

Alts Managers Say PE Is Key

New Research from Towers Watson says that private equity is critical to their portfolios. Private equity assets account for 33% of the slightly more than $3 trillion in assets held by the world's top 100 alternative assets managers.

Private Equity accounts for some 14% of pension portfolios, beat out only by real-estate investments. Read the full survey here.

South Africa: Private Equity Growing Again

In 2012, the South African private equity industry added 10.4% to its total funds under management, which closed at R126.4 billion. The 2012 growth surpasses the previous four years' combined cumulative growth of only 4.6%, according to a new survey from KPMG and the South African Venture Capital and Private Equity Association (SAVCA).

"This year's survey has highlighted a reignited industry" says Warren Watkins, KPMG Partner, Private Equity South Africa.

Movers And Shakers: Mission Creek Capital Partners Launches

By: Bailey McCann
Private Equity Strategies

Former Thomas Weisel Asset Management LLC (Stifel, Nicolaus & Co.) leader, Henri Moudi, CFA, is launching Mission Creek Capital Partners, Inc., an independent investment advisory firm based in California. The company will provide private equity distribution management and advisory services on a discretionary basis for select institutional and private clients. So far, Mission Creek currently manages customized distribution management mandates for institutional clients with combined private equity commitments approaching $3.0bn.

The firm's distribution management platform seeks to preserve and enhance overall cash-on-cash returns for private equity limited partners, executives and entrepreneurs on a separately managed account basis.

Weisel comes to this business with a background in helping some of the largest institutions like CalPERs manage private equity investments. "Our focus is on the back end of the private equity lifecycle," Moudi tells Private Equity Strategies. "The appropriate management of exits is a crucial element of the private equity life cycle that is often overlooked and taken for granted. A lot of the people in this space have their fingers in a lot of pies. Clients and competitors often don't know which hat they are wearing at a given time; we've opted to make this our core focus and remain independent, and unconflicted. We consider distribution management as a 'core' focus and not simply as an 'ancillary' service."

Often instead of returning cash back to LPs, private equity firms distribute in-kind or give stock back. This is typically advantageous for both the LP and the GP in terms of tax efficiency and return. However, LPs need additional infrastructure in order to monetize these shares effectively so they can be redeployed.

"When a GP distributes in kind the very first day and the stock begins trading, the shares are usually down significantly as a lot of LPs seek to exit, and overwhelm the available liquidity," Moudi explains. "Often as those shares are converted to cash they see a negative distribution decline typically of anywhere between 0-3.5% on the first day, but that can be significantly higher, our platform is designed to help mitigate that."

The actual overall cash-on-cash return that the LP sees can be significantly different from what a GP reports. GP's typically look at the value of distributed shares, while LPs are focused on cash-on-cash return. Moudi and his team look for catalysts that will better position the LP to take advantage of their shares.

"We take an area that has historically resulted in a negative detractor and create a source of additional outperformance," he says. "Investors with a significant part of their portfolio in private equity commitments will find value here."

Over the years, Moudi and his partner Charles Gehring, CFA, have developed experience using hedge and overlay strategies utilizing index and equity options to selectively enhance returns and mitigate risks on concentrated exposures. This experience provides the backbone for Mission Creek.

Moudi says that GPs typically make distributions so the recipient and the GP can each determine on an individual basis how to best time capital gains realization. "Private placements are limited in terms how much they can sell at any point in time, but if they distribute to LPs, there is a safe harbor allowance that will give greater flexibility to the exit than a private equity or venture capital firm would have otherwise."

"When a distribution occurs, a third of the recipients sell quickly, a third sell within three months, and the remaining third hold on over the longer term, so it's a way of putting more shares out into the market place with less impact on the stock's liquidity than if they did one large block trade all at once. So it's an important toolset that provides private equity funds additional flexibility. We can then help LPs realize the value of these distributions as well."

Insiders View: Venture Capital Investments Have Changed Slightly, But Still Provide Value

By: Bailey McCann
Private Equity Strategies

Since its consolidation, venture capital has had a hard time gaining traction with investors. Following the crisis, many were wary of making investments that come embedded with a significant, if not likely, blowout risk. Yet, veterans in the space say that dealflow is strong, and opportunities abound.

It may not be the go-go years of the 1990s internet boom, but some VC transactions are still making waves. What's bubbling below the surface is how those transactions have changed. Instead of building the internet as we know it, VC funding is now going to niches and disrupters like Air BnB or Uber, which turn common services like hotel bookings or hailing a taxi into peer, based transactions.

VC investments too, are smaller as new technology has enabled super lean startups to qualify for VC attention. Larger investors in the space note that they're looking at smaller funds that make investments on the order of thousands of dollar investments in many companies instead of million dollar investments in just a few.

Hall Capital is one of those investors. They've been in the VC space for a number of years as part of their overall interest in private equity. Hall Capital is an outsourced CIO with approximately $25.1bn under management, $10.4bn of that is in alternatives. The firm builds global multi-asset class investment portfolios for families, endowments, and foundations and provides a platform of pooled vehicles.

"With the low cost these days of starting a new technology company, the challenge with venture investing is fund size. We have been investing in recent years with smaller funds that are better able to target small seed stage investments," Rachel D. Kort, managing director and member of Hall Capital's Portfolio Management practice, tells Private Equity Strategies.

Despite taking a fairly conservative stance when building their portfolios, Hall Capital still sees value in venture capital.

"We expect a lot of portfolio companies in seed investing and VC to return zero, but we see significant value in the few successes," says Simon Krinsky, Director of Portfolio Management at Hall. ""With seed investing, like many VC strategies, you make a number of investments and you expect that probably only one or two will be very successful and end up making the fund."

He notes that in order to realize value now, investors have to make the right size of investment at the right time, based on proven, fundamental venture strategies. That may look like a $200,000 investment in an unproven company, rather than waiting to make a $2 million investment when it's more developed. "In the US we've gone back to emphasizing seed and traditional VC investments over large and mega-buyout strategies, balanced against some later stage funding, particularly in the emerging markets."

New Ventures: SEB Venture Capital invests in 3D graphics business

By: Bailey McCann
Private Equity Strategies

The venture capital arm of SEB, the Northern European financial Group is getting into 3D with a new transaction. SEB Venture Capital has invested in Donya Labs AB, a global leader in optimization of 3D graphics for computer games. The new capital will enable accelerated growth and diversification towards computer-aided design (CAD), architecture and film.

SEB Venture Capital has been investing in venture capital transactions for the past 18 years. With a capital base of SEK 2.5bn, it currently has 28 portfolio companies within technology and life science and has completed 70 exits since inception.

"We already have an investment in this segment, that produces 2D and 3D graphics. So, we are quite familiar with the market, and we think that the market will grow including 3D printing especially in areas like CAD," says Ulf Lewander, Investment Manager, SEB Venture Capital, in an interview with Private Equity Strategies.

Donya Labs AB has developed unique software called Simplygon, to automatically optimize advanced 3D graphics. Traditionally, optimization of 3D graphics has been expensive and time consuming as a manual process. By automatically optimizing 3D graphics for applications such as real-time visualization, interactivity and 3D printing, workflows can be streamlined and integrated.

"We believe the new business model which operates a cloud version of the technology will open a huge market opportunity," Lewander says. "Right now the company only sells licensing to high end gaming companies. Those companies pay thousands of dollars per license, per game. We have been able to prove that one 3D model at a time done on the cloud is also justifiable."

SEB Venture Capital has subscribed to a new share issue of SEK 10m focused on growing this cloud offer and adding new geographies to the company's footprint. SEB and Donya Labs will be looking for additional subscribers in for a serial round B in the future.

Lewander notes that SEB Venture Capital is focused on finding companies like this that can move from one niche to a broader market. "We are looking for companies that have already proven themselves in tough spaces, going forward we think that will be mostly in software, not hardware."

Sector Focus: Partners Group Takes Controlling Stake In CSS Corp for $270m – Eyes Emerging Markets

By: Bailey McCann
Private Equity Strategies

Partners Group, a Swiss investment manager, has acquired a majority stake in CSS Corp on behalf of its clients in a $270 million transaction. CSS Corp, is a global technology support services company. The company serves a client base in the US and Europe and has a large delivery presence in India, the US, the Philippines, Poland, Mauritius, Costa Rica and China.

"We have a high opinion of the management team, and have conviction about the business' growth potential," Cyrus Driver, Managing Director, Partners Group, tells Private Equity Strategies.

CSS Corp was founded in 1996, and is now a world leader in technology support services with service delivery centers in 13 locations worldwide. CSS Corp's CEO, "Tiger" TG Ramesh, has assembled a hand-picked team of executives from multi-billion dollar IT firms to drive a global expansion strategy. Driver explains that Partners Group saw an opportunity to provide growth equity financing for this next phase.

The focus of this transaction will be to build-out sales and further expand the firm's service footprint by adding delivery centers in new geographies. CSS Corp will focus on building its business in analytics-led customer support, mobility, virtualization and telecom services.

"A large majority of CSS customers are based in the US but they also service customers in Europe and Asia. We think that the business will benefit from untapped growth opportunities in Latin America, that we can help access," Driver says.

According to Driver, the interest in CSS stems from being able to expand into emerging markets. "We are not restricted by industry. Across industries, we seek investment opportunities in midcap businesses that straddle emerging and developed markets and that we can help grow to the next level. We continue to see a lot of opportunities in emerging markets. We recognize that emerging markets are no longer undiscovered and hence investors need to generate alpha to drive returns. We focus on investments with development potential and which we can add substantial value to."

Partners has approximately EUR 28bn in investment programs under management in private equity, private real estate, private infrastructure and private debt.

Quick Hits

Old Mutual launches another private equity fund - the new fund targets investors, with investments starting at R100,000, through the pooling of investor capital in a fund-of-funds structure.

Fieldwood Energy, a unit of New York private equity firm Riverstone Holdings, is working through a $3.75 billion purchase of energy assets in the Gulf of Mexico from Apache Corp.

Frontier Capital is getting into the human resources business with an investment in WilsonHCG, a Florida-based HR consulting and recruitment firm. Terms of the deal were not disclosed.

Carlyle Group is selling off the last of its stake in Boston Private Financial Holdings (BPFH). Carlyle invested $75 million to become Boston Private's biggest shareholder, as of the sale the firm only had about a 10% stake.

Post Oak Energy Capital and funds managed by Goldman Sachs Asset Management (GSAM) have made a $100 million capital commitment to PetroEdge Energy III LLC.

Keith Fenwick has been appointed chair of Fusion AI Partners' advisory board. Fenwick was previously at Guy Carpenter.

Milwaukee-based private equity fund Generation Growth Capital, Inc. has announced the final close of its second fund, Generation Growth Capital Fund II, L.P. which significantly exceeded total capital commitments raised for Fund I. In addition, the company also announced the close of companion fund, Generation Growth Capital Wisconsin Fund II Wisconsin, L.P.

Private-equity firm Providence Equity Partners is increasing its stake in cable operator Hathway Cable & Datacom Ltd with an $18.5m investment

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Chennai-based Capricorn Food Products India Ltd, an integrated food processing company, has raised private equity investment of $10 million from Quadria India for a minority stake in the company.

Events

SuperReturn Asia

September 16-19, 2013
Hosted By: SuperReturn
JW Marriott Hong Kong

Private Equity Investing In For-Profit Education Companies -- Activity Is Gearing Up

Hosted by: The Capital Roundtable

July 28, 2013 New York, NY

About the Editor: Bailey McCann is a reporter and analyst based in the US, with experience covering government, policy and regulatory issues in addition to her coverage of alternative investments. Prior to her work with Opalesque, she provided research and media intelligence for members of Congressional and White House offices, government contractors, and Fortune 500 companies. She has also reported on, and done policy analysis of state and local government issues. She may be reached directly at mccann@opalesque.com

OPALESQUE

PRIVATE EQUITY STRATEGIES

PUBLISHER
Matthias Knab
knab@opalesque.com

EDITOR
Bailey McCann
mccann@opalesque.com

ADVERTISING DIRECTOR
Greg Despoelberch
gdespo@opalesque.com