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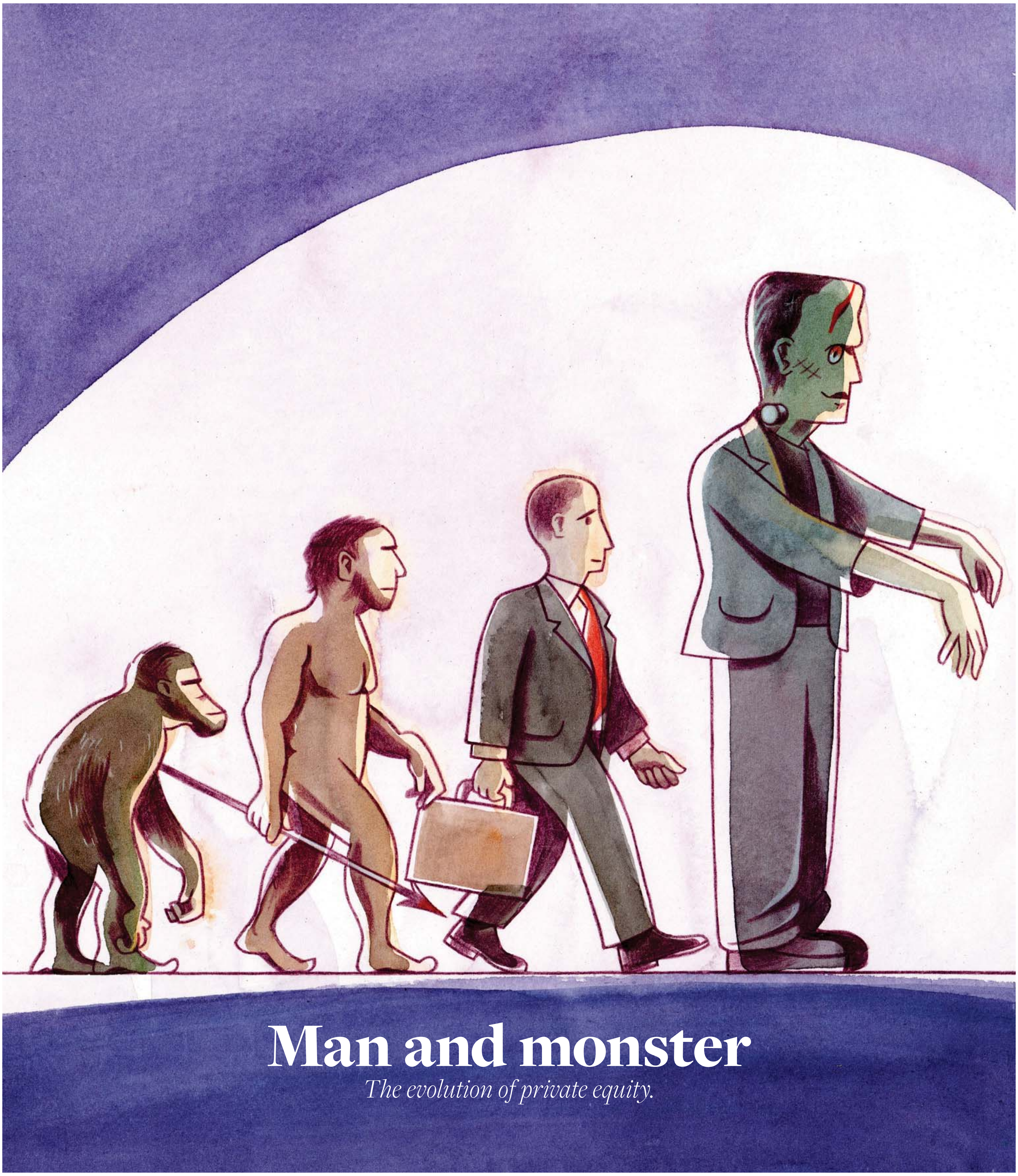

Man and monster

The evolution of private equity.

PENSIONS

SLIDING FORTUNES

In February this year CalPERS cut its private equity allocation target by two per cent. It might reduce further.

By *Nicholas Neveling*

The private equity industry has always been able to take succour from the fact that limited partner allocations to the asset class have had plenty of room to grow.

Even when fundraising figures were at their lowest, the fact that most LPs allocated only a fraction of their total assets under management to the asset class suggested that the long-term drivers were in private equity's favour.

A decision by the California Public Employees' Retirement System (CalPERs) in February this year to reduce its target allocation to private equity from 14 per cent to 12 per cent, however, shows that the industry shouldn't assume that LP allocations to private equity will only ever go one way. Indeed, an agenda item for CalPERs investment committee meeting on 19 May shows that the pension fund is debating whether it should reduce its private equity allocation further to ten per cent.

No decision has been made, but the idea is very much on the table.

CalPERs is not the only LP wrestling with whether it should pare back its private equity programme. Buyout firms have returned so much cash to investors during the last two years that LPs have found it difficult to find enough managers of sufficient quality to reinvest with.

"Private equity investors received a record amount of net cash last year from distributions. Simply turning around and reinvesting that huge amount of cash is not easy," says Antoine Drean, the founder of private equity marketplace Palico and chairman of Triago.

"Current allocation targets for most private equity investors were set using lower distribution expectations than the actual amount LPs have been receiving over the last couple of years. They were also set with the expectation that equity market appreciation would be in line with historic averages. Instead, a record amount of cash is pouring into investor coffers from private equity and global stock markets have soared."

There is also a growing concern that too much froth is building in the industry. Undrawn committed capital is at a near-record high and according to CalPERs the typical private equity purchase price multiple is sitting at 9.5 times corporate cash flow versus a long-term average of 8.1 times.

There is a lot of money chasing a limited pool of deals and investors are worried that this could push up prices and reduce returns.

The private equity industry has done an excellent job for its investors recently, returning significant amounts of capital. But that does not mean that they will redeploy all that cash into the asset class.

If LPs don't see managers of sufficient quality, they are prepared to reduce overall private equity allocations.

"GPs who have difficulty standing out from the crowd, or who have mediocre performance will continue to have difficulty raising funds, while exceptional funds will raise easily," Drean says.

"What you've got here is a trumpet blast for all to hear signalling that the record wave of net cash going back into [LPs'] pockets won't change the long-term reality of a bifurcated fundraising market."

LP allocations to private equity have traditionally been a small part of their overall investment programmes.

Despite the assets class's recent run, that could be difficult to change. ●

FOOD & DRINK

The Elior the better

French catering company Elior is the latest private equity-backed business to prepare for an IPO. Other portfolio companies that hope to follow in its footsteps should move fast.

By *Nicholas Neveling*

The IPO bandwagon just keeps on rolling and the private equity industry has been loving the ride.

Last year, according to data compiled by EY, 36 private equity-backed portfolio companies listed in Europe raising $16.8bn (€12.1bn) between them.

The momentum has carried into 2014, with eight buyout-backed businesses raising a total of $2.9bn.

Charterhouse portfolio company Elior, Europe's third biggest contract caterer, is the latest buyout business to jump aboard. The company plans to raise €700m from a June flotation on Paris's Euronext bourses in a listing that could value the business at more than €4bn.

In an indication of how lucrative IPO market exits have become for private equity firms, Charterhouse will bring Elior to stock market after a bid from BC Partners and CVC of around €3bn failed to meet Charterhouse's pricing expectations, even though the offer would have valued Elior at more than eight times Ebitda.

Indeed on many deals stock market investors have consistently been able to not only match the offers of trade buyers and private equity players but exceed them. Once disliked because it didn't offer a clean sale of a business, the IPO has become the exit route of choice.

Happily for private equity firms in exit mode, all indications suggest the IPO window could remain open for some time yet.

Investor appetite for new assets has remained strong and after fleeing risky plays for safe bets in the crisis, investors are searching for growth once again.

According to Cannacord Genuity, in 2009 pension funds had 72 per cent of their assets in equities; now the figure is only 38 per cent. Insurance companies had 65 per cent of their assets in equities and now they only have five per cent.

There is still a large amount of capital that fund managers have to move out of safer investments back into equities to match pre-crisis levels. Private equity firms that want to exit via IPO, however, are probably best advised to get a move on while the going is still good. Although the outlook is positive, there are signs the IPO boom could start running out of puff. The $2.9bn raised in the first quarter of this year may be an impressive number, but it's a long way short of the $9.1bn raised in the fourth quarter of last year.

It is also worth noting that half of the private equity-backed businesses that have listed this year have suffered a drop off from the offer price to the first day of trading. Last year only a handful of buyout-backed IPOs didn't trade up in the aftermarket.

The IPO window is still very much open, but firms eyeing exits should take advantage before it shuts. The more people who climb on a bandwagon, the more the value of being aboard diminishes. ●

> **"Half of the private equity-backed businesses that have listed this year have suffered a drop from the offer price to the first day of trading"**