

The PE Investor Relations Conference - 9 December 2010, London

- First Protocol Conference Report

INTRODUCTION

First Protocol was pleased to sponsor the PE Investor Relations Conference in London on December 9th 2010. [Link to event website.](#)

The forum brought together an impressive range of senior private equity professionals from a range of functions and areas of specialism to discuss common issues, challenges and opportunities facing the industry. Of First Protocol's many clients in this space, those in attendance included senior representatives from Advent International, Pantheon, Collier Capital and HarbourVest Partners.

The content of the day was primarily focused on issues relating to investor relations activities such as fundraising, changing LP information requirements and the role of the AGM as a part of an annual communication toolkit. The event also featured panel discussions which covered more structural issues relating to the current fundraising environment and the contractual relationship between LPs and GP's.

Purpose of this paper

This document is not meant to be a comprehensive report on all of the detailed presentations delivered at the event, but is designed to give the reader a flavour of the subjects covered and some headline insights raised during the plenary session and the subsequent Q&A.

GENERAL OBSERVATIONS

It was universally accepted that over the last 5 – 10 years the IR function within private equity has grown in scale, legitimacy and is in general becoming a far more professional function. Beyond consistency of past performance and having a compelling investment strategy, an informed, proactive and trusted IR function is one of the few differentiators available for funds looking to raise capital in an increasingly competitive marketplace.

What does an effective IR professional need to do to deliver value and meet LP requirements? The core message from the day was that IR functions need to primarily stay abreast of fund, portfolio and team news and communicate tailored information to them "*frequently, with due completeness and with bad news, very quickly*". All news (good or bad) must come first from the fund and not the wider industry grapevine or even worse the media; or as one LP put it, this "*sets off huge alarm bells*".

LPs expect the IR function to be fully represented at partner meetings and to crucially stay close to and "*educate*" GPs on the changing LP requirements. It was also raised that the seniority and quality of the IR team speaks volumes to potential LPs who wish to see IR functions as being the source of trusted information and not merely a conduit from (or gatekeeper to) the deal teams.

LPs value the important role IR professionals play in the provision of information, but LPs do want to maintain visibility (and access to) fund partners and the investment team. This is not purely a seniority issue; as effective reporting requires a balance between quantitative and qualitative data, and it is the deal teams who are far better placed to offer the latter. LPs do not wish to tie up investment personnel with reporting duties (and in doing so keep them away from their core deal portfolio/deal duties), but

Precision in the Art of Communication

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they need to be assured that access to fund principals is there should they desire. It was suggested that the mark of a good IR team is when this degree of access is offered, but rarely utilized.

The information being requested by LPs is increasingly detailed in nature and being requested in formats particular to each LP. These two factors are combining to substantially increase the administrative aspect to IR professionals' workloads. It was suggested that harmonizing reporting protocols and formats across LP's would be an ideal outcome, but there was widespread skepticism as to if this was feasible.

(FP Comment: The Institutional Limited Partners Association (ILPA¹) has since the event issued version 2 of their Standardized Reporting Industry Templates on 11th January 2011² following comments from GPs and LPs on Version 1, so perhaps this initiative might gain further traction and uptake going forwards.

It was suggested by a few participants that secure websites are currently being underused by many funds. These sites offer LPs the opportunity to have access to a significant level of fund and portfolio detail from which they can then determine the level of information they wish to download or request more information on from the IR team. Again this comes back to the prevailing theme that effective IR functions need to be being more proactive in the provision of performance data to their LP base.

It was also suggested that too few funds invite LPs to provide detailed feedback on how the fund's IR function could be improved. Feedback on reporting formats, processes and quality is rarely invited, but if handled in the right manner could yield significant benefits for the funds in question.

FUNDRAISING

The general view held at the conference was that in a market where there is a real shortage of capital, those organisations that have and continue to neglect their Investor Relations function will suffer, not only in terms of raising sufficient capital to invest, but also to meet their fiduciary obligations. One IR event speaker stated that *"GP performance is not enough anymore"* and that having an effective and senior IR function is pivotal for a fund wishing to raise new funds in the current investment environment. This observation was universally endorsed by the full range of industry stakeholders presents at the event; (LPs, GPs, IR personnel, consultants and intermediaries.)

The core IR function is to communicate information and nurture investor relationships; but this is inextricably linked to fundraising which has become increasingly difficult over the past three years. The reasons for this tough fundraising marketplace were agreed to be an unhelpful combination of both low capital supply and demand remaining comparably high. The lack of sufficient capital was primarily attributed to generic investor caution, a deliberate strategy of LPs reducing the number GP relationships they maintain, (Prequin suggests a 20-40% drop in GP relationships) and "active" capital being held in unrealized portfolios due to the continuing poor exit environment. At the same time demand for capital is starting to increase, with Prequin's 3rd Quarter report of 2010 stating that for the first time since Q1 of 2009 there is an increase in the number of funds raising capital; *"there are currently 1,547 funds on the road seeking an aggregate of \$571bn"*. This combination of factors would suggest that the IR function within PE funds has a crucial and expanding role to play in an increasingly competitive environment.

The importance of this sales role was unambiguously presented by one morning panelist; *"the number one priority for PE firms is raising the next fund; all decisions need to be taken with this objective in mind and increasingly the Investor Relations department is being called upon to (if not lead) then at least proactively coordinate this ongoing activity"*. It was suggested that fundraising needs to be seen as perpetual and not a periodic activity and that the marketing or investor relation function must be

¹ <http://ilpa.org/>

² <http://ilpa.org/principles-version-2-0/>

considered an investment and not a cost. Relationships need to be developed and cultivated on an ongoing basis, not simply worked on when fundraising has formally begun.

Compounding this increasingly sales focused role for IR professionals is the current need for GPs to be far more operationally involved with portfolio companies than in years past to deliver the same returns, thereby removing them far more from the sales cycle.

An interesting observation raised was the need for all fund personnel to be as coordinated, trained and disciplined in conveying the fund's fundraising strategy as they are around its investment strategy; "*one firm, one message*". It was suggested that too often opportunities are lost and the fundraising process is hindered when the message is muddled across an increasingly integrated LP base.

An additional need for coordination is around which potential investors are being approached by whom within the fund and when. It was the view of many event participants that too often fundraising is still being conducted in an unsystematic manner which leads to both confusion for targeted LPs and other fruitful avenues being missed.

INVESTMENT CRITERIA

A handful of consistent themes emerged during the day on what factors LPs focus on when making investment decisions and the role IR professionals can play in this process.

- A key factor in the sales process is differentiating the investment strategy and communicating the character of the fund and its GPs. One speaker observed that average is "*very average*" and it is "*angles*" that "*secure deals and add value*". The challenge comes in consistently and credibly communicating the angle to LPs.
- An attractive angle consistently raised related to funds which are "*at ease with complexity*" and can identify and convert value from otherwise opaque or challenging investment opportunities. This speaks to GPs (and/or a fund's roster of operating partners) capable of taking a leading role in identifying complex and proprietary deals with seemingly unclear value generating prospects and then executing against the investment strategy. This approach necessarily increases fund overheads and transaction costs, but if communicated well and supported by past performance data, this attribute remains a compelling proposition.
- Proof of concept deals are often key to creating a "snowball effect" within the fundraising process. Additionally, convincing an opinion leader to invest early is of great benefit for the same reasons. Whilst LPs are doing more independent due diligence and research, there remains a sense of security in making investments other LPs have deemed viable.
- Leveraging past performance remains key, because it often *is* an indication of future potential. Consistency of results remains a central criteria for LPs and this is a key factor LPs are considering in the current drive to reduce the number of GP relationships they are maintaining.

FUND TERMS

The willingness of funds to agree terms which reflect how the balance of influence between LPs and GPs has shifted over the past 3-4 years is also a key factor influencing where LPs place capital. The fact that many previously theoretical contractual terms are now in play and being enacted by LPs has heightened attention on terms for new funds. A selection of issues raised at the event were:

- Reducing the barriers for LPs to enact "no fault divorce clauses". This was a position firmly presented by an LP panelist who saw this as an issue which required GPs to demonstrate "*confidence in their abilities*".

- Readjusting the transaction / carry structure (especially with larger funds) and the ability of LPs to influence carry structures. The suggestion isn't necessarily that all fees should be lowered, but that LPs are demanding greater transparency on fund costs and specifically how remuneration is being distributed between key personnel.
- Strengthening the "key man" provision within fund terms to protect LP investment assumptions. It was however noted that reducing the "no fault divorce" voting requirements would in effect take care of this concern.

THE AGM

The most significant investor relations activity that a private equity firm produces is the annual meeting. Private equity IR executives spend months preparing for the event, which has become more challenging to pull off successfully amid a transformed market. This is an opportunity for investors to get a comprehensive snap shot of fund performance, to see firsthand how the investment teams operate as a unit, to have direct access to fund principals/deal teams/CEOs and to network with fellow LPs. These meetings also very much reflect the character of the firm; is it dominated by a few leaders or is it a real team, and is the culture formal or informal? There are very few places for bad or uncomfortable news to hide at AGMs, which continues to make them a highly effective tool in the ongoing LP/GP relationship despite the effort and expense required to host them.

A number of elements relating to AGMs were discussed; however our observations center around four key aspects.

Content

The AGM has increasingly become the primary source of information for investors and this is driving greater transparency around performance and strategy. LPs consistently demand increasingly more detail on portfolio companies and fund investment strategies. The event itself is a key differentiator for private equity firms, both in terms of how they present this information but also the brand experience that they deliver.

It was suggested that for larger firms with a greater number of funds to report on, that additional more localized events should take place to enable firms to both communicate the appropriate level of information, but also dedicate sufficient time to relationship building in more informal environments. Some firms are already going beyond the typical one annual AGM and having more regular regional or sector specific sub meetings to compliment the annual event.

Networking

As the AGM grows, ensuring networking opportunities are used effectively has become an increasing challenge. Suggestions for enhancing networking opportunities included simply extending coffee breaks, ensuring junior team members are sufficiently prepared and active on the day, and the introduction of breakfast groups to facilitate more intimate dialogue before the plenary begins. It was suggested that engaging with LPs prior to AGMs to establish bespoke networking diaries for each attendee might also be appropriate for larger funds.

Interaction

Once AGM audiences become greater than fifty, the level of interaction and ability to hold a dialogue with the audience in the plenary session is greatly diminished. Suggestions for maintaining interaction between speakers, panelists and the floor included the use of voting technology and gathering LP questions prior to the event as part of the registration process.

Networking areas can also be divided by industry sector and/or geography during breaks to facilitate interaction between groups with similar areas of interest.

Good to Great

Expectations around the AGM have also increased as competitor meetings become more professionalized. Organisation of the annual meeting is no longer something that can be left to the Managing Partner's PA, nor can senior partners abdicate responsibility for its success to more junior staff.

The AGM is the single most important event for the private equity firm and requires huge resources in terms of time, money and expertise. A significant amount of planning goes in to delivering a successful AGM, with content being developed as far as six months out. Soliciting input from LPs and firm stakeholders in advance and post each AGM is vital to maintaining the relevancy of content, structure and outcomes.

CONCLUSION

We hope that you have found these observations useful. Should you be interested in finding out more about First Protocol, the services we offer and the work we deliver in support of our clients' investor communication activities please contact First Protocol Director Ed Stanger on the details below.

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