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PRIVATE EQUITY & VENTURE CAPITAL

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Q HOW WOULD YOU CHARACTERISE PRIVATE EQUITY DEALMAKING IN THE US OVER THE LAST 12-18 MONTHS? WHAT KINDS OF TRANSACTION VALUES ARE APPARENT AND IS THERE STRONG COMPETITION FOR DEALS?

FUMAI: Private equity (PE) activity remains strong in the US. While industry research indicates a slowdown in the number of deals closing, parties are busy striving to put limited partner (LP) money to work. Competition for deals in the marketplace is robust, with PE dry powder and excess cash on corporate balance sheets both at record high levels. This competition, along with higher values, has only intensified the search for the perfect deal. One result is that higher quality deals are closing, which could favourably impact future returns.

Q TO WHAT EXTENT ARE BANKS EAGER TO PROVIDE FINANCING FOR LEVERAGED BUYOUTS? ARE 'NON-TRADITIONAL' LENDERS ALSO VISIBLE IN THE MARKET?

FUMAI: Banks will continue to show up for quality deals. That said, we have seen a decline in the amount of debt in leveraged buyout (LBO) transactions in recent years and that trend has continued this year. PE firms have been working harder to secure financing because of higher market values and increased regulatory scrutiny at banks. This trend has opened up the market for non-traditional lenders, particularly outside of the US. But even domestically, hedge funds and business development companies are stepping in to provide more debt financing. They are also doing this across tranches, taking on more risk and processing the loans faster than a traditional bank – all of which provides significant benefit to PE firms. In the process, non-bank lenders are becoming more viable and accepted participants in the institutional lending market.

Q COULD YOU OUTLINE THE MOST SIGNIFICANT LEGAL AND REGULATORY DEVELOPMENTS FACING THE PRIVATE EQUITY INDUSTRY? IN YOUR OPINION, HOW WILL THEY SHAPE THE ASSET CLASS IN THE LONG TERM?

FUMAI: We are continuing to see an ongoing trend toward increased regulatory oversight of private fund advisers. As industry participants learn the results of recent regulatory inspections, certain topics continue to be spotlighted. These include a growing focus on conflicts of interest, fee and expense allocation, and enhanced disclosure to investors. All of these topics are interrelated in that LPs want more information to understand how certain decisions are being made. For example, LPs want to know which fund an investment will be assigned to, how dead deal expenses are being allocated and what fees are being borne by the manager. Firms are describing these activities more often during fundraising, building out processes to periodically self-monitor and test compliance, and disclosing more information over the life of a fund.

Q HOW ARE PRIVATE EQUITY FIRMS ACTIVELY REDUCING RISK AND IMPROVING RETURNS ACROSS THEIR PORTFOLIO?

FUMAI: A big part of investment success at a PE firm relies upon upfront due diligence and continued monitoring of portfolio company investments. On the diligence side, emerging trends include performing more operational diligence by looking at key functional areas of a target company, and using data and analytics to understand and improve performance. While focusing on the operations of an individual portfolio investment remains critical, we are also seeing PE firms taking an overall portfolio approach: looking for leading practices or functional areas at their highest-performing portfolio companies and sharing those experiences across the entire portfolio. These activities help lower the overall operational risk in the aggregate, while supporting value creation and can get the company to a position where its chances of success are higher.

Q HOW ARE PRIVATE EQUITY EXITS PLAYING OUT IN THE US? IS THERE AN EMPHASIS TOWARD TRADE SALES, IPOS OR SECONDARY BUYOUTS, FOR EXAMPLE?

FUMAI: While the most recent market data shows a decline in PE exits, high levels of existing available investment capital – in the forms of both corporate cash and LP commitments – would indicate that any slowdown is simply a timing difference. It may also be the result of higher valuations and the longer diligence cycles that have emerged. Recently, the biggest contributions to exits have been trade sales and secondary buyouts, likely demonstrating the ability for sellers to take advantage of market participants' desire to find attractive returns for their investors.

Q COULD YOU PROVIDE AN INSIGHT INTO THE MAJOR ISSUES SHAPING THE RELATIONSHIP BETWEEN GENERAL PARTNERS (GPS) AND LIMITED PARTNERS (LPS)?

FUMAI: The topic of transparency between GPs and LPs has been around for a number of years, and the trend line has improved dramatically over time. GPs have worked closely with LPs to develop a cadence in reporting that is both useful to LPs and not disruptive to GP operations. Organisations like the Institutional Limited Partners Association have worked to create standardised reporting templates that meet the needs of all parties. GPs are hoping this will reduce the number of one-off data requests. Currently, a lot of the dialogue is focused on the types of fees that are being charged back to LPs. While LPs understand that costs are necessary to run a PE business, to deploy capital and to remain competitive, firms will now need to answer questions such as 'where exactly is the line between running a business, versus adding value to the portfolio?' and 'what amounts should be borne by investors?' Ongoing collaboration will continue to shape the relationship over time.

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Q LOOKING AHEAD, WHAT ARE YOUR PREDICTIONS FOR PRIVATE EQUITY FUNDRAISING IN THE COMING MONTHS?

FUMAI: We recently examined historical PE market trends and forecasted growth in assets under management for the next five years. We note that PE returns have outperformed relevant US indices for the last 25 plus years on an annualised basis – an accomplishment that supports the industry's growing popularity. We have also seen firms expanding into complementary asset classes. For these reasons, we are projecting PE fundraising to remain strong in future years and show growth through 2020, although at a slower rate than over the previous 10 years.

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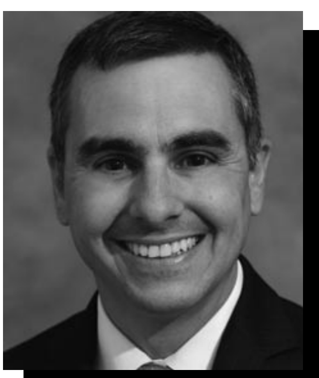

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Frank Fumai is the national audit leader for Deloitte's private equity practice. For over 20 years, he has served a diverse range of clients, including private equity firms, publicly-traded companies, registered investment advisers, registered broker dealer entities, and other investment funds. He has an extensive understanding of the financial services industry, SEC registrants and the rules impacting the investment management industry. He is a contributor to Deloitte's Investment Management Industry Outlook and Private Equity Fair Valuation Survey.

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