

MISSION: IMPOSSIBLE

With the threat of LP defaults looming on the horizon, Rikke Lilla Eckhoff talks to Charles Lemon at Matrix Private Funds Group and Dr Jim Strang of Dunedin Capital Partners about how fundraisers can handle the market slump and the strategies they can employ to ensure their long term success

The current hiatus in the market is allowing LPs to rethink their positions and, according to Charles Lemon, partner at placement agent Matrix Private Funds Group, some LPs will be forced to reduce their commitments or pull out of the market altogether, while others have already contacted their fund managers to notify them of their liquidity constraints. “We will certainly see more LPs defaulting on commitments as deal activity picks up, probably during Q4,” he predicts.

The private equity world has been shell-shocked, leaving both GPs and LPs cautious regarding future investments. Uncertainty in the market makes forecasts of future earnings near impossible. As a result, not only do company valuations become ever more challenging, but also LPs’ decisions on ticket sizes and allocations, with some LPs opting to hold back investments altogether. While many US LPs have turned the tap off for all new fund commitments, European fund investors are struggling with over-commitment strategies and denominator effects; the fundraising environment going forward is expected to be tough by any standards.

Yet, some funds will have to go to market. As shown in the table opposite, sourced from the *unquote*” *European Fundraising Review 2009*, several Nordic funds are due to fundraise in the coming years. Jim Strang, director of fund investments at Dunedin Capital Partners, advises any GP considering going to launch a new fund now to ask themselves if they really need

to go to market straight away and to explore all other options. Among potential alternatives GPs could take, he lists extended investment periods, top-up funds for new investments and annex funds with extra capital to support struggling portfolio companies.

Lemon notes that for any fund manager hoping to secure LP commitments for new vehicles this year, how they handled their communications could prove to be the breaking point: “A lot will depend on how funds have handled their PR and investor relations over the past year: how many times they have visited their LPs, how thorough their reporting has been, and how well they have maintained a dialogue with LPs that didn’t invest in their previous fund,” he says.

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The sweet spot

Both Lemon and Strang remain moderately optimistic about the Nordic region. The majority of Nordic funds are in the mid-market bracket, which by many is believed to still be attractive to LPs. Nonetheless, Lemon concedes: “Despite a theoretical desire to target smaller and medium-sized funds, many LPs will find it very difficult to justify writing significantly

smaller tickets to their investment committees.” Furthermore, smaller tickets to a larger number of funds would also require more administration, which some LPs might not be prepared to take on. On the other hand, with the ground-shaking changes in the financial world, it is only natural that LPs’ portfolios also evolve according to the macroeconomic environment. Italian IDeA Capital Funds recently changed its strategy for its second fund-of-funds. Targeting €300m, substantially smaller than previous vehicles, with fundraises every 18-24 months, the new fund marks a shift in strategy from IDeAs’ larger funds raised every three to four years. Furthermore, the fund will increase its allocations for emerging markets to up to one third of the fund.

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Charles Lemon, Matrix**

Lemon hopes for more gutsy LPs with a more open-minded approach to first-time funds: “I think they need to fundamentally re-visit their ‘five-fund track record’ approach to investing. In fact, some of the best overall fund returns in recent years have come from smaller funds, most of which were not backed by the brand name institutional investors. But of course, it is a risk and return game; there were lots of failures too.”

On the bright side, the Nordic market is holding up relatively well, as noted by Strang. “The market has matured, and Nordic fund managers have accumulated deal experience

to survive this. Additionally, with the Scandinavian model of relationship banking, deals could still be completed,” he comments. Lemon concurs: “The Nordic region is still attractive, and not over populated with players.” Furthermore, the domestic funds have backing from strong institutional players, such as Danske Bank, and government backed investors such as Argentum, the Swedish Pension

Funds and Finnish Industry Investment. As an example, Verdane Capital Fund recently held a first close of SEK 650m for its seventh secondary direct fund. Its cornerstone investor was government-backed Argentum, which was joined by, among others, another government-backed LP Finnish Industry Investment. All backers were existing investors, apart from Gjensidige and Varner Gruppen, both part of Argentum’s Nordic Private Equity Programme (NPEP).

Also in the market is Danish small- to mid-market buyout fund Polaris Private Equity. The fund launched in October 2008 and held a first close of its third fund on €275m in April this year. A final close on the target of €350m is expected this summer, making the fundraising process nearly 12 months long.

For other funds going to market, Lemon has the following advice to GPs: “Do your job, stick to your strategy, manage your portfolio and talk to your LPs.” As simple as it gets. ■

| Nordic funds going to market | | | | | | | |
|------------------------------|---------------------------|---------|-------------|-----------|--------|-------------|---------|
| Investor group | Last fund | Country | Stage focus | €m raised | Closed | % committed | Due out |
| Axcel | Axcel III | Denmark | Buyout | 402 | Apr-06 | 75+ | H1 2010 |
| IK Investment Partners | IndustriKapital 2007 | Sweden | Buyout | 1675 | Jul-06 | 20 | H1 2012 |
| Litorina Kapital | Litorina Kapital III | Sweden | Buyout | 147 | Dec-07 | 70 | H1 2010 |
| Polaris Private Equity | Polaris Private Equity II | Denmark | Buyout | 270 | Apr-06 | 46 | H2 2011 |
| Reiten & Co | Reiten VII | Norway | Buyout | 256 | Oct-07 | 15 | H1 2012 |
| Segulah | Segulah IV | Sweden | Buyout | 543 | Oct-07 | 22 | H1 2012 |

Source: unquote” European Fundraising Review 2009 / Private Equity Insight