



**stevensonjames**  
search & advisory



# 2019

*The Stevenson James*  
**ANNUAL INVESTOR  
RELATIONS AND  
FUNDRAISING SURVEY**



***Giraffe (Characteristics) -**  
Communication, intuition,  
attaining the unreachable*

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## STEVENSON JAMES ABOUT US

Stevenson James is an Executive Search firm dedicated to the Private Capital sector. It was established in 2004 by Richard Collins and Tom Quinnen who have over 40 years combined experience of Executive Search.

The firm focusses on providing retained executive search services to the Private Capital market, working with leading GPs, LPs and Placement Agents to fulfill many of their internal staffing needs. Our expertise covers the Investor Reactions (IR), Fundraising, Investment, Finance, Operations, Environmental Social Governance (ESG), Digital and Marketing functions.

Stevenson James boasts an impressive history of repeat business from clients, which include some of the most notable and successful firms in the industry.

In 2016, in response to significant growth in the Private Debt market, the firm appointed industry specialist Tim McKean to lead mandates for Investment, IR and Fundraising professionals within Private Debt. With over 17 years of experience, initially as an Investment Manager before moving into an Investor Relations role, Tim was previously an equity partner and a member of the senior executive team at 3i Debt Management (formerly Mizuho Investment Management).

The team is supported by Craig Parris - Director, Head of Research, Phoebe Hatley - Business Manager and Kate Goodall - Consultant, Investor Relations Survey. Each have either worked in the Private Capital sector or the Executive Search industry.

The business is overseen by its Non-Executive Chairman John Webster. John began his career in financial services more than 30 years ago with James Capel, where he worked in senior management positions in both London and New York. He spent 13 years consulting to Investment Managers and Investment Banks with Greenwich Associates, the global strategy consulting firm based in Greenwich CT, USA, before returning to the UK in 2006 as Chief Executive Officer of Altima Partners LLP, an Alternative Asset Manager.

Since retiring from full time work, John has assumed a number of Non-Executive roles. In addition to Stevenson James, he is also Chairman of DWS Investments UK Limited (formerly Deutsche Asset Management UK Limited) as well as Chairman of Altima Partners LLP.

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## STEVENSON JAMES INVESTOR RELATIONS & FUNDRAISING

Since its inception in 2004, Stevenson James has successfully executed numerous IR and Fundraising mandates across the globe for some of the most notable and successful firms within the Private Capital industry and, as a result, has built an unrivalled reputation for its comprehensive understanding of the IR and Fundraising sector.

### OUR TEAM



**Tom Quinnen**

*Managing Director*



**Richard Collins**

*Managing Director*



**Tim McKean**

*Director*



**Phoebe Hatley**

*Business Manager*



**John Webster**

*Non-Executive  
Chairman*



**Craig Parris**

*Director,  
Head of Research*



**Kate Goodall**

*Consultant, Investor  
Relations Survey*

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## FOREWORD



Tom Quinnen

*Managing Director, Stevenson James*  
*tquinnen@stevensonjames.com*

It always gives me great pleasure to write the foreword to our Annual Investor Relations and Fundraising survey and this year is no different. This is our fifth incarnation and in a year where fundraising levels again exceed both expectation and anticipation, it is important to recognise the fact that without the insight and investment of time from the LPs who contribute, production would not be possible. Their involvement has allowed us to continue to produce reports with real content that people across the Private Capital world find invaluable. So, thank you to everyone who has and continues to support this project.

In particular, we are very grateful for the contributions from: Narinder Bhatowa, Managing Director and Head of Leveraged Portfolio at Mizuho Bank; Allan Nielsen, Managing Director at Ares Management; Andreas Klein, Managing Director at ICG and Neil Rickard, Head of Credit Research and Portfolio Manager with Investcorp Credit Management EU who talked to Tim McKean, Director – Head of Private Debt at Stevenson James, about the development of the Private Debt market, comparing their experiences of the past year and their respective expectations for 2019. The article which appears in Section 2 of the survey gives a wonderful insight into the Private Debt market at a particularly pivotal time for this asset class given the astonishing rate of growth of the last few years and the widely shared belief that we are due for a market correction.

Publishing the survey at the start of the year allows us to enjoy the annual review of the fundraising market that Prequin publish, and it never ceases to produce surprising conclusions. 2018 exceeded the anticipated performance; it was the second largest year for fundraising on record with \$757bn in total capital raised (with this total expected to be revised up by 10%). Given most in the industry have been expecting a contraction for over two years now, what is perhaps more surprising is that LPs expect to allocate more capital in 2019 than they did in 2018. This is not to suggest that this makes fundraising easy, particularly given the continued divide between large and small GPs, but perhaps it is a continued reflection of the transition of the asset class from “Alternative” to a fundamental part of the mainstream.

It is clear from the responses provided by LPs that GPs are doing a huge amount right in their IR approach and essentially, the feedback is highly complementary. Stevenson James has been a first-hand observer and market participant as GPs have been through this lengthy and challenging evolution. It is wonderful to see that the hard work in building high calibre teams is paying

off with recognition from their clients. We recently conducted some analysis, at the suggestion of a client, to understand the scale of the growth of IR teams over the last 10 years. We found the scale of headcount growth to be truly startling.

However, we can also report that while the industry has achieved outstanding progress, very few GPs are sitting back with the feeling that the job is complete. Across the market, GPs are evaluating their IR teams and looking to evolve and strengthen their offering. In some cases this is through increasing specialisation of the role, which could result in implementing a more structured delineation between Relationship Management and Project Management or, hiring more product specialists as their range of fund offering develops.

Unsurprisingly, this means that the competition for talent presents possibly the greatest challenge at this point in the market's development. While there has always been a shortage of proven experience within the fundraising space, fundraising professionals seem to be happier than ever before as their roles have developed in line with the addition of new products, the increased importance GPs are placing on their IR and Fundraising team, and the fact that they are being paid on a par with Investment teams.

The range of tasks that the IR professional is being asked to assume has extended significantly to include managing the GPs Strategy, Product Development, Corporate Governance and Marketing to name a few. This means that the IR role has never been more demanding or rewarding and reflects the quality of the professionals working in these roles today. It is therefore no surprise to see the Head of IR becoming the Chief Operating Officer of a GP and this is a trend that we expect to continue developing with GPs becoming more sophisticated corporate structures as they grow their range of product offerings.

There are a number of challenges that the industry faces over the next few years. Despite the Preqin figures for 2019, it seems to be recognised across the industry that the scale of capital being deployed by LPs must be close to peaking, and therefore the

competition for capital can only become greater. How do GPs react to this challenge? Do they need to further invest in their fundraising resources or is this the time to consolidate?

When looking at the Private Debt market one has to ask if corporate structures are capable of coping with a correction? This market has grown at such an astonishing rate since the crisis, reaching \$667bn in AUM at the end of 2017<sup>(i)</sup>, but fundraising in 2018 is substantially down on 2017<sup>(ii)</sup> indicating a change of appetite from LPs. This has been evidenced by a small number of participants in the survey who confirmed that they expect to see a decrease in their future allocations to the asset class. Barring the largest Private Debt GPs, most are currently very lightly staffed in non investment roles, and yet one of the greatest lessons the Private Equity market learned during the crash was that managing the relationship with LPs is critical at times of stress. No LP wants to hear of a portfolio problem via the market, and how firms handle these problems has a huge impact on the success of a firm going forward.

At the time of writing, the US Government is into its longest ever shutdown due to the standoff over who will pay for President Trump's Wall, and the UK Parliament has just delivered the largest ever defeat in the House of Commons over the Brexit Strategy! Given this geopolitical backdrop, it is remarkable that the industry finds itself in such good health. There are clearly a number of challenges to overcome in the future, including the substantial task of improving diversity within the industry and a greater commitment to ESG and Impact investing, all while delivering on investment commitments to LPs. But it is clear from the outcome of the survey that LPs, who it should not be forgotten are the customers in this relationship, are very supportive of the IR standards being applied in today's market.

Source:

(i) Preqin Private Debt Update August 2018;

(ii) Private Debt Investor Q3 2018 Fundraising report

## INTRODUCTION

When Stevenson James undertook the first survey at the end of 2013, the role of IR had already been through a period of development in the wake of the financial crisis. In response to a more challenging fundraising environment and the evident increase in information requirements from investors, we observed firms taking a more proactive approach to IR, applying resource to the function whilst the role itself became a more complex blend of communication and relationship management alongside technical skills and knowledge. However, not all firms reacted in the same way, and whilst some firms undertook an institutional-style approach to IR, others continued with a more passive approach, managing their investor relationships alongside their investment activities.

In the absence of an industry standard we were keen to understand what value LPs placed on IR, what impact the presence of a dedicated IR function had on the service delivered to LPs, and how the role was rated in importance alongside other functions.

Having surveyed a variety of LPs for the first survey which collectively represented over £80bn in assets and included both public and private pension funds, fund of funds, corporates and family offices from across the UK, Europe and the US, we were not surprised to discover that all of the LPs we talked to rated the IR function as important or very important. However, in contrast to the efforts of many firms, 50% of the LPs we talked to felt the function was only moderately resourced with 19% of LPs commenting that it was inadequately resourced.

Over the past five years we have witnessed the growing importance of the role, not just in terms of the service delivered to LPs but as a means of attracting capital from new investors. Undoubtedly, the most significant feedback has been confirmation that the presence of an IR function can materially add value during the fundraising process. In 2016, 53% of the LPs confirmed that when appraising opportunities with GPs who have a similar strategy and focus and if all things are equal in terms of performance and track record, the presence of a well-regarded IR function would be the deciding

factor between competing GPs. There was little change to this number in 2017 but this year, it increased significantly to 75%.

In this, the fifth edition, we look closely at how much has changed since the survey began, focussing on the continued development of the role and its value to LPs; how the quality of the service delivered has changed and whether sufficient resource is now being applied by GPs within the wider Private Capital market. In addition to our focus on IR and Fundraising, we also took the opportunity to survey the participating LPs on the subject of Brexit, specifically whether their respective investment strategies had changed as a result of the referendum and how the GPs have responded. We also talked to the LPs about Subscription Line Financing which, if a report in the Financial Times is to be believed, is 'Private Equity's dirty finance secret' (July 2017). The findings are far less startling than this and other headlines would suggest.

In particular, Tim McKean has interviewed a number of senior professionals and portfolio managers, including Neil Rickard - Investcorp Credit Management, Allan Nielsen - Ares Management, Narinder Bhatowa - Mizuho Bank and Andreas Klein - Intermediate Capital Group (ICG). The interviews take the opinion of both the sell-side and buy-side credit investment landscape, with a view to understanding how they saw the market develop in 2018, with a particular emphasis on both internal and external market pressures, as well as their expectations for the year ahead.

As with each previous edition of the survey, our core objectives remain, to produce research which will provide a meaningful contribution to the continued discussion around IR and Fundraising throughout the Private Capital market, assist in establishing parameters for a "Best in Class" offering and provide valuable data and information which can be used by GPs to support the development of an IR function that meets the needs of LPs and helps to support sustainable, long term relationships.



## METHODOLOGY

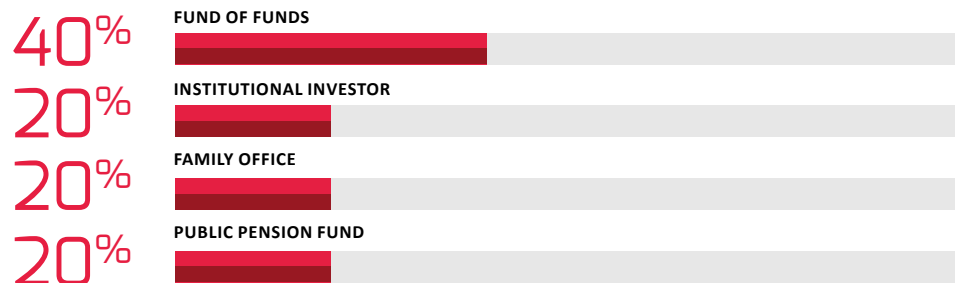
'The Stevenson James Investor Relations and Fundraising Survey' has been designed to gather the feedback and opinions of Investors or LPs on the IR and Fundraising function within the Private Capital market.

As the role has developed, so too has the remit for which IR professionals have responsibility. These developments are reflected both in the number and type of questions asked. As with each previous edition, we use a series of qualitative and quantitative questions in order to generate commentary alongside data driven responses.

In each survey we have included a core set of questions which has enabled us to identify trends and changes in sentiment. Where possible, we do present comparative analysis. However, as the survey has developed over the past five years, questions have been added to reflect our interest in different subjects - in this case, Brexit and the use of Subscription Line Financing. Once again, our focus is on the wider Private Capital market to reflect the continued growth of LP allocations to assets across the Private Capital spectrum.

The research was undertaken during the third quarter of 2018. The survey respondents represent Private Capital investors from across the UK, Europe and the US with more than £480bn\* of Assets Under Management (AUM), a figure that has increased significantly since the first edition of the survey which stood at £80bn.

A breakdown of the respondent type can be found below:



\*Currency conversion XE.com

## EXECUTIVE SUMMARY

### Key highlights from this year's survey:

- **Asset allocation and GP relationships** - LPs participating in this edition of the survey confirm their continued support for Private Capital assets with the highest allocations to Private Equity and Venture Capital (88%).

Private Equity & Venture Capital and Private Debt are expected to attract the highest allocations in the future. Contrary to reports suggesting high levels of asset concentration in funds managed by the largest managers, 86% of respondents confirmed that they have increased the number of GP relationships over the past five years. However, 67% of them expect the number of relationships to stay the same in the future.

- **Brexit** - 60% of the LPs we talked to have not changed their strategies in response to the results of the referendum, primarily because there is still so much uncertainty. However, 40% of the LPs surveyed have changed their strategies and whilst 60% have reduced their exposure to the UK, 40% have increased their exposure to the UK. Whilst there is evident caution amongst investors, feedback from LPs demonstrates continued support for UK focussed managers and the expectations that Brexit will likely present some interesting opportunities going forward.

90% of respondents believe that the GPs are adequately prepared for Brexit with 10% being well prepared. However, one LP commented that with so much uncertainty, it is difficult to measure how well the GPs are prepared and another questioned what the GPs need to be prepared for.

The communication strategies of the GPs in response to Brexit has been good. 90% are satisfied with the level of information being received from GPs and 70% would describe the communications strategies as proactive. Only 10% suggested that their GPs are being inactive.

- **Subscription Line Financing** - this is clearly not the 'PE con artist trick' or 'dirty finance secret' that the media would have us believe. The majority of the LPs surveyed (78%) are aware of it, 22% are not. However, whilst seen by most as a useful practice and one which would have a positive influence on an LPs decision to invest, **100%** of the LPs who participated in our survey confirmed that they **would** undertake more due diligence on those GPs who use Subscription Line Financing than those who do not.



72% of LPs do NOT believe the GPs to be adequately resourced to meet the increase in the IR remit going forward.

Interestingly, when asked about whether the Private Capital market was managing this financing method, 34% said no and one of the LPs commented, "If the economy were to go into a Global Financial Crisis situation again, the banks may well call in these subscription lines at the same time which could cause problems for GPs and LPs" which is one of the concerns raised in the media.

- **The Investor Relations function** - Communication remains central to the role but managing both the co-investment and Fundraising processes are now widely recognised by LPs as key aspects of the IR function. This is a theme we have observed over the past three years which demonstrates a definite shift from the perception that IR is simply an interface or conduit between LP and GP.

- **Requisite skills and qualifications for IR professionals** 88% of LPs deem Investment experience to be essential or preferred. This is consistent with previous years but interestingly, this year, a higher number of LPs now believe professional qualifications to be essential. In previous years there has been a consistent preference for professional qualifications, and whilst there was a high level of no-preference, over a quarter of the LPs surveyed agreed that it is essential to the role of IR.

- **The Investment Committee** - A high number of LPs (63%) believe that IR should have a seat on the Investment Committee (IC) and, for the first time, not one of the LPs surveyed believe that IR should **NOT** be represented on the IC.

- **Compensation** - Base salary, discretionary bonus and carry remains the preferred compensation structure and for the first time in three years, **100%** of the LPs surveyed believe that the IR professional should have carry.

- **Value of IR** - **100%** of LPs regard the IR function as valuable or extremely valuable and **75%** believe that when appraising opportunities with GPs who share a similar focus, track record and performance, a well-regarded IR function could be the deciding factor between competing firms. This was the standout highlight of the survey in 2016 when around half of the LPs surveyed agreed that this was the case.

Another highlight is the feedback that 75% of the LPs concurred that the Investment professionals should **NOT** be responsible for IR and the management of investor queries. There has been a gradual increase in support of this point over the past 3 years from 50% in 2016.

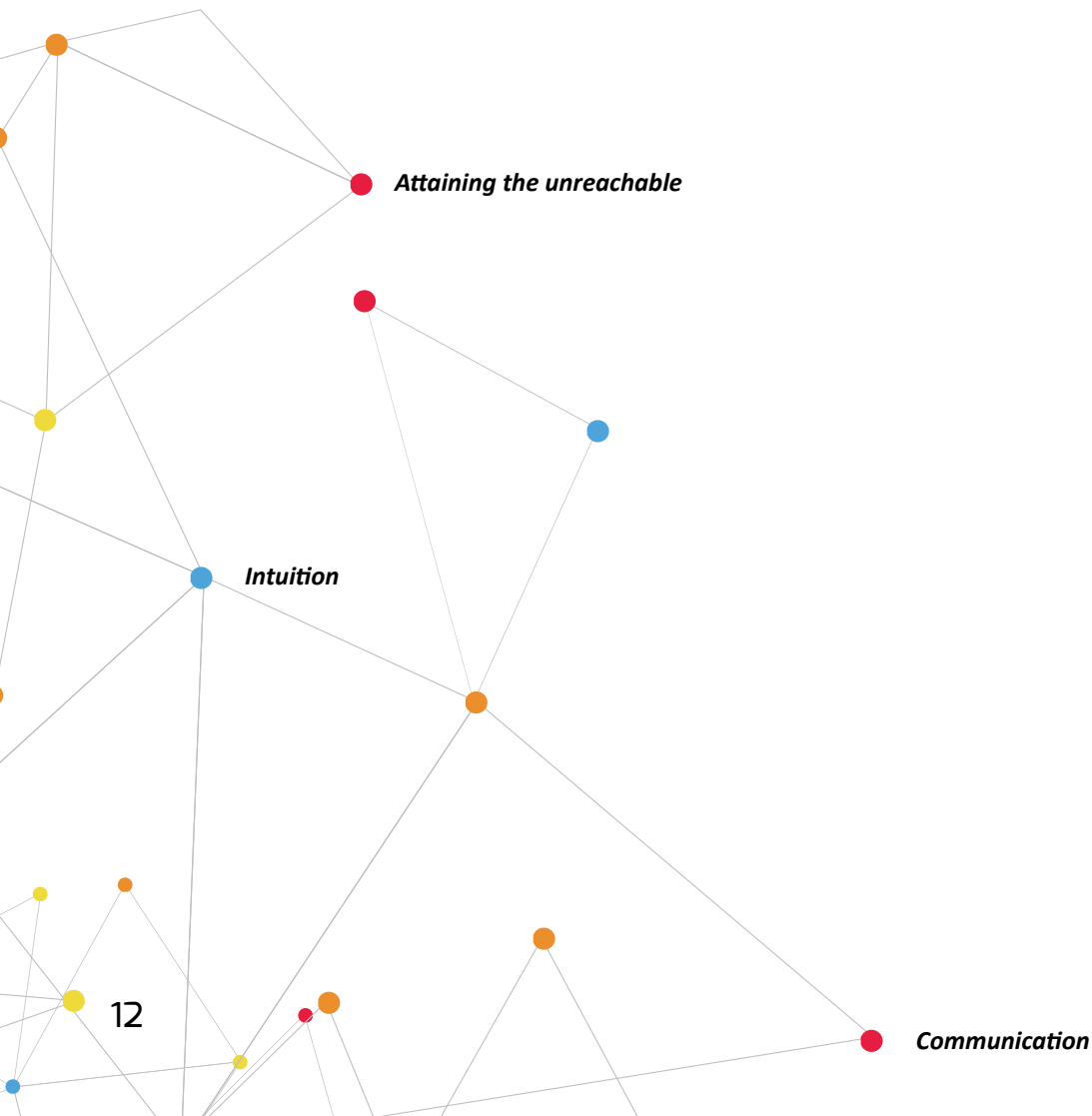
- **The deliverables** - 50% of LPs believe that the amount of information required from GPs has substantially increased, up from 46% last year and 25% the year before. This is the highest substantial increase over 5 years and could be driven by the increase in speed of investment cycles, and the continued increase in co-investment activity. Timeliness and delivery of reports is still the service that LPs are most likely to be dissatisfied with. However, 75% of LPs have this year confirmed that they have discussed issues with their respective GPs.

The good news is that for the first time in five years, LPs participating in the survey believe the resource applied to the IR function to be excellent and c.60% suggested it was good. This is a marked improvement on last year when only 8% of the LPs surveyed believed the resource applied to IR to be sufficient.

- **12 month update** - In the last 12 months, 75% of LPs confirmed that the value of the IR function has increased. There has been no deterioration in the service delivered and 50% have seen an improvement in the service either marginal or substantial.

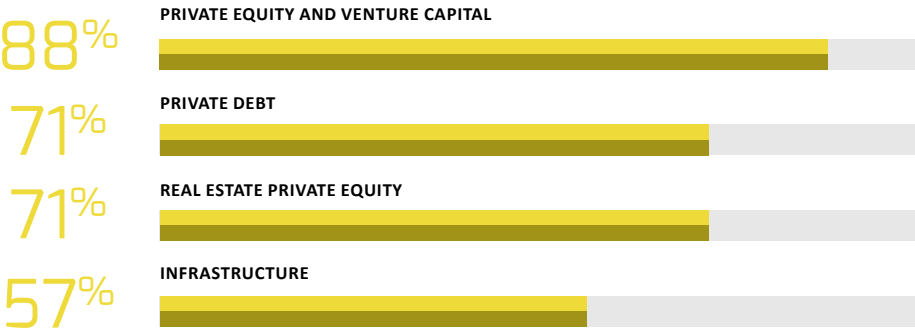
However, whilst over 50% of the respondents expect there to be an increase in the Investor Relations remit going forward, **72% of LPs do NOT believe the GPs to be adequately resourced to meet the increase** ●

## 2

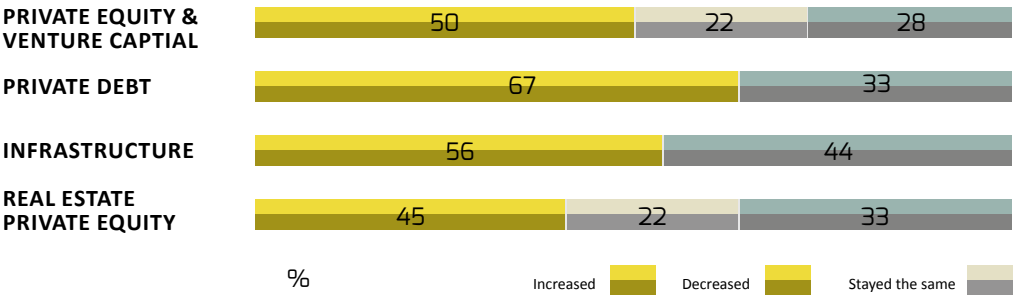
BACKGROUND -  
ASSET ALLOCATIONS  
& GENERAL PARTNER  
RELATIONSHIPS

Participating LPs confirmed their continued commitment to Private Capital assets. This year the highest allocations were to Private Equity and Venture Capital (88%) with an equal weighting to Private Debt and Real Estate Private Equity (71%).

One LP we talked to believes that Private Capital continues to present a safer option to investors than the public markets given the level of uncertainty and ongoing volatility.

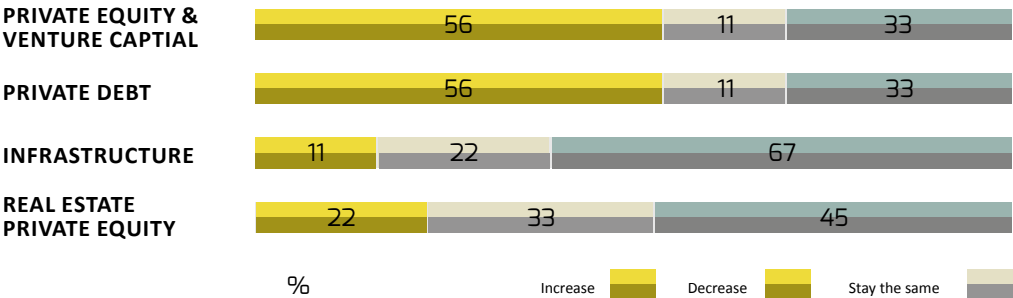


How allocations have changed in the past five years



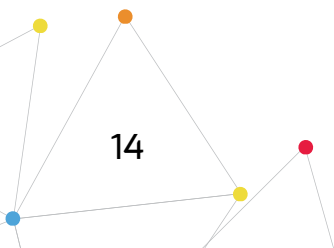
Over the past five years, a notable observation is the increase in allocations to Private Debt either via dedicated Private Debt managers or into funds managed by traditional Private Equity managers developing new fund strategies in order to grow their firm’s AUM and therefore diversifying their investment strategies.

How do you expect your allocations to these assets to change in the future?



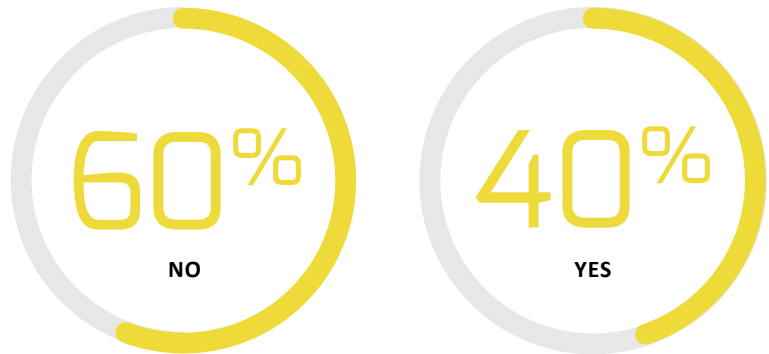
How has the number of GP relationships changed in the past five years?

86% of respondents confirmed that they have increased the number of GP relationships. This compares to 68% in 2017 and 43% in 2016. However, in the future, 67% of LPs responding to the survey expect the number of GP relationships to remain unchanged from the current level and only 33% expect a further increase in numbers.



## BREXIT

*Has your investment strategy changed since the result of the referendum was announced?*



The majority of LPs have made no changes to their respective investment strategies since the result of the referendum was announced. The primary reason given is the continued uncertainty and lack of clarity about what the outcome will be and what impact this will have on the broader economy.

Comments from LPs included:

“ There remains too much uncertainty, the outcome is still not yet clear so we will continue to focus on investing in the best managers ”

“ The UK forms a relatively small part of our global strategy and until we know what is happening with Brexit we won't make any changes ”

“ We can adopt and seek out strategies that are relevant to all macro and micro Economic environments ”



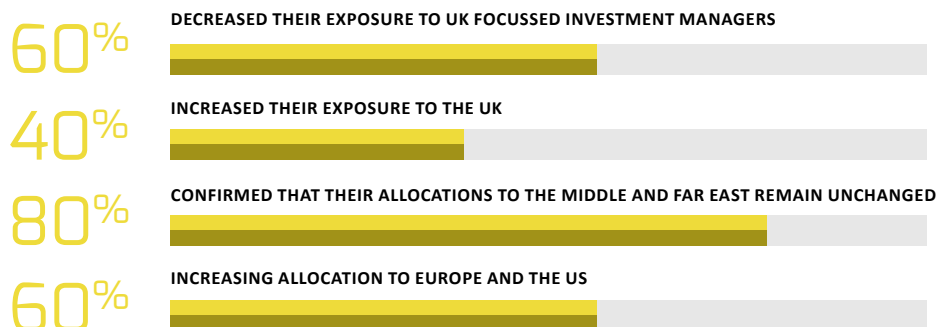
The majority of LPs have made no changes to their respective investment strategies since the result of the referendum was announced

Others were keen to comment on why the UK remains part of their investment strategies:



Whilst the majority of LPs surveyed have made no changes to their strategies, 40% have. The feedback suggests that allocations previously directed to UK focussed investment managers have been re-allocated to managers focussed on Europe and the US.

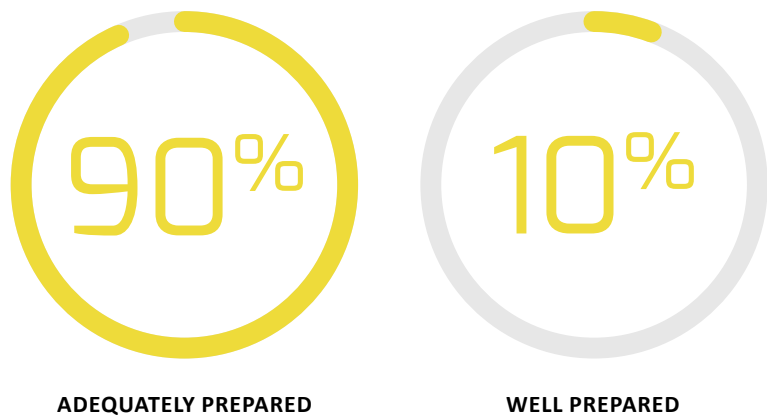
#### How have investment strategies changed?



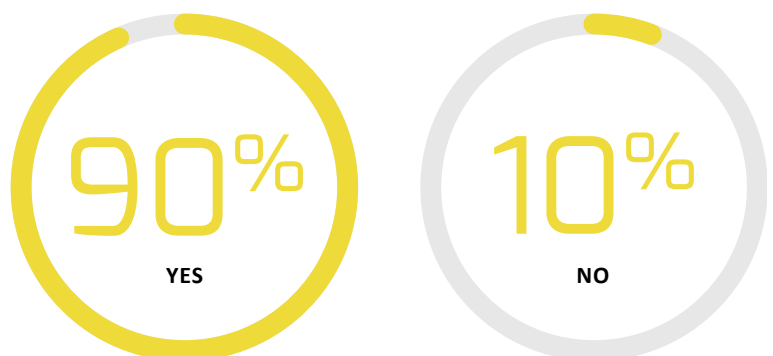


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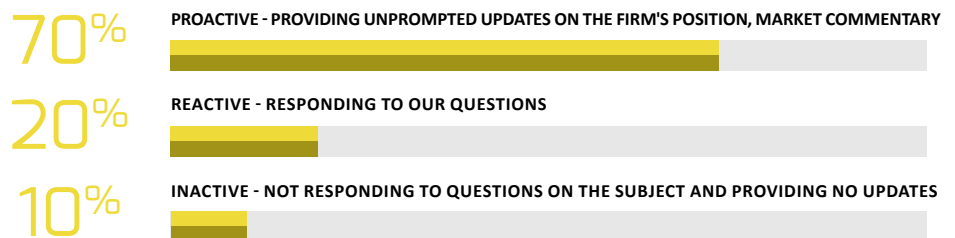
We were interested to see that whilst 60% of those who have changed their investment strategies have decreased their exposure to UK focussed investment managers, 40% have increased their exposure to this market. The reasons given mirror the comments made by LPs whose investment strategies have not changed, and for whom the UK remains an important market. One LP commented, "Brexit will likely present some interesting opportunities which is why we will continue to support UK focussed managers."

*How well are your GPs prepared for Brexit?*

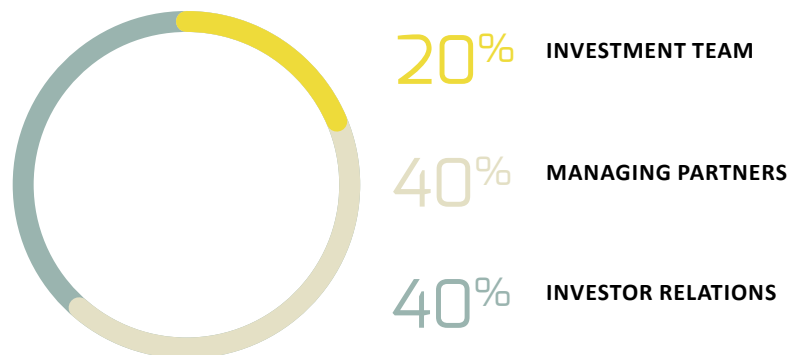
100% of the LPs participating in the survey concluded that the GPs are either adequately or well prepared for Brexit. None of the LPs surveyed suggested that the GPs are unprepared, however, one LP did make the point that with so much uncertainty, it is difficult to measure how well the GPs are prepared whilst another questioned what the GPs need to be prepared for?

*Are you satisfied with the level of information you are receiving from your GPs?*

*In general, how would you describe the communications strategies of the GPs in whose funds you are invested?*



*Which team or individual within the GPs in whose funds you are invested has been responsible for communication on the subject of Brexit or to whom would you direct questions?*



Consistent with the feedback received in previous editions of the survey, the responsibility for communication falls firmly in the remit of the IR team. One LP commented, **“The IR team is always the first point of contact for us. The next in line would be members of the Investment team”**.

However, during the third survey conducted in 2016 we explored the correlation between the importance of the information being delivered and the increased role of the Managing Partners in communicating with investors. Our findings confirmed that it is the subject of the communication that dictates which member of the firm or which team should deliver it and whilst it is widely accepted that information and updates relating to the firm, its funds and underlying portfolio companies will be provided by the IR teams, LPs would evidently prefer news which could have a material impact on the value of their investment e.g. news that a portfolio company is in difficulty, the departure and succession of key members of the team - to be delivered to them by the Management team.

We concurred that this is not a reflection on the capability of the IR team but rather that the LPs believe that it is the Management team who have ultimate responsibility for the firm, and therefore must not only communicate the news but also provide details of how a situation is to be managed and in some cases, rectified.

## SUBSCRIPTION LINE FINANCING

In a report published by the Financial Times in July 2017, a method of financing used by Private Equity GPs known as Subscription Line Financing was referred to as “PE’s dirty finance secret”. Other publications followed suit with references to a “financing trick” and “PE’s latest con”. We were therefore keen to understand how this financing method is regarded by LPs.

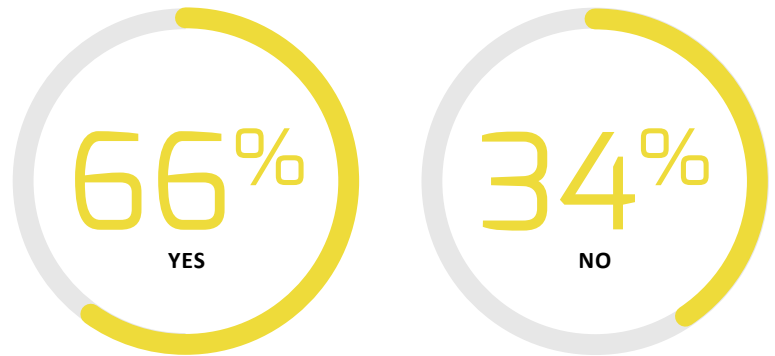
78% of respondents are aware of the use of Subscription Line Financing, 22% are not. When asked how widely this financing practice is used, the LPs participating in our survey suggested that at least half and as many as 93% of the GPs they invest with utilise it. Of those who said that they are aware of its use, 86% regard it as a useful practice whereas only 14% do not.

67% said the use of Subscription Line Financing would have no influence on their decision to invest with a GP whilst 33% said yes, in a positive way.

“We are not crazy about GPs using this but its not a deal breaker. We will always look at team, performance, returns, and potential returns first.”

However, whilst seen by most as a useful practice and one which would have a positive influence on an LPs decision to invest, 100% of the LPs who participated in our survey confirmed that they **would** undertake more due diligence on those GPs who use Subscription Line Financing than those who do not.

*Do you believe that the industry is managing this financing method?*



Comments included:

“ There needs to be a common methodology to make relevant comparisons ”

“ GPs are using this as standard now but some don't have sufficient limitations in place. If the economy were to go into a Global Financial Crisis situation again, the banks may well call in these subscription lines at the same time which could cause problems for GPs and LPs ”



Tim McKean

**Tim McKean**  
*Director*  
*Stevenson James*  
[tmckean@stevensonjames.com](mailto:tmckean@stevensonjames.com)

## PERSPECTIVES ON THE DEVELOPMENT OF THE EUROPEAN PRIVATE DEBT MARKETS IN 2018

The European Private Debt market has experienced significant growth and maturity over recent years, probably more so than any other area of the Private Capital market.

Private Debt encompasses a broad range of sub-markets including (but not limited to) the already mature European Leveraged Finance space, the maturing Direct Lending market, special situations, opportunities and distressed investing, as well as CLO fund management and the nascent Venture Debt market.

In recognition of recent developments within the space, we thought it would be interesting to compare the experiences of a range of participants in this market, with a particular focus on developments during 2018.

To this end, we have interviewed representatives from across the Leveraged Finance, Private Debt and CLO markets, where there is a degree of crossover in both investment strategy and target investments. We have asked participants to reflect on their experiences in 2018 and give us their expectations for 2019.

The answers given provide a fascinating insight into the increasing sophistication of the Private Debt market in Europe, as well as demonstrating an underlying optimism in the future, against a backdrop of intense competition. In particular, considering the four interviewees cover three different, albeit related, market segments within the broad Private Debt market, it's interesting to note how similarly they view the market at present and going forward, both in terms of opportunities and pressures. We believe that this is a very clear demonstration of the increasing maturity of the market and an indication of the increased overlap within the broad 'buy-side' debt space.

## THE PANEL



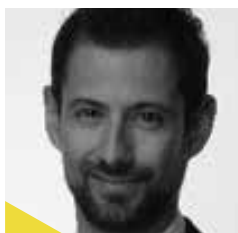
**Narinder Bhatowa**

**Narinder Bhatowa**  
Managing Director  
and Head of Leveraged  
Portfolio - Mizuho Bank



**Allan Nielsen**

**Allan Nielsen**  
Managing Director -  
Ares Management



**Andreas Klein**

**Andreas Klein**  
Managing Director -  
ICG



**Neil Rickard**

**Neil Rickard**  
Director,  
Head of Credit Research  
and Portfolio Manager  
- Investcorp Credit  
Management EU

**Narinder Bhatowa** is Head of Investments and Portfolio Management within Mizuho Bank's Acquisition Finance Department. He is responsible for investing in leveraged loans for the Bank and the firms managed account platform and he has overall portfolio management responsibility. He joined the firm in 2005 having previously been at ING Acquisition Finance where he spent 6 years developing the Co-Arranging business and executing debt facilities in sponsor driven leveraged buyouts. Prior to that he worked at Barclays for 9 years in various roles covering the financing needs of a wide range of clients from small businesses to large corporations, as well as mid market private equity sponsors. In total he has over 20 years of experience in the leveraged finance sector. Narinder holds a BSc first class honours degree in Financial Services and is an Associate of the Chartered Institute of Bankers.

**Allan Nielsen** is a Managing Director in the Ares Credit Group, where he focuses on European direct lending. Prior to joining Ares in 2015, Allan was a Senior Director in the International Acquisition Finance team at Mizuho Bank, where he focused on originating and structuring large-cap LBOs for Private Equity sponsors across Europe. Allan was previously part of the Mergers and Acquisitions team at Bear Stearns in London, where he focused on leveraged finance and corporate finance advisory. He holds an M.Sc. from City University Business School (now Cass Business School) in Finance, Economics and Econometrics, and a B.A. (Hons) from South Bank University in Business Administration.

**Andreas Klein** joined ICG in 2014 and is currently a Managing Director in the Senior Debt Partners team covering senior direct lending opportunities. Prior to joining ICG, Andreas spent over six years with Mizuho Bank focussing on the origination and execution of pan-European sponsor-backed debt finance. Before that he spent four years in KPMG's Corporate Finance division focussing on mid-cap M&A and debt advisory. Andreas holds a Master's degree in Engineering from the University of Warwick and an MBA from the McCombs School of Business at the University of Texas.

**Neil Rickard** is a Director for ICM EU. Neil heads up the dedicated Credit Research function at ICM EU and is also the Portfolio Manager. Neil joined 3i Debt Management, the predecessor to ICM EU in 2011 following the acquisition of Mizuho Investment Management (MIM) from Mizuho Corporate Bank. Prior to joining Mizuho in 2005, Neil held Credit Analyst roles across various institutions. Neil is a qualified accountant. He also holds a 2.1 BSc in Management and Chemical Sciences and an MSc in International Business, both of which were obtained from UMIST.

*Can you outline the trends in the European Private Debt market over the last 12 months, with particular reference to any noticeable changes in deal size; deal structures/ documentation; deal volumes; and transaction pricing/loan yields?*

**Narinder** - 2018 has been a strong year for fund raising across the leveraged credit spectrum. CLO issuance reached record levels whilst leverage loan issuance was broadly similar to 2017.

This increase in supply partly drove the return of the mega deals we saw in 2018 as well as the rise in valuations, increase in leverage and aggressive documentation. On the plus side, liquidity has massively improved with pricing in the European market being more supply - demand driven than ever before.

**Allan** - Despite the macro uncertainties (both economic and political) deal volumes have been very strong in 2018. The obvious general trends in direct lending have been towards tighter economics and weaker documentation controls.

In response to concerns with credit terms, we look for other ways to de-risk investments by 1) leading transactions as agent, 2) using our strong incumbent relationships to drive better deal terms, 3) remain highly selective picking the best fundamental credits, 4) use our scale to help drive better terms. We seek to lead and control the documents of the tranche or the credit that we commit to invest.

In terms of deal size, unitranches at €300m+ are starting to become more prevalent driven by the speed of execution in auction processes, buy-and-build situations and ability to provide bespoke structures.

**Andreas** - The overall landscape continued, for the most part, to favour borrowers in 2018 as the slight imbalance between dry powder and transaction volume endures. As a result, we generally observe some further dilution on yield, risk and controls at a macro level although the degree of dilution varies across different segments of the market.

Scale has become an ever increasingly important differentiator to drive speed of execution, certainty of deliverability and acquisition support. This has created a pocket in the larger-end of the upper mid-market where, by virtue of fewer direct competitors, fund managers have been able to maintain harder lines of discipline to retain attractive risk/return dynamics along with strong downside protection. We believe that our strategy focussed on selectivity and downside protection will put us in a strong position in the event the macro environment were to soften.

*Can you outline the trends in the European Private Debt market over the last 12 months, with particular reference to any noticeable changes in deal size; deal structures/ documentation; deal volumes; and transaction pricing/loan yields?*

*continued...*

Nevertheless, we expect that the recent volatility of the markets which has been driven by economic and geopolitical uncertainties may well bring a welcome caution back to the markets which, if here to stay, could recalibrate some of the yield and documentation trends we observed in 2018 and offer significant opportunities in the medium term.

**Neil** - According to LCD 2018 loan issuance ended the year at €96bn and was down ca. 21% year on year, however sponsor backed activity hit €76bn from 157 transactions, just falling short of the €79bn from the 205 transactions recorded in 2017. So overall a decent issuance year.

Loan volume has clearly been boosted by a handful of very large transactions, namely Refinitiv, Flora Foods Group and Akzo Nobel Speciality Chemicals. In our opinion 2018 can be classified as a period where we saw the return of the jumbo or mega loan deal. Interestingly, alongside the supersized transactions, the average LBO senior deal size rose to €691m, from €447m in 2017, thus making 2018 the highest such figure on record. So, the statistics would imply that transaction sizes have increased over the 2018 period.

In terms of structures/documentation, we have continued to witness a general loosening of terms and conditions, thus continuing the trend seen during 2017. 'Covenant lite' continues to be the predominant structure for European Senior Facility Agreements ("SFA") with this noted 81% of the time during 2018, with the Revolving Credit Facility ("RCF") maintaining some form of loose maintenance covenant that is only tested once drawn above a certain threshold.

European SFAs are gradually becoming more like High Yield Bond ("HYB") indentures, with covenant packages and corresponding terms and events of default triggers, that adopt bond style incurrence covenants. The unwelcome 'Bond-ification' of loans continues and we would expect to see this increasing during 2019.

At the end of 2018 the European market has started to see pricing and Original Issue Discounts ("OID") move wider, with this a reflection of the increased risk aversion and general repricing of risk. Weighted average new issue Term Loan B margins contracted ca. 50bps over 2017 to 350bps, before widening out to 400bps during H1-2018.



Following very strong demand and very limited supply over Q3-2018, then margins contracted, but widened out again towards the year end as we saw the sell off and according to LCD the year ended at an average of 380bps.

In Europe the average OID ended the year at 99.98, with the average bid at Dec-18 closing at 97.7, down over 165bps on Dec-17. The year was mixed with a short sell off over the summer to 98, followed by a recovery over Q3 to back above par with a further sell off over Q4, particularly in the latter part of December.

*We think that the growth of non-bank lenders (in particular CLO managers and Direct Lenders) has supplemented rather than supplanted the existing bank lending market, thus deepening the Private Debt market and increasing overall liquidity. Do you agree with this statement and if so why?*

**Narinder** - I agree. The growth of non-bank lenders has been significant over the past few years driven by investors looking for yield whilst at the same time banks have been pulling back given capital constraints. Alternative lenders have certainly supplemented growth of the overall leveraged debt market as well as improving liquidity for par, stressed and distressed names.

**Allan** - Absolutely. Without CLOs the underwriting banks would have a very limited buyer universe, and these days most banks supplement hold tickets with underwriting. On the direct lending side, there will be some overlap in the sub €100m space where a borrower could either go with a unitranche or try to put a bank club together. However, direct lenders can also prove helpful to banks for placing hung bridges or clearing out a portfolio on the balance sheet.

**Andreas** - Indeed, direct lending which started out in theory as replacement capital to the balance sheet-constrained banks and equity-thin CLOs, has emerged to become mostly complementary in nature. Banks have largely cleaned up their balance sheets in recent years and appetite for risk assets to boost return on equity has recovered strongly. Over the same period, CLOs have re-emerged under versions 2.0 and 3.0 bringing liquidity back to the market. However, instead of challenging the direct lending hypothesis, the differing pools of capital have adapted to coexist with transaction dynamics often dictating the optimal funding source. Whether it is because of structuring complexities, timetable demands or follow-on capital requirements, there are use-cases where a Private Credit solution will offer a borrower clear benefits over a bank or institutional solution.

**Neil** - Yes, I would agree. Both seem to co-exist and the overall increase in liquidity is definitely welcomed by borrowers.

*Do you feel that banks and funds more often complement or compete with each other? In particular, do banks compete in the same space as funds and to what extent do they overlap?*

**Narinder** - Definitely complement but the two are still very different in their approach. Banks are, on the whole, still very credit focused and can invest in tranches and currencies that the funds can't. Banks don't have the same pressure to put cash to work as funds; which was the main driver of the risk/ reward imbalance over the last 12 months.

On the flip side, some banks still want/need covenants and can be slow to meet tight deadlines or adapt to changes in the market. The funds make faster decisions and are typically better at pricing risk.

**Allan** - It very much depends on the type of deal. For large cap transactions with EBITDA above €75m, direct lending funds will often provide the second lien with banks underwriting and placing the first lien with CLOs. For a smaller transaction, there will be competition but the choice between banks vs a fund will often come down to non-economic reasons (e.g. ability to scale or speed of execution).

**Andreas** - Our view is that Private Credit is more often an alternative to bank finance than a direct competitor. The borrower and shareholder strategy, the transaction characteristics and the cashflow or asset dynamics, amongst others, will often dictate whether a Private Credit or bank solution is more accretive to the overall growth prospects of a business. True value and IRR creation for a shareholder is rarely driven by the cost of debt but more often by the flexibility of that debt - with regards to the latter the direct lenders have a clear advantage over banks. It is for this reason that we continue to consistently see funds take market share away from banks over the past few years.

**Neil** - At the inception of a large rated flow name transaction then banks clearly complement the funds, with the banks typically providing the undrawn RCF / Capex facilities and the funds providing the drawn Term Loan Facility (TLF), although in the case of commercial banks then they will typically take a split across the tranches. Funds in this instance would include CLO managers, managed account providers etc.

The recent trend for 'resetting', or 'termining out' of the drawn RCF / Capex facilities with an additional drawn TLF could be considered another example of banks and funds complementing each other as opposed to competing with each other, and during 2018 we saw a number of transactions where this occurred. Circet and IPH Brammer would be examples of borrowers who have adopted this trend.

When you reduce the size of the transaction such that it no longer requires a rating, then you could argue that funds compete with the banks. In this instance I would argue that the direct lenders do offer a credible threat to the banks, with this best illustrated by the continued

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growth experienced in the direct lending space. By contrast the banks do seem to have the upper hand in the small local club space. During 2018 we have seen this dynamic play out on a number of occasions where banks have been willing to 'club' a transaction at what we would consider off market terms and conditions for our CLO funds. When things do go wrong, then we would argue that funds and banks do not complement each other during the restructuring processes despite being in the same creditor class. My criticism of banks would be that they are very slow to react, assets tend to get passed around internally from the portfolio team to the workout team with this leading to slower decision making, and individuals not knowing the history or indeed empowered to make quick decisions. This all leads to excessive restructuring fees that will ultimately have to be funded by the lenders through lower recoveries.

*On a macro level how would you define the 'risk/reward' balance in the Credit market at present. If possible, could you focus on asset availability, quality and whether you feel that generally the rewards still outweigh risk, or vice versa.*

**Narinder** - The macro environment has been characterised by a number of risks including Brexit, trade wars, geopolitical issues, rising interest rates, central banks pulling back from pumping money into the financial system and more recently economic weakness in China and Europe. Despite all of this, and driven largely by technical factors, the leveraged loan market remained robust through most of 2018 with pricing hitting a new low and leverage at levels not seen since the Financial Crisis (with documentation much worse). Some of this reversed in December with a number of deals pricing higher and documentation being tightened, which rebalanced the risk/ reward equation.

**Allan** - It is definitely closer to the risk side of the equation than it has been over the last couple of years. There are plenty of deals out there, so it's all about selectivity and staying disciplined on quality and economics at the moment. For us, we focus on situations where we have an angle over other lenders (e.g. incumbency or sponsor relationship) and the benefit of longevity in the market is becoming increasingly important.

In 2018 (through September 30, 2018), our team saw more than 600 investment opportunities, of which we financed 24 transactions (or approximately 4%), highlighting our strong discipline and high selectivity.

*On a macro level how would you define the 'risk/reward' balance in the Debt market at present. If possible, could you focus on asset availability, quality and whether you feel that generally the rewards still outweigh risk, or vice versa.*

*continued...*

**Andreas** - For the most part we see it out of kilter. That is not to say that there aren't good credit deals being struck but just that they are becoming rarer and therefore managers have to dig deeper. As such, the depth of a manager's network and origination channels will determine its ability to find attractive opportunities. Our ability to leverage our growing portfolio of investments and relationships meant that we have been able to have a strong year of deployment without diluting quality, yield and downside protection.

**Neil** - Risk reward for loans needs to be balanced against other asset classes and for us this would be European high yield. This time last year European high yield valuations were stretched, both in absolute return terms and with limited tiering between credits. This is perhaps demonstrated by European high yield moving from above 102 at Dec-17 to close at 94.8 in Dec-18. You could argue it either way, in that this year's moves represent a re-striking of valuations to fairer levels, in line with historical averages, or the first step in an unfolding bear market.

By contrast, the European leveraged loan market has been more adept at navigating the worsening economic data and geopolitical turmoil, with this mainly driven by the perceived 'safe haven' status as well as the strong CLO technical bid. CLO issuance has been strong during 2018, thus maintaining the strong long only technical bid.

Despite the convergence of European high yield and European leveraged loans, with this being driven by the proliferation of senior secured bonds, and loan investors fully embracing the 'cov lite' concept. The differences in investor base for the two products means conditions across the two markets can be remarkably different. For example, the CLOs continue to provide stability within the loan market given the long-only nature of the market, whereas in general the bond market needs to contend with the movement in fund outflows, hence added volatility.

One measure of risk that the market looks at is the level of leverage in a transaction. Headline leverage levels have been rising, with LCD noting that leverage on newly originated first lien loans has been trending to 4.8x, with this now being above 2007 levels. By contrast European senior secured high yield leverage has not followed the loan trend, mainly as a result of the return of the subordinated bond and the senior proportion of the new buyout activity being predominantly funded in the loan market.



The European leveraged loan market has been more adept at navigating the worsening economic data and geopolitical turmoil

Expected and actual default levels are also one of the key considerations when looking at the overall level of return. When looking at defaults, then the notional weighted European high default rate has remained between 0-3% so far this cycle. By contrast, the leveraged loan market has had more of a troubled past period, with losses accruing from pre-crisis legacy LBOs. This has resulted in a default rate that has averaged 3.2% since 2010, more than double the 1.4% suffered in the bond market.

So where is the risk reward balance as of today? I think we will only know this when we have a few issuers come to market and test investor appetite.

*Following on from the previous question, how would you categorise your firms' appetite for adding risk and how has this changed over the last 12 months?*

**Narinder** - The team largely consists of individuals that have leverage finance experience through the last financial crisis, so I think we are well placed for the next downturn. The macro economic environment has been precarious for some time now and we have amended our approach to portfolio management and asset selection accordingly. We are more proactive in secondary, avoid cyclical sectors and place a very high importance on credit quality. In short, our appetite to add risk remains strong (for the right asset!).

**Allan** - There hasn't been a shift in our appetite, but there is increased focus to ensure we are being appropriately compensated for taking on that risk.

**Andreas** - We have always been, but are even more so currently, extremely selective with regards to deployment of capital into new assets with Brexit, trade wars, monetary tightening and increasing sanctions (amongst others) at back of mind in context of a heated credit market.

Having said this, however, we have had a year of record deployment in 2018 through a much stronger focus on our portfolio and off-market transactions where the risk/return profile still makes sense. It is likely that persistent uncertainty and volatility in the market will translate into better yield opportunities in 2019. We will therefore continue to selectively invest in sensible opportunities but I do not see any acceleration in risk appetite if these current market conditions prevail.

*To what extent does Brexit factor in your thoughts from either a general fund management or specific asset investment perspective?*

**Neil** - Given our high weighting towards CLOs then we are long-only managers and will continue to invest over the cycle. However, we have definitely been reducing our risk appetite over the last 12 months with this best demonstrated by an increase in our decline rate on new primary transactions as, with this being a function of what we would consider as an imbalance between risk and reward. We continue to try and pick our spots in terms of sectors that we feel are less exposed to any future downturn.

**Narinder** - Brexit has been a focus for some time now. From a portfolio perspective we are confident we are in a good position in relation to assets with exposure to the UK and/ or consumer related. The impact of a hard Brexit on the macroeconomic environment will be negative but how negative is difficult to say.

**Allan** - For individual investments, we look at both potential macro and micro impacts of Brexit. In terms of macro, we avoid anything heavily correlated with consumer spending or dependent on GDP growth. On a micro level, we look at what specific business factors around regulation, workforce availability, export restrictions, FX may be impacted by Brexit.

**Andreas** - The UK has historically been the highest volume market by virtue of its maturity, favourable legal framework, appetite for innovation and stable political environment. Since the 2016 referendum though, the latter is clearly more uncertain and we have observed a reduced appetite for risk and lower deal flow as a consequence. On the positive side, however, fund platforms with a strong local European presence such as ours and a select few of our peers, have been able to capitalise on the increasing adoption of Private Credit solutions across the channel. In fact, this has enabled many managers to rebalance the diversification in their portfolios to mitigate geographic risk, which is a good thing.

Rather than necessarily focussing on new deal flow, a lot of our focus over the past 18 months in the UK has been to evaluate the potential Brexit risks underlying our existing portfolio and working with the company and shareholders to mitigate those. We feel that although the outcome of Brexit remains unpredictable, we are well prepared for any eventuality and the capitalisation of our portfolio is strong.

**Neil** - Brexit continues to feature in our thoughts, both in terms of specific investments as well as general fund management.

In terms of general fund management, we are satisfied that we will still be able to operate in any new post-Brexit (if it ever happens) environment. With respect to new investments, we continue to think about the themes of inflation, currency, labour migration etc. We adopted this approach pre the result of the initial vote.

*From your perspective what are the particular strengths and weaknesses in your market and in your firms' business model. In the case of weaknesses, how are you going to address these going forward?*

**Narinder** - Our key strengths have always been our long term and established relationships with the Private Equity community, our longevity in the market and our balance sheet. This has been recently supplemented with the establishment of our managed account platform, the absence of which was our main weakness.

**Allan** - Strengths of the market includes its maturity levels and acceptance of direct lending as an asset class. Over the last 3-5 years direct lending has been the real market driver and now constitutes a very sizeable part of the market.

Weakness of the market is the current level of 'overcapacity' with too much money chasing deal flow and therefore putting pressure on returns. I believe smaller managers may struggle to achieve the returns they've indicated to their LPs.

**Andreas** - The real key strength of our business model is the partnership approach to capital. The ability to react quickly, follow on capital, and create an operational environment for a company to grow is vital in driving shareholder value. Few pools of capital can compete with the private credit on these fronts.

In terms of weaknesses, although slightly better than the traditionally sluggish banks, I feel like fund managers have not been much better at adopting technology to drive operational efficiency – systems are fragmented and have not been customised properly to meet the requirements of the business model. It feels like a lot is currently left on the table and there are numerous upside opportunities around cost, speed of execution, availability and analysis of data, etc.

**Neil** - Our key strengths continue to be our long-term established relationships given that we have been a market participant for ca.15 years. A weakness would be our limited other strategies in direct lending, structured credit etc.

*Do you feel that this is a crowded market i.e. is there space for everyone (i.e. banks and funds) and do you anticipate consolidation and/or contraction over the medium term?*

**Narinder** - There is space for everyone. However, the Banks need to continually innovate and adapt otherwise they will get left behind. The market is changing at an ever-increasing pace and the Banks need to make sure they keep up if they want to continue to invest in leveraged loans. I expect consolidation in the fund market to continue; size will be important to stay relevant.

**Allan** - I would certainly expect consolidation over the medium term although this is unlikely to materially change the landscape. As we saw with the PE industry through the last downturn, a number of underperforming managers effectively went in-to run-off mode but there was minimal consolidation - I'd expect something similar to happen in private debt over the next cycle.

**Andreas** - The Private Credit space is currently too crowded with material overcapacity and differentiation and value-add by manager is diminishing. This will inevitably lead to consolidation and run-off. Without access to funds and deal-flow the smaller/newer players will struggle, and it is likely that many will wind down over the short to medium term taking out excess capacity. We are already starting to see some bifurcation amongst fund managers at two levels. Firstly, around fundraising where investors (LPs) have clearly recalibrated their allocations towards the larger and more established fund managers and away from first vintage funds. And secondly at the deal level where sponsors are increasingly focused on partnering with funds demonstrating longevity and deliverability.

Banks will continue to play an important role in the mid-market but it is likely that this role will increasingly refocus on traditional banking products - operational, working capital and ancillary facilities. This will co-exist well alongside the fund model. Clearly in the upper mid-market and beyond, banks will continue to dominate underwrites and book-builds.



**Neil** - With specific reference to the CLO market, then this has increased rapidly over the last five years, both in terms of issuance as well as number of managers. We estimate that in 2018 Europe ended with ca. 45 managers, and we feel that the European market has a growing pipeline of potential new managers. Clearly this is beneficial for the wider market as each new manager adopts a slightly different strategy in terms of management style, therefore influencing asset choice and ultimately allowing for a differentiation in performance and choice to liability investors. In the event of a downturn we could envisage a situation similar to that which happened just after the last crisis where some of the smaller managers were purchased by some of the larger players and some sort of consolidation did play out. This time around, risk retention could however be a stumbling block.

For banks, European leveraged loans still represent an attractive asset class in terms of return. However, we continue to see the European banks take smaller and smaller final holds, with the slack ultimately being picked up by the funds. Both the bank and funds are ultimately reliant upon the supply of loans, and for us one of the key forward indicators of supply is the amount of Private Equity dry powder that is in the system. Preqin estimates that ca. €250bn of private equity dry powder exists in Europe. We would expect this investment capital to be deployed by sponsors, thus creating new loan/ bond supply that should ensure adequate new supply.

*On a related note, in terms of the current market landscape, who and/or what do you see as the major threats to your market over the next 36 months?*

**Narinder** - A sharp slowdown in the macro economic environment is the main threat in the near term.

**Allan** - Macro and political environment on portfolio performance.

**Andreas** - In a rising interest environment that almost always predictably precedes a period of softer economic conditions, it is very likely that levered balance sheets will come under strain and significant effort will need to be dedicated to resolving the problems. That in itself is not a remarkable prophecy or necessarily a big issue, but it feels like most managers are unprepared whether it be lack of expertise or resources. ICG has been around for 30 years and has experienced cycles first hand. Underestimating the effort required will be the threat and if not properly addressed we can expect to see significant value erosion for investors.

**Neil** - Apart from specific sector risks, and indeed individual borrower credit risks, then the credit markets typically like stability and certainty, so wider market events that are outside of our control such as Brexit, the potential China/USA trade war, French political uncertainty, Italy, ECB, US rates etc., could all feature as impacts that will lead to market uncertainty and ultimately market volatility, which creates both threats and opportunities for our markets in the short term.

Over the medium term we do feel that we are now entering the closing scene of what has been a very long credit bull run, and defaults could ultimately be the sting in the tail. A rise in the level of defaults will therefore negatively impact our ability to raise new funds.

*What are your concluding thoughts and expectations for 2019?*

**Narinder** - Overall the macro issues we've seen in 2018 will continue in to 2019. We have seen short term cycles in the leveraged loan market over the last few years and it does feel like we are going through an overdue correction at the moment. In my view demand for leveraged loan issuance is likely to remain robust for well structured, non-cyclical credits. However, there are dangers looming in the macro environment and a cautious approach will be needed to navigate through successfully.

**Allan** - The market volatility over the last couple of weeks may well continue into 2019, which would mean an increasing number of businesses will look to alternative financing sources. The capital market volatility and backdrop of political uncertainty will put increasing emphasis on ability to price risk.

That being said, the market opportunity for direct lending has evolved over the last several decades as commercial banks reduced their willingness to originate and hold significant amounts of leveraged loans to middle market companies. The shift in bank behaviour was driven by significant consolidation, increased regulation (i.e. liquidity constraints), and lack of infrastructure. As a result, banks have ceded market share to a growing number of non-bank, direct lending platforms who have filled the void in the marketplace. We believe this trend represents a secular shift and is unlikely to change and will continue to benefit alternative asset managers that have scale, origination advantages and significant credit expertise.

**Andreas** - It is very hard to say, but leading macro indicators remain stable which implies there is unlikely to be any material recessionary pressures in the short term. A few darker political clouds linger on the horizon that may jeopardise this in the medium term. However, a recalibration of the market without any significant recessionary pressures is likely to be a welcome outcome from all players across the value chain. If institutional and high yield liquidity dries up, it could play very well into the hands of the private credit managers, particularly those of scale.

For 2019 I wouldn't expect things to change drastically and the base case would be continued deployment of capital through rigorous diligence and high selectivity.

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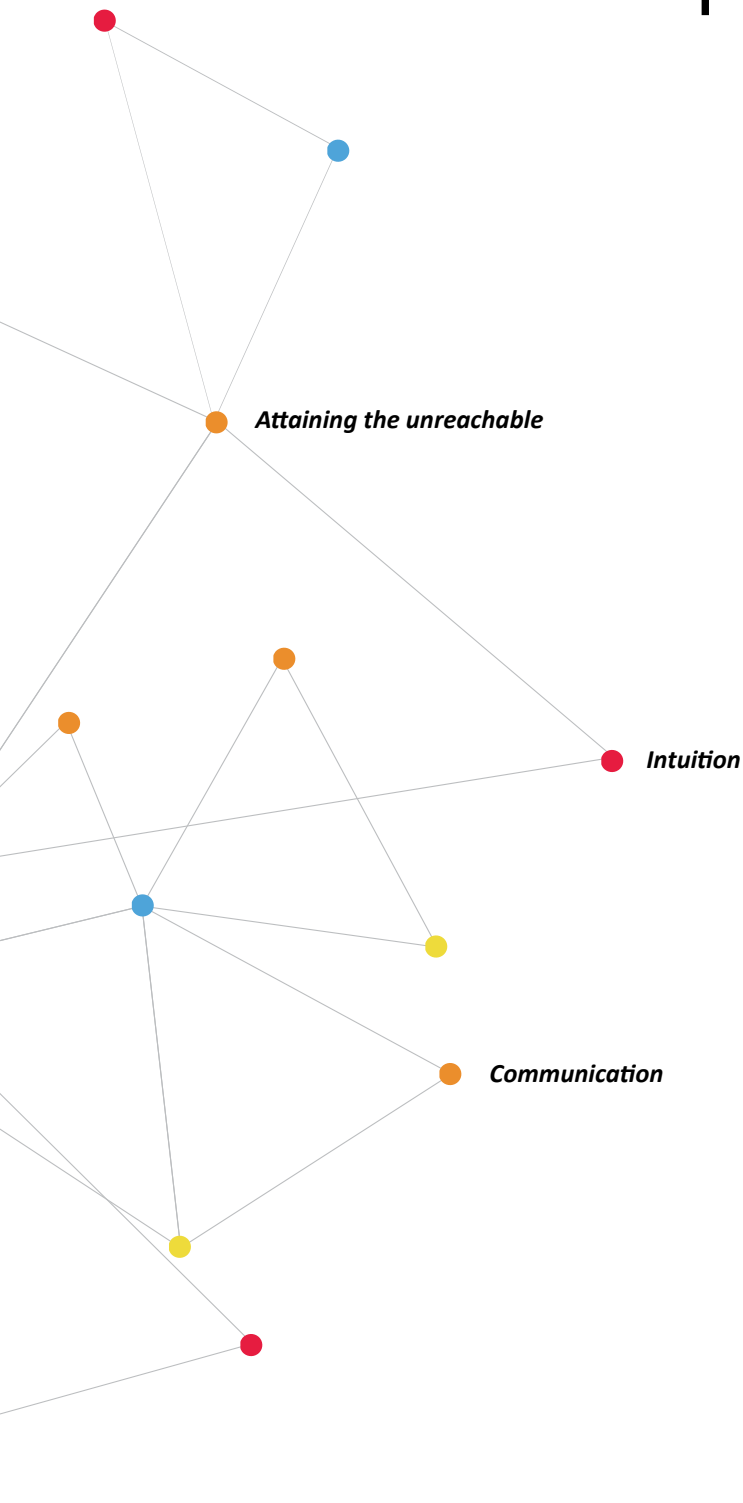
*Neil* - In terms of defaults, we don't expect them to meaningfully rise unless the economy accelerates into a recession, and even then, we will most likely see a generous lag due to the historical low interest rate environment and the lack of any teeth in loan documentation.

As mentioned previously the 'Bond-ification' trend continued strongly during 2018 and as such this will allow for a lag to defaults. Consensus seems to expect a 1-2% default rate through 2019, which again is not that high, again supporting the lag. Given the number of uncertainties, some of which we have touched on above, then we would expect 2019 to be a period of increased volatility which will create opportunities. Returns are difficult to call, but initially we would expect new issue premiums in January with this potentially acting as a stabilising impact for the market in the short term and then we move back to trend.

Given the amount of dry powder then we expect sponsors to continue to buy assets. Beyond that, who knows! ●

# 3

## DEFINING THE INVESTOR RELATIONS FUNCTION



*What are the three key areas or services that should be covered by IR - in order of importance to your firm:*

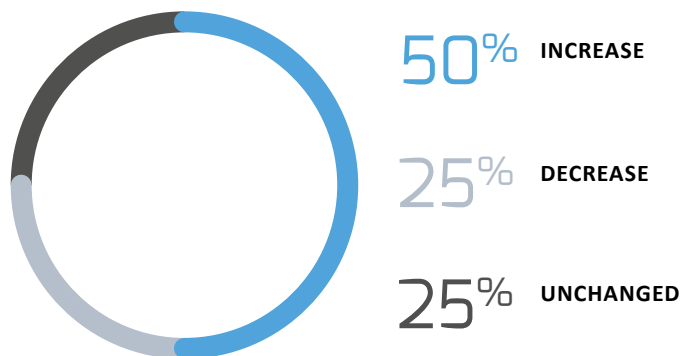
- 1 **COMMUNICATION - UPDATES ON THE FIRM, ITS TEAM, PORTFOLIO PERFORMANCE AND RESPONDING, PROMPTLY, TO QUESTIONS**
- 2 **MANAGING THE CO-INVESTMENT PROCESS**
- 3 **MANAGING THE FUNDRAISING PROCESS**

*Others included - providing access to the Investment Team, managing compliance.*

*How has this changed over the past five years?*

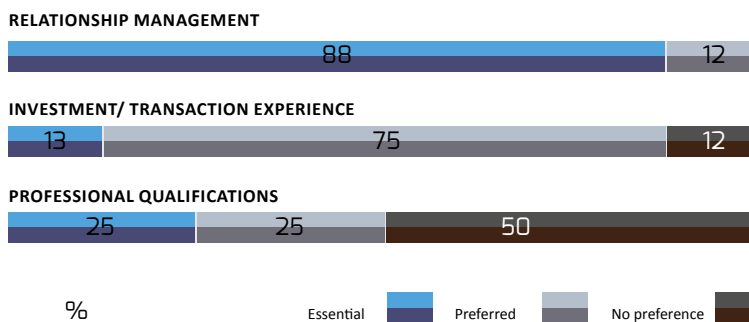
Our findings demonstrate that communication and the management of the fundraising process are central to the role of IR. This feedback has not changed in the five years since we launched the first survey. However, during that time, the management of the co-investment process has become a more prominent feature of the role. We have observed GPs responding to the continued growth of co-investment activity by applying a dedicated resource to the management of their co-investment programmes. It is understandable that this responsibility increasingly falls into the IR remit thanks to the close relationship enjoyed by IR professionals and their respective LPs, together with their knowledge of, and proximity to, the investment portfolio.

*Have you noticed a change in the services for which the IR function is responsible?*



This feedback is consistent with our observations of the changes to the IR remit and the breadth of responsibilities now covered and is, we believe, a response to the continued increase in the levels of information required by investors; the increase in co-investment activity; and the current speed of fundraising cycles. According to Preqin, Private Equity firms in particular are leaving less time between fundraising cycles with the average time taken between final fund closures falling by 10 months since 2013.

*Please rate the following skills and qualifications that you believe an IR professional should possess?*



This year, 100% of LPs believe relationship management to be either essential or preferred, 75% would prefer to see the IR team have investment or transaction experience with 13% of respondents believing it to be essential.

## HOW HAVE THESE NUMBERS CHANGED?

	2014			2015			2016			2017			2018		
	Essential	Preferred	No Preference	Essential	Preferred	No Preference	Essential	Preferred	No Preference	Essential	Preferred	No Preference	Essential	Preferred	No Preference
	%			%			%			%			%		
Relationship Management	100	0	0	93	7	0	76	19	5	80	20	0	88	12	0
Investment/ transaction experience	30	65	5	0	86	14	5	81	14	24	68	8	13	75	12
Professional qualifications	0	60	40	0	65	35	0	48	52	8	32	60	25	25	50

*Continued...*

Whilst relationship management remains key, investment/transaction experience is deemed by 86% of respondents as either essential or preferred. With only moderate variation, this has been a consistent theme over the past five years which we believe is driven, in part, by the move away from traditional fund models and an increase in co-investment activity for which the IR function has become increasingly responsible. Furthermore, we have observed a positive reaction to IR professionals whose investment experience enables them to respond to detailed questions themselves rather than deferring to the Investment team, who the LPs believe should remain focussed on investment activities.

We were interested to find a higher number of LPs now believe professional qualifications to be essential. However, the majority still do not consider professional qualifications to be a prerequisite. This may be because, unlike the public markets, IR professionals are not required to possess a professional qualification in order to do the job. Indeed, one LP commented that whilst an MBA might help an individual on entry into the Private Capital market, the need for relationship management and an understanding of the business and the portfolio is far more valuable.

Tom Quinnen, Managing Director with Stevenson James commented - "There is no evidence of formal qualifications being required but given the background of the people who now work in IR and Fundraising, it would be unusual to find people without a top-class academic background which, for many, may also include an MBA."



Given the quality of the people who now work in IR and Fundraising, it would be unusual to find people without a top-class academic background



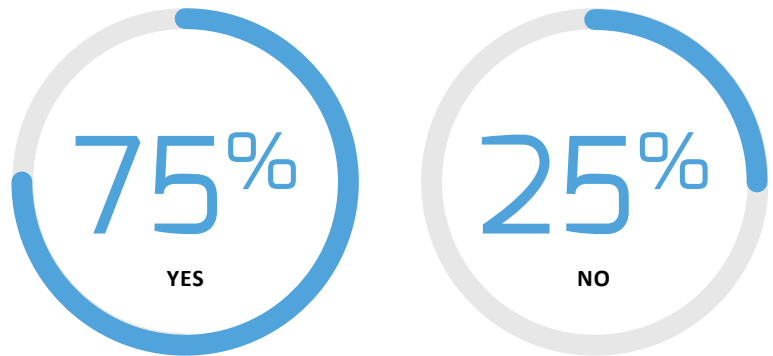
*Should the IR professional or a representative from the IR team have a seat on the Investment Committee?*

	2014	2015	2016	2017	2018
	%				
Yes	6	50	29	4	63
Yes with observer rights only	44	17	53	42	12
No	31	16	12	8	0
No preference	19	17	6	46	25

We were interested to find that 63% of LPs surveyed believe that the IR function should have a seat on the IC. This is an increase (59%) on last year and is coupled with the most notable finding that for the first time in five years none of the LPs surveyed believe that IR should **NOT** have a seat on the Investment Committee. As the data shows, over the past five years, LPs have consistently supported a preference for IR to have a seat on the IC - either with or without observer rights only - and from the comments provided, we attribute this to the value placed by LPs on IR to represent them during the crucial stage of the investment process.

Over the past five years the reason for the IR function taking an active role on the IC has generated some interesting comments, most notably the perception that the IR function acts as the “eyes and ears” of the LPs; and that “the IR individual understands the clients’ perspective on the GP’s investment strategy” and can act as a “voice of reason to potentially avoid strategy drift”. Another LP raised a concern that without IR being part of the IC, “softer issues such as ESG could be overlooked”.

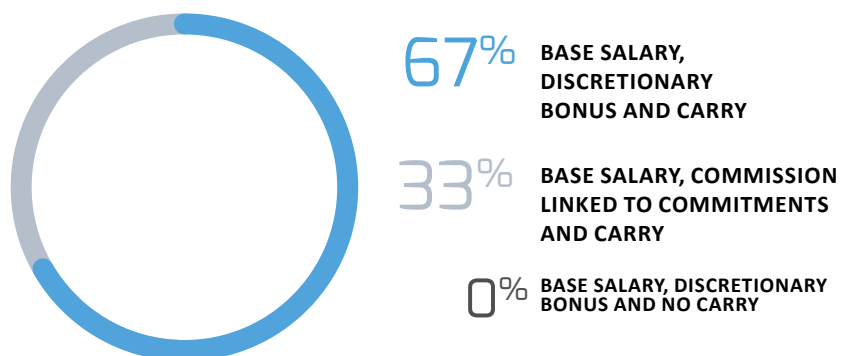
*Without representation by the IR team at the Investment Committee, do you believe your interests as an LP are being represented fairly?*



Whilst there is evidence of consistent support for the IR function to be part of the Investment Committee, 75% of the LPs we surveyed confirmed that even without representation, their interests as an LP are being represented fairly. This is consistent with feedback received in the previous two surveys. In 2017, 87.5% of the LPs confirmed "yes", versus 12.5% confirming "no" and in 2016, 70.6% responded "yes" versus 29.4% responding "no".

When we asked LPs why they believe their interests are represented fairly in the absence of IR representation at the IC, the responses focused broadly on the LP Agreement (LPA) and the close alignment of interests between LP and GP. However, one LP who answered "no" did caveat their answer with the comment "It depends on whether the Managing Partners are listening to their investors".

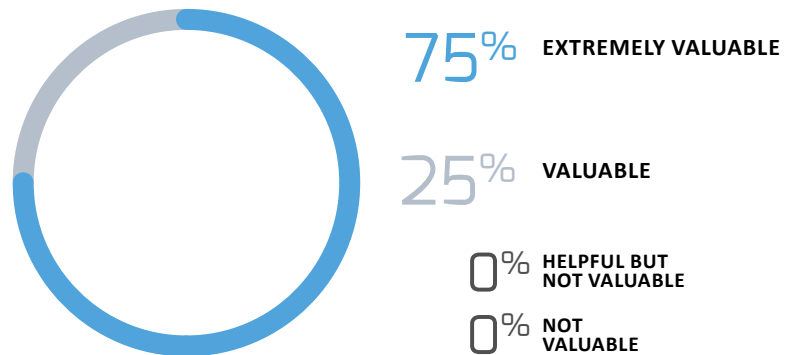
*In your opinion, how should an IR professional be compensated?*



Base salary, discretionary bonus and carry remains the preferred compensation structure amongst the LPs participating in the survey. Notably, for the first time in three years, all of the LPs surveyed believe IR professionals should have access to carry.

## THE VALUE OF INVESTOR RELATIONS

*How valuable is the IR function to you?*



100% of respondents to the survey confirmed that the IR function is valuable with 75% of respondents confirming it to be extremely valuable.

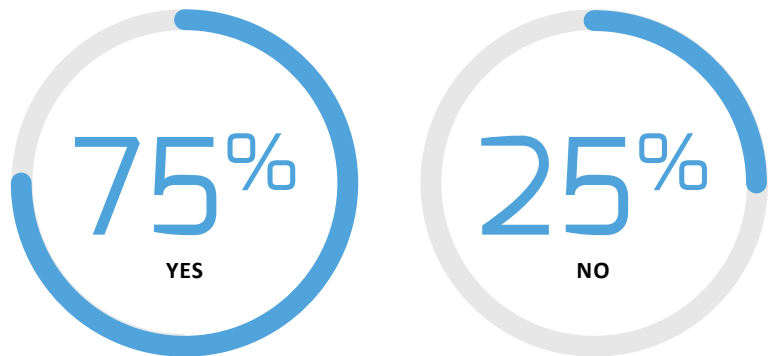
The responses to this question have been consistent across all five surveys with between 80% and 100% of LPs, each year, confirming the role to be important and valuable. Comments from LPs in support of this feedback confirm IR to be “crucial”, “a very important function” and the “main point of contact for us”. Another referred to the IR function as “an essential interface between a firm and its clients”.

This year one LP focussed on the fact that different teams within their organisation need different information which is why it is so important that they have a dedicated point of contact.



100% of respondents to the survey confirmed that the IR function is valuable with 75% of respondents confirming it to be extremely valuable.

*When appraising opportunities with GPs who have a similar strategy and focus and if all things are equal in terms of track record and performance, would the presence of a well-regarded IR function be the deciding factor between competing GPs?*



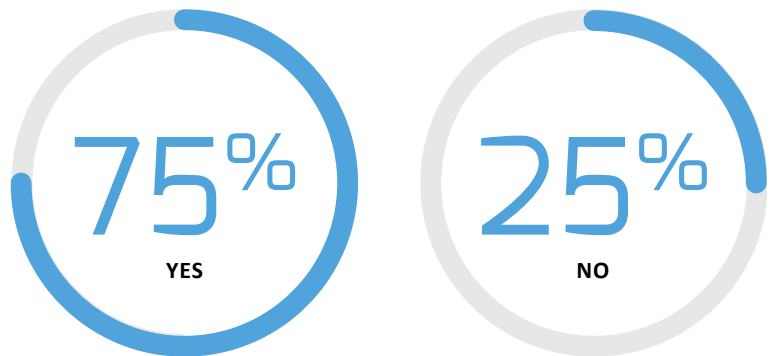
When we first asked this question in our 2016 survey, the response was our stand out highlight with 53% of LPs confirming that the presence of a well-regarded IR function could be the deciding factor between competing GPs.

This year we were interested to find this number increasing to 75%, confirming the value of the function and its continued importance to LPs. One LP made a particularly interesting comment, “Yes - funds have to be of Institutional quality which means we must have access to key information and developments at all times as part of our fiduciary responsibility to investors”.

Another talked about their experience of a GP whose team and track record were excellent but there was no IR professional in place. “We were concerned about how this would impact the Investment team. We talked to them and an IR professional was hired to join the team”.

However, in contrast, one of the respondents who did not agree commented that “the quality of the LP communication/ how much they listen to investors is important - not necessarily whether they have a dedicated IR team in place”.

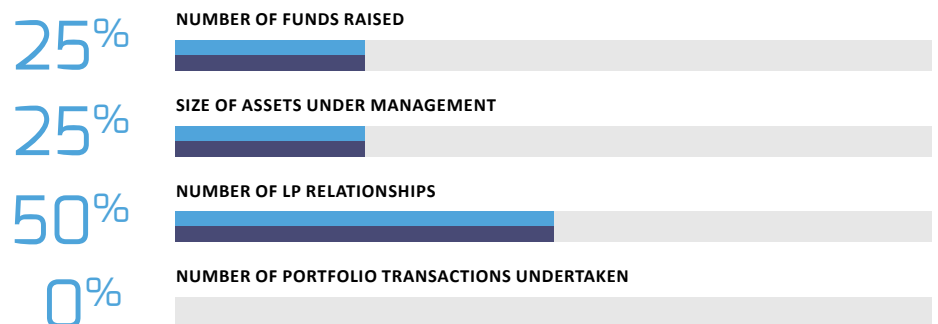
Investment professionals should **NOT** be responsible for IR and the management of Investor queries. Do you agree?



We first asked this question in the 2016 edition of the survey and half of the LPs we surveyed confirmed that they agreed. In 2017, the number rose to 70% and this year three quarters of LPs confirmed their agreement. The principal reason for this is that LPs do not believe the Investment team should be distracted from their investment activities by requests for information and questions. With the increase in information now required by LPs we have therefore been unsurprised to see an increase in the number of LPs who agree with this statement.

However, one LP concurred that some small funds do not have the luxury of separate roles which leads on to the question of when a GP should put a dedicated function in place?

When should a GP put a dedicated IR function in place?



Given the value of the IR function to LPs, it is unsurprising that a high number would like to see an IR function in place at inception or soon thereafter. However, we know this is not always possible given the limited resources available to some new GPs. It is therefore interesting to note that the number of LPs is regarded by most investors to be the key driver for putting a dedicated IR function in place.

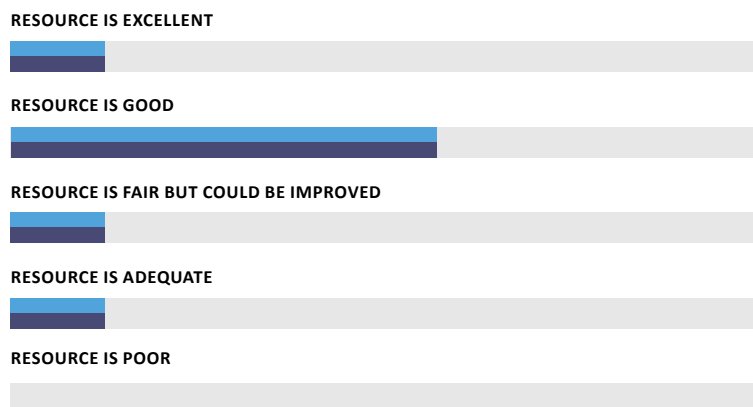
## INVESTOR RELATIONS - DELIVERABLES

*Has the amount of information  
you require from GPs changed  
(reporting, portfolio updates,  
due diligence requirements)?*

	2016	2017	2018
	%		
Substantial increase	25	46	50
Marginal increase	56	25	25
Stayed the same	19	29	25
Decrease	0	0	0

*Do you believe your  
GPs apply adequate  
resource to the  
IR function?*

12.5%  
62.5%  
12.5%  
12.5%  
0%



This response demonstrates a marked improvement on the feedback received in each of our previous surveys which showed that whilst recognised by LPs as valuable and important, the resource applied by GPs was evidently lacking. In the first four surveys the LPs confirmed that the resource applied was either 'adequate' or 'fair and in need of improvement' - 46% in 2015, 81.3% in 2016 and 83.3% in 2017. In our first survey comments from LPs at that time included "pitiful" and "too difficult to respond, some are good, some are awful" and "GPs are generally under resourced in this area". In 2016 and 2017 we were alarmed to find that a small number of LPs regarded the resource applied to IR as poor.

We were therefore, encouraged to find that for the first time in five years, a number of LPs responding to our survey regard the resource applied to IR as "excellent" with the majority rating the resource as "good".

Which of the following factors contribute to the quality of the IR function and the service provided?

(LPs were asked to tick all that apply.)

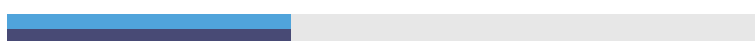
37.5%

87.5%

50%

37.5%

SIZE OF TEAM



COMPOSITION OF TEAM - LEVELS OF EXPERIENCE



COMPOSITION OF TEAM - LEVELS OF SENIORITY



LOCATION OF IR FUNCTION OR PROFESSIONALS AND THE ABILITY TO COVER MULTIPLE JURISDICTIONS



When considering the relationships with your GPs and the service provided, which of the following are you most likely to be dissatisfied with?

(LPs were asked to tick all that apply.)

29%

71%

57%

43%

42%

0%

QUALITY AND CONTENT OF REPORTS



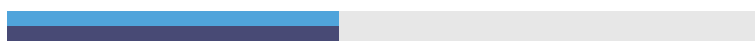
TIMELINESS OF DELIVERY OF REPORTS



QUALITY AND CONTENT OF UPDATES



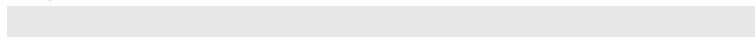
TIMELINESS AND DELIVERY OF UPDATES



FREQUENCY OF COMMUNICATION - TOO MUCH OR NOT ENOUGH

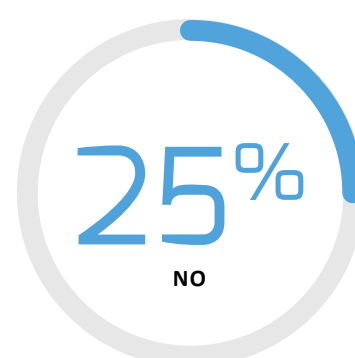
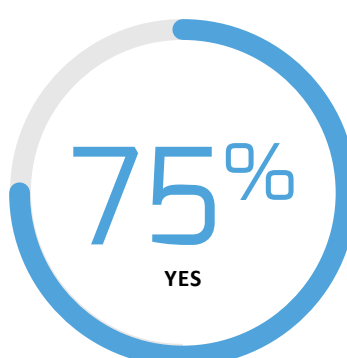


FREQUENCY OF MEETINGS - TOO FEW OR TOO MANY



We were encouraged to see that whilst the timeliness of delivery of reports is a service that LPs are most likely to be dissatisfied with, the quality and content of reports has improved (58% in 2017). In contrast, the level of dissatisfaction with the quality and content of updates has more than doubled since last year (25% in 2017). One LP commented that GPs are not so good at delivering 'bad news'.

Have you ever talked to your GPs about either your satisfaction or dissatisfaction with any aspect of the Investor Relations service you receive?



Would it be helpful to have any of the following standardised as part of the overall IR service?

(LPs were asked to tick all that apply.)

75%  
25%  
38%

REPORTING

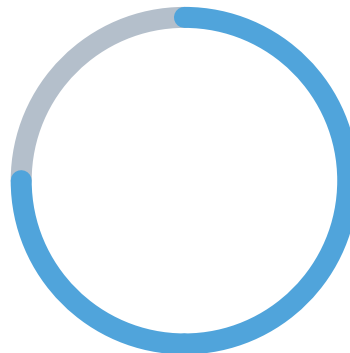
STRUCTURE AND DELIVERY OF PORTFOLIO UPDATES

STRUCTURE AND DELIVERY OF TEAM UPDATES

Since our annual survey began, the feedback around standardisation of reporting has been consistently high. However, on closer inspection, we know that LPs also place significant value on a bespoke approach which meets their own specific needs. Finding a way to satisfy the information requirements of all LPs continues to present a challenge for GPs, however the feedback from LPs confirms that a well-resourced IR function that has a thorough understanding of its LPs can deliver a highly valued service.

## 12 MONTH UPDATE

Has your view of the value of the IR function increased or decreased over the last 12 months?

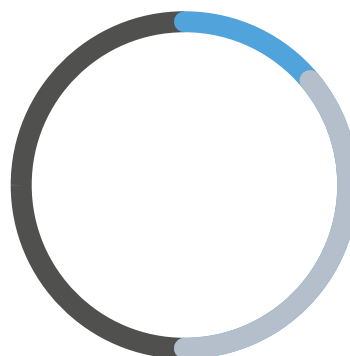


75% INCREASED

25% STAYED THE SAME

0% DECREASED

In general, has the IR service you receive from your GPs changed over the last 12 months?



13% SERVICE HAS SUBSTANTIALLY IMPROVED

37% SERVICE HAS SEEN SOME IMPROVEMENT

50% SERVICE HAS STAYED THE SAME

0% SERVICE HAS DETERIORATED



## FUTURE REQUIREMENTS

*Do you envisage an increase in the remit of IR going forward?*

	2014	2015	2016	2017	2018
	%				
Increase	80	100	75	55	63
No increase	20	0	25	45	37

Each year, the feedback from LPs has confirmed that they envisage an increase in the remit going forward. However, in contrast (with the exception of the feedback received last year, and to a lesser degree in 2016), a consistently high number of LPs do **not** believe the GPs are adequately resourced to meet the anticipated increase in remit.

*Do you believe GPs are adequately resourced to meet an increase in the remit of the IR function?*

	2014	2015	2016	2017	2018
	%				
Yes	18	25	44	67	28
No	72	75	56	33	72



A consistently high number of LPs do not believe the GPs are adequately resourced to meet the anticipated increase in remit.

We were particularly interested in the feedback received this year given that, as we have shown, the value of the IR function has increased over the last 12 months and there has been an improvement in the service received during this period. It is clear that, in order to maintain the evident improvements, GPs must actively appraise the resource currently applied to the IR function to ensure that it can support the expected growth in remit and to ensure LPs receive a consistently high level of service ●

# 4

## SUMMARY



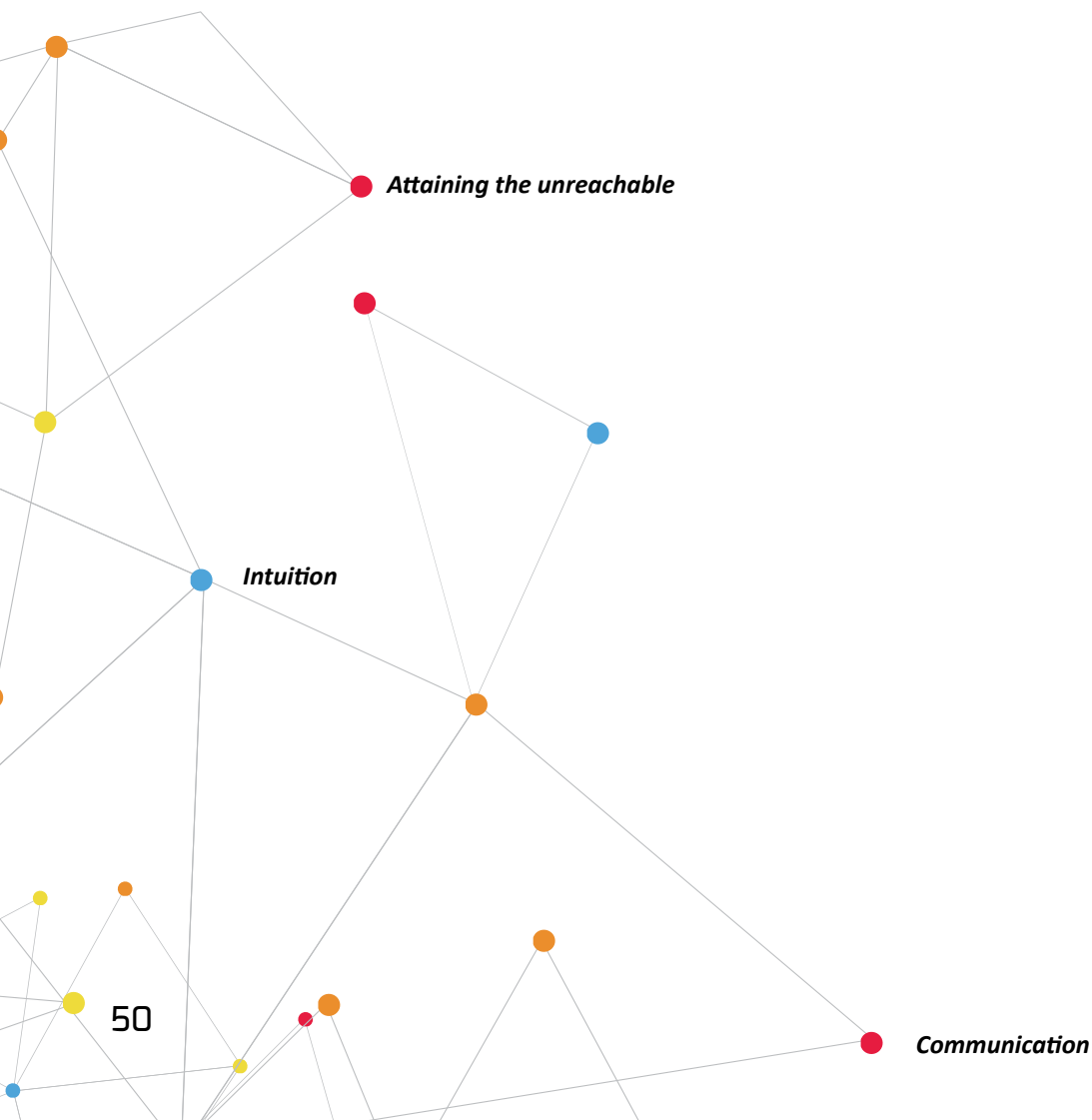
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Over the past five years, we have observed some significant changes to the role of IR. The remit has become broader, encompassing the management of the fundraising and co-investment programmes alongside the central, established tenets of relationship management and communication. We have seen the value of the function increase and this year, 100% of LPs regard the IR function as “valuable” and “extremely valuable”.

Whilst it is clearly regarded by LPs as an important and integral function within the Private Capital market, which over half of the LPs surveyed believe should have a seat on the IC, one of the most significant findings of our Annual Survey is the feedback that a well-regarded IR function can be the deciding factor between competing GPs which share the same focus, strategy and level of performance and track record. This signalled a marked change in LP sentiment from that presented in our first survey, which suggested that IR was largely perceived by LPs to be an interface or conduit between a GP and its investors.

We know that GPs measure the quality of an IR function by the service delivered - the timely delivery of quality reports and the ability to respond quickly and efficiently to questions and requests for information without having to defer to the Investment professionals, leaving them alone to concentrate on investment activities - and as the service has improved, so too has the value placed by LPs on the IR function.

However, maintaining and delivering a high-quality service to LPs, whilst also managing active co-investment programmes and keeping pace with current fundraising cycles, demands well resourced IR functions. Having teams comprised of highly skilled, technically capable individuals with a thorough understanding of the specific requirements of individual LPs remains a critical function of the role.

Whilst GPs should be applauded for their efforts and commended for the fact that, for the first time in five years, LPs participating in the survey believe the resource applied to IR to be excellent or good, the evident pressure on GPs to maintain and develop the support of existing LPs whilst securing commitments from new investors will continue to rise. Aside from Brexit and the confusion and lack of clarity which abounds, over half of the LPs surveyed envisage, once again, an increase in the IR remit going forward. Unfortunately, this year, 72% of respondents do not believe GPs are adequately resourced to meet the increase.

It is clear that GPs intent on meeting the challenge in order to grow and develop their respective businesses must review carefully the resource applied to such an important function, ensuring that the individuals responsible have the requisite capacity, experience and skill set.

Stevenson James looks forward to being part of the continued development of the Private Capital market and providing guidance and assistance to GPs seeking to either establish or enhance their respective IR and Fundraising functions ●

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