OPALESQUE

PRIVATE EQUITY STRATEGIES

Issue 114 | February 28, 2017

Welcome to the latest issue of Private Equity Strategies. We are kicking off a new year and a variety of concerns are battling for the tops of private equity's priority list. Our introductory piece looks at how Pantheon is trying to include private equity investment opportunities in custom target date funds.

In our latest Opalesque Marketplace listing we highlight a new real estate opportunity in Europe.

In our Movers and Shakers column, we caught up with Northern Trust about their efforts to streamline private equity fund administration with blockchain technology.

Our data snapshots look at increasing levels of private equity dry powder and how the role of the private equity CTO has evolved.

We also catch up with Indigo Partners a private equity firm that specializes in establishing low cost airlines. Finally, our regular features - Regs Watch and Quick Hits keep you up to date on new regulations and fund news.

I hope you enjoy the issue. If you have any story ideas reach out to mccann {at} opalesque.com

In This Issue

OPALESQUE Market Place

New Listing:

7% NOI return residential real estate in Europe for 10.8 million Euros.
Apartment complex with 181 apartments located in Riga, Latvia.
Low price of 1,570 Euros per square meter. Priced 1.2 million below valuation.
6,865 sqm of leasable space and 3,175 sqm of land.

Contact Matthias Knab for an introduction to the seller:
Email Knab@Opalesque.com or call +49 170 1890077.

Private Equity Looks For A Path Into The Defined Contribution Market

Bailey McCann
Private Equity Strategies

Private equity as an industry has come to rely on pension allocations as a significant, if not majority source of new allocations over the years. That model has worked quite well for a few decades, but now as retirement accounts shift from pension plans to 401(k) and other defined contribution vehicles, private equity isn't part of the mix. Private equity investments don't offer the daily liquidity that is often required by these types of retirement offerings. That's sent the industry scrambling to find new ways of including long-term investments in products that are biased toward short-term liquidity.

Enter Pantheon. London-based Pantheon, a veteran investor in private equity, infrastructure, and real assets, has introduced a new product that would allow custom target date funds to include private equity in the asset allocation mix. Notably, the product includes performance-based pricing.

"We want to be able to offer the same investment access and benefits to the defined contribution market that individuals in a defined benefit plan receive," explains Kevin Albert, Managing Director at Pantheon in an interview with Private Equity Strategies. "Defined benefit plans have been able to plan for long-term funding by investing in asset classes like private equity, but that security is not available to the DC market."

The U.S. retirement market consists of both defined benefit (DB) and DC plans, and more than 90 million U.S. citizens are covered by DC plans, with DC assets in excess of $6.7 trillion. Historically, DB plans have outperformed DC plans for reasons that include a shift toward alternative assets and differing investment fee structures. Based on the strong returns the private equity asset class has delivered in recent years, Pantheon believes that private equity strategies have the potential to address the performance delta between DB and DC plans and merit consideration as a viable investment option by plan sponsors.

"We believe it is essential to take action to close the performance gap between DB and DC plans," Albert says. "Research shows that 52% of American households are currently at risk of not having enough to maintain their living standards during retirement.Retirees can ill afford to suffer continued underperformance in their DC plans."

The performance pricing option applies only to that portion of a portfolio actually invested in private equity investments (e.g., not including cash and liquid securities). A performance-based fee is only accrued when the performance of the private assets in the portfolio beats its benchmark, which is the S&P 500.

Pantheon does not receive all the performance fee it accrued immediately. When a performance fee is accrued, it is gradually paid to Pantheon over at least eight calendar quarters. This is so there can be a reservoir available to reverse performance fee accruals in scenarios of underperformance.

(Continued on the next page)

Because Pantheon's strategy intends to accommodate periodic trading, and the fee accrued would be reflected in the strategy NAV as of the relevant period, investors will not pay for performance they did not experience.

Pantheon is working with a number of General Partners, including KKR, to seek to manage the less predictable and irregular investor capital inflows that can be expected in a DC plan, and to facilitate efficient deployment.

The types of private equity investments in the strategy will look roughly similar to others Pantheon already has. The target-date fund team will be included as another client within the investment committee, which considers co-investments, secondaries fund investments, infrastructure funds, buyouts funds, etc. "The product has the benefit of offering diversification by manager not just by deal," Albert contends.

Pantheon isn't the only firm looking for new ways to include private equity in DC vehicles. Last week Blackstone acquired Aon Hewitt's record keeping business, which could signal the firm's desire to infuse private equity in more corners of the retirement market. Aon Hewitt is the fifth-largest record keeper of DC plans by assets, with $377 billion under administration as of Sep. 30, 2015, according to Pensions & Investments data.

Prudential also offers a similar setup to DC plans for real asset investments that includes a mix of REITs and listed infrastructure and real estate companies.

It's still early days for the Pantheon product. The company has had several review sessions with private equity and retirement plan consultants to ensure that it will fit the needs of custom target date funds and so far the reception has been positive. "I think the key issue is, this is a new asset class for DC plan sponsors and everyone wants to make sure they don't get on the wrong side of risk and litigation concerns. We feel confident we've addressed those possibilities," Albert adds.

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.

India: Regulation Of Compensation Agreements By SEBI

India is making changes to the way it treats compensation agreements and that could have a significant impact on private equity firms in the region. Read More.

All change for UK money laundering regulation? - Impact for the private equity industry

Of particular interest to the private equity industry will be the proposed new criminal offence of failure to prevent the facilitation of tax evasion, a strict liability offence which will require consideration by way of risk assessment and will need to be addressed when formulating policies and procedures. Read More.

Private equity GPs fret over fundrising and regulation

Regulation and fundraising stood out as the most substantial challenges for private equity fund managers (general partners, or GPs) worldwide in 2016 and remain major concerns in 2017, according to research by private equity fund administrator Augentius. Read more.

Trump Moves to Roll Back Obama-Era Financial Regulations

President Trump has moved to chisel away at the Obama administration's legacy on financial regulation, announcing steps to revisit the rules enacted after the 2008 financial crisis and to back away from a measure intended to protect consumers from bad investment advice. Read more.

Deregulation could add banks to private equity sector

Fund managers at small, new or otherwise aspiring private equity groups seem hopeful a rising tide of deregulation in financial services could lift their ships as well. Read more.

Credit easing, regulation put plans on critical list

U.S. corporate defined benefit plans have been closing and freezing benefit accruals for decades, with a number of industry experts pointing to the very regulations meant to protect them as a top contributing factor. Read more.

CSRC: China is to accelerate financial reform

CHINA is trying to lure more foreign capital into the mainland's financial market and will stick to the stance of reform and opening-up, the country's top securities regulator said today during a press conference amid recent regulatory signals for further financial reforms. Read more.

The Top Ten Regulatory and Litigation Risks for Private Funds in 2017

The top of every private fund adviser's list for 2017 – and how to assess and manage the associated risks.
Read more.

Sunken ship

President Trump's latest private equity hire Philip Bilden has officially withdrawn his name from consideration as Secretary of the Navy.

Bilden is a former managing director with HarbourVest Partners and said that he wouldn't be able to disentangle himself from his financial investments in order to take the job.

Deal or No Deal

The proposed $31 billion merger between the London Stock Exchange and Deutsche Boerse is likely dead. British regulators said the deal wouldn't pass anti-trust checks. The merger would have combined stock exchanges in the UK, Germany and Italy, plus many of Europe's largest clearinghouses.

The deal will also stop a €510 million sale of LCH Clearnet's French arm to Euronext. That deal was backed by LSE and was contingent on the merger with Deutsche Beorse.

Movers & Shakers: Northern Trust Launches Blockchain Offering For Private Equity With IBM

by Bailey McCann
Private Equity Strategies

Northern Trust has launched the first commercial deployment of blockchain technology for private equity fund administration. The firm is partnering with IBM for technology development, which works off of the Hyperledger Fabric. Hyperledger is an open-source blockchain development platform that is focused on finding ways to use distributed technology in financial services.

Northern Trust started working with $20 billion Swiss asset manager Unigestion, in 2016, to create the blockchain offering for its private equity business. The blockchain platform has been designed to support compliance with current, local regulations. Northern Trust will also make use of IBM's high-security network for blockchain to ensure that private keys and platform security are constantly maintained.

"One of the main challenges for private equity is certifying documents. Paper is being passed around for capital calls, investments, and other transfers. Blockchain provides an immutable, certified record of which documents are current and approved," explains Peter Cherecwich, President of Corporate & Institutional Services, Northern Trust in an interview with Private Equity Strategies.

According to Cherecwich, using blockchain will allow funds to have "one version of the truth" which will ultimately be able to cut down the time from fund launch to capital deployment. Unlike traditional document management systems which are often files of PDFs, distributed ledger technology ensures certification, permissioning, and version control so that investors, external auditors, and others are always working from the most up-to-date materials without the possibility of losing one or more PDFs. Funds that use the technology will also avoid being locked into a single vendor's product line.

The Unigestion private equity fund that served as a trial balloon for this technology is domiciled in Guernsey. Cherecwich says that Northern Trust went through an in-depth process including an external security audit by local regulators to get the official sign off - a process it is prepared to replicate with other, popular fund domiciles.

"Guernsey has been at the forefront of innovation in the financial industry for many years. As a jurisdiction, we continually monitor new technologies, support businesses in developing groundbreaking new ideas and provide a supportive environment where products can not only flourish but be first-to-market," said Chief Minister of Guernsey, Gavin St Pier in a statement on the launch.

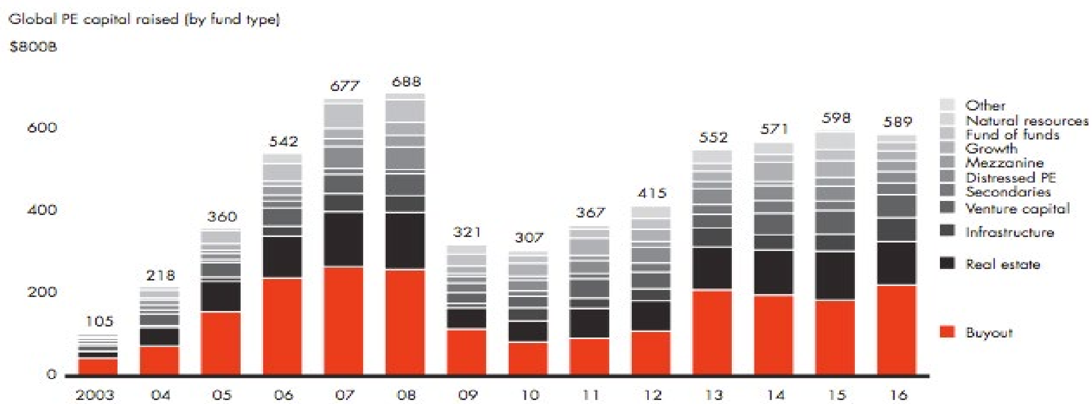
Northern Trust will be making the platform available to other private equity firms and investors that have a relationship with the firm. "We'd like to start building an ecosystem of GPs and LPs that are using the technology," Cherecwich said. "We have already had other firms reach out to us about getting involved."

Data Snapshot: Private Equity Dry Powder Hits New Record

With investors on the hunt for yield, PE remains a favored asset for institutional investors. Fundraising surged as limited partners (LPs) continued to recycle distributions into new capital commitments. Returns also had another strong showing, continuing to outperform public markets by a sizable gap over both short-term and long-term time horizons. Global buyout activity, on the other hand, declined amid a challenging deal-making environment.

A new report from Bain & Company shows that it is becoming harder for private equity to deploy its billions and still find the kind of returns it is used to. In 2016, buyout-backed exits around the world dropped 23 percent in value and 19 percent in count from 2015 and fell even further from the record levels of 2014. But, asset sales of $328 billion in disclosed value from 984 deals actually constitutes an extremely strong run, helping the industry deliver its fourth-best year ever by value.

With nearly all of the pre-crisis deals exited, buyout firms are adjusting to a new normal with longer holding periods of about 5 years – up from the historical average of about 3.5-4 years. Bain expects this trend to continue in the medium term, as a result of high purchase prices and limited sources of market beta, requiring general partners (GPs) to roll up their sleeves and do the time-consuming work of creating value with their assets.



Notes: Includes funds with final close and represents the year in which funds held their final close; buyout includes buyout and balanced funds; distressed PE includes distressed debt, special situation and turnaround funds; other includes private investment in public equity and hybrid funds
Source: Preqin

"Deals are undoubtedly hard to come by. On average, studies show that PE firms see less than 20 percent of deals relevant to them in their pipeline," said Hugh MacArthur, who leads Bain's Global Private Equity Practice.

According to MacArthur, when deals do materialize, they command high prices. And with an expected hold time of about 5 years, the margin of error for generating alpha and delivering acceptable returns to LPs has greatly narrowed. In response, GPs are codifying their battle-tested approaches – what they are good at, what has and has not created value, and where and how their funds have made money for investors – to build playbooks that consist of detailed, sequenced actions taken over time to maximize value from each investment.

But could this be as good as it gets? Many GPs are apprehensive that the industry cannot sustain the torrid pace of fund-raising for much longer. Bain expects that distributions will continue to outpace contributions and LP commitment to the PE asset class will stay strong. However, the fund-raising environment may not be as favorable in coming years, making it important for GPs tfocus on what makes them stand out from the pack.

Data Snapshot: Private Equity CTOs Add Outsourcing, Increased Security To Priority Lists

by Bailey McCann
Private Equity Strategies

The role of the private equity CTO has changed significantly. New technology along with a growing list of cybersecurity threats have placed more demands on the IT department than ever before. According to a new survey of private equity CTOs from Eze Castle Integration, these demands have led to an evolution in the role of the CTO away from simply maintaining hardware and workflows and into making the CTO an integral part of information security and compliance support.

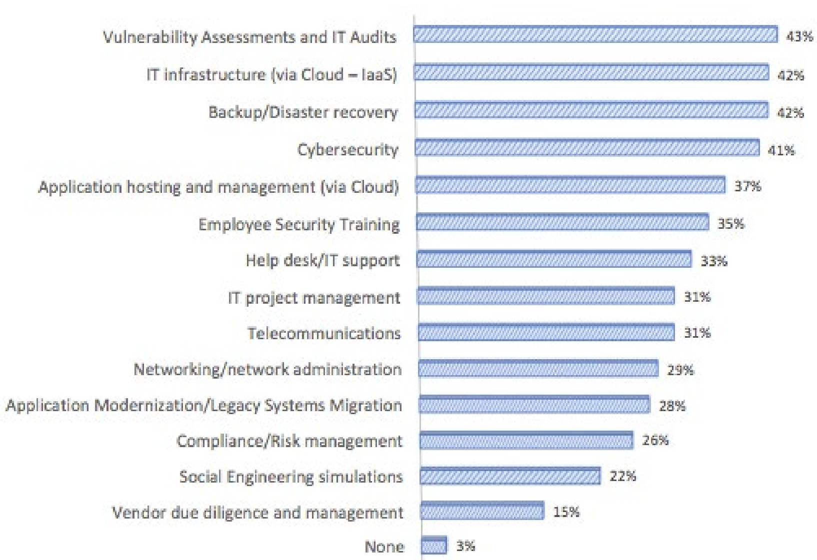
For 2017, respondents to the survey said that their key priorities were cybersecurity, improving customer experience and updating older technologies. Outsourcing some business functions and technology infrastructure to cloud services providers and others also made the list in a big way, with firms looking to outsource a variety of operations.

None of this comes as a surprise to Eze Castle's Chief Strategy Officer, Mark Coriaty. He says that private equity CTOs have been looking to companies like Eze Castle for those new technologies as well as guidance on how best to implement them.

"Outsourcing has grown significantly over the past three years. Firms are looking for guidance, advice and managed services capabilities," Coriaty tells Private Equity Strategies. "Private equity firms, specifically, are looking closely at how they manage and maintain data securely. Many firms lack a centralized data source. We can provide a private cloud that allows for centralization and data management." He adds that Eze Castle also works with CTOs on a consulting basis to help them learn about best practices for information security and maintaining compliance.

The figure below outlines what CTOs are likely to outsource over the next year:

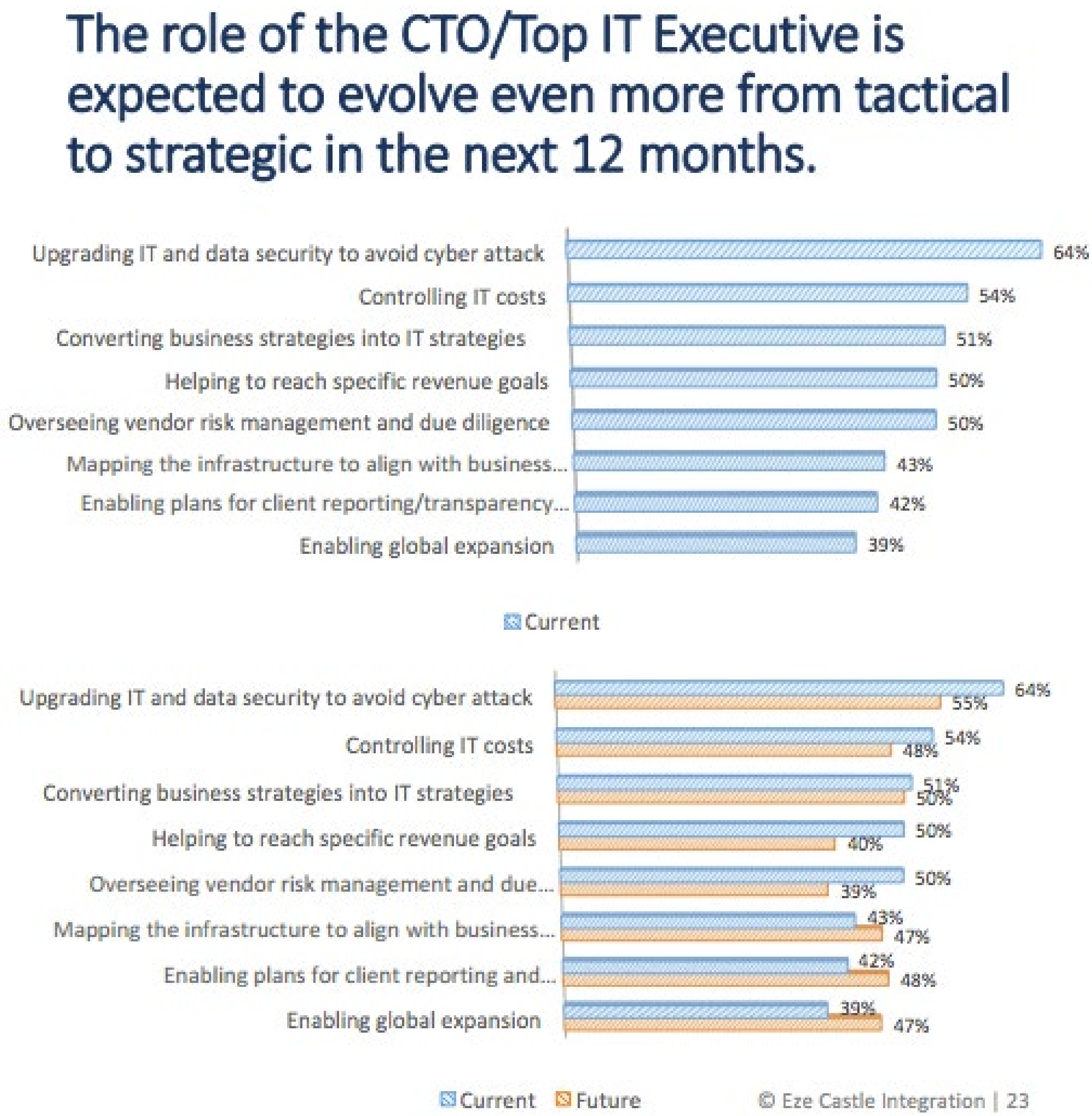
Firms are willing to outsource most services/functions, most often: cybersecurity services, cloud and backup.



In addition to outsourcing, private equity firms are also looking for ways to implement cloud services. Cloud technology can allow firms to scale up in size rapidly, while maintaining security. Working with a cloud services provider also eliminates the need for sprawling and complex networks of hardware.

According to Coriaty, most private equity firms are working in a private cloud environment, but some have started to consider a partially public cloud -- also known as a hybrid cloud - when they work with counterparties to ensure consistent security throughout processes. Over the long-term Coriaty expects that firms will continue to explore ways that they can outsource basic business operations in order to cut costs and free up investment staff to focus on deal making.

Even as CTOs split some of their duties with third party technology providers, the role of the CTO is likely to become more important and demanding over time. Data in the report shows that the CTO is taking on a more strategic position within private equity firms and will be asked to contribute more heavily across in the organization. See the figure below for how the role of the CTO is expected to evolve over the next year. More information on these trends is available in the full report [here.](here)



Indigo Partners Low-Cost Airline Investments Take Off

by Bailey McCann
Private Equity Strategies

Earlier this month, Indigo Partners, the private investment firm of Bill Franke announced that it was launching a new low cost airline in Chile. The airline will be the first low cost provider in the region, but the model is nothing new for Franke who has made a name for himself with critical growth investments in other low cost providers including Spirit and Frontier Airlines.

He is currently the Chairman of Frontier Airlines and Wizz Airlines another low cost provider in Eastern Europe. Prior to starting Indigo Partners he was the CEO of America West Airlines.

JetSMART, the new Chilean airline will launch with three aircraft to take passengers throughout Chile. The airline will operate brand-new Airbus A320 aircraft and expects to grow the fleet to nine by the end of 2018.

"We are excited to do business in Chile and believe there is an overlooked customer segment wanting to fly, but for the right price," Franke tells Private Equity Strategies. "There are many other reasons why Chile is an attractive entry point for the launch of a low fare carrier, including its economic stability and aviation traffic growth; Chile's growing economy; supportive and fair regulatory environment; and open skies and strong bilateral treaties with neighboring countries, among others."

Franke says that after the announcement went public he was approached by other regional entities looking to either expand JetSMART or set up a similar low cost model in their countries.

Unlike traditional airlines, the ultra low cost model offered by JetSMART and others, gives fliers a seat on the plane and little else unless they pay incrementally for specific services like checked baggage, legroom, beverages and other amenities. The model is popular with a growing number of travelers who don't mind a bare bones trip from point A to point B.

According to Franke, outreach to millennials has been positive in terms of grabbing market share for low cost carriers, because they don't come with the fond memories of airline glamour that defined flying in the industry's early days. "In Europe, low-cost airlines account for 40% of all air travel. In the United States, they represent about 7% and the market share has grown for these companies by 10.3% in the last three years. By 2034, low-fare operators are expected to account for 21% of the world market," he says. When it comes to getting an airline like JetSMART off the ground, Franke says finding millennials online is easiest. Outreach to older generations happens with a mix of print ads and television. Once fliers get comfortable with the itemized approach low cost carriers use in pricing, they are usually hooked he contends.

"This business model ensures that consumers will not pay for products and services they do not want or need. And even if you select additional services and products, we want customers to pay less than the average fare currently available on the market", explains Mr. Franke. In this way, people have the option to build their experience according to their needs and the services they want.

Quick Hits

Bought: Dospuntos, backed by Varde Partners, acquired Via Celere, a Spanish development and construction company, for €90 million.

Fund News: Kohlberg & Company has acquired Pexco, an Alpharetta, Ga.-based specialty plastics manufacturer, from Odyssey Investment Partners. Terms of the deal were not disclosed.

Bought: Generation Growth Capital acquired BestMark, a Minneapolis provider of customer experience measurement services and analytics. Financial terms weren't disclosed.

People: Edward Beckley has joined TPG Capital to focus on global infrastructure opportunities. He previously led the European infrastructure fund management unit of Macquarie.

Fund News: Vanedge Capital Partners, a Vancouver-based venture capital firm, has closed its second fund with C$161 million in capital commitments.

Fund News: Arle Capital Partners, a London-based private equity firm, is shutting down, according to Financial News.

Fund News: Silver Lake is reportedly moving its New York offices to the new Hudson Yards development where it will join other PE firms including KKR.

Fund News: WSJ reported that Terra Firma Capital Partners has hired Barclays and KeyBanc to find a buyer for EverPower Wind Holdings, a wind energy company it wishes to exit.

Fund News: Aliter Capital, a new British buyout firm focused on the business services sector, has closed its debut fund with £90 million in capital commitments.

Fund News: LLR Equity Partners is raising its fifth private equity fund, according to regulatory filings. The Philadelphia-based firm closed its last fund on $950M in 2012.

Events

Best Practices for Launching & Managing an SBIC

March 23, 2017 | New York
Hosted By: Capital Roundtable

Best Practices for Overseeing PE Portfolio Companies

May 11, 2017 | New York

Best Practices for Investing in Troubled Middle-Market Companies

May 18, 2017 | New York, NY
Hosted By: Capital Roundtable

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