ROUNDTABLE

Fundraising: Then vs now

In a recent fundraising roundtable hosted by Real Deals, a group of industry experts discussed the impact of Covid-19 on current fundraising and the difference between pre- and post-pandemic practices.

By *Sam Birchall*

SPEAKERS:

Sophie Smith
Kirkland & Ellis

Klas Tikkanen
Nordic Capital

Simon King
Aztec Group

Morten Welo
FSN Capital

Andrew Bentley
Campbell Lutyens

What considerations have to be factored into a remote fundraise? And what are some of the main lessons that have been learned so far?

Klas Tikkanen: Well, going back just to create a bit of drama, we had no idea if remote fundraising would work or not. Some of our LPs are government bodies or state bodies in the US and their decision-making processes cannot simply be changed overnight. Disregarding the purely legal or bureaucratic aspect of fundraising, another crucial part was working out how to build human rapport. We knew some LPs very well, but other investors were new to us. We also grew the fund size in the latest Nordic Capital fund quite a bit, so we needed to grow tickets from existing LPs. Typically, we invite people to come to Stockholm, or London, and then we're all there with the whole senior team, but how do you translate it onto a Zoom environment? In the end, we added some pre-DD meetings where investors got to meet some of us in the senior team one-on-one just to build that relationship ahead of the formal DD meeting, which I thought worked really well. For the actual DD meetings, we emulated what we normally do, so we set up conference rooms and had an LP in one conference room on the video and then we had the senior team walk around one-on-one.

Of course, we had to get LPs comfortable around the existing Nordic Capital portfolio before we could get them to focus on committing new money. As a result, the key DD topic moved away from how to invest new LP money to how the portfolio was weathering Covid.

In Q1 2020, we set up a pandemic taskforce that worked really hard to assess the situation and set up portfolio company guidelines and ethical guidelines like no profiteering, health and safety first, capital needs, those types of things.

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>
> **Sophie Smith**

Morten Welo: Regardless of whether you were fundraising or not, Covid enabled us to work even more closely with our portfolio companies and that has in itself created a good opportunity to showcase our active ownership approach to potential LPs. When Covid hit us in the first weeks of last year, it was all about health and safety, liquidity control, etc., so every third week we had updates with our LPs, then it was every six weeks and then it returned back to quarterly webinars. We recorded those webinars and made them available for LPs regardless of if they are current or potential, new LPs, so it's been a good way to market ourselves toward investors, showing them how we actually work in practice. We can see that the number of LPs downloading these webinars is very, very high, so they are clearly interested in how we work.

Andrew, from a placement agent perspective, what did you see as some of the key changes and challenges around remote fund launches and fundraises?

Andrew Bentley: One of the key ways the pandemic has changed fundraising is increased accessibility. Everyone is sitting in their home office and nobody's out on the road. So accessibility has gone up and I think that's really helped us. The pandemic has also accelerated current trends, such as the very large houses proliferating new products and that acceleration presents a real challenge for the pure play managers in the mid-market, for first-time funds, for smaller managers and for managers with good but not amazing performance. As a placement agent, it's been a phenomenally efficient year for fundraising. Many LPs are saying they've invested more than they expected to and we've seen that timetables have been able to be more compressed and easier to organise.

There have been some differences though. One example is that it has been more difficult for us to assess exactly where each fundraising is because pre-pandemic you'd track who'd come to onsite DD, and then apply certain conversion metrics to that. When we assess our clients' fundraises today, it is not as easy because the DD sessions are more separated out, maybe three sessions not one, and they don't cost the LPs so much time to commit to. So we've been impressed by the number of virtual meetings we are getting from initial approach and the number of virtual DD sessions that have resulted from those first meetings, but have been slightly disappointed by how that's translated in a number of cases, into commitments. LPs are actually dropping out later in the process because they weren't really in DD, they were happy to take the meetings but they weren't mentally committed. So we have to view fundraising progress differently.

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> **Klas Tikkanen**

Simon King: Regarding general activity, we actually experienced a record-breaking year across the group and therefore, we continued to grow. It seemed like everyone was busier, whether that was new deals being completed very quickly at the beginning of the pandemic, existing clients launching new funds, and more established clients launching bigger funds. We also deal with third parties, such as regulators and registries, and it was good to see that they were generally in a robust state as well.

Transitioning to a remote environment seemed to go smoothly across the board and from an ESG and sustainability perspective, we were creating a lot less paper and doing a lot less travel. So while not meeting face-to-face did present some initial relationship challenges, particularly when building new relationships, it means we had to think of new and creative ways to build those relationships. I think the industry as a whole has done pretty well over the last year, all things considered.

Sophie, have you seen any examples of where virtual fundraises have worked very successfully in the last year?

Sophie Smith: As lawyers, we were able to adjust to a virtual fundraise environment fairly seamlessly. Unlike the DD process which tends to be more focussed on face-to-face interactions, much of our work with LPs has historically been done via email and conference calls so the way in which we engaged with LPs was not as affected by Covid. We did, however, see a shift in fundraising strategy over the last year as a result of Covid. When Covid first hit, sponsors, like many others, were unsure about the impact Covid would have on the fundraising environment. As a result, we saw a number of sponsors accelerate their closing timetables in order to close on LPs in process as soon as possible. This was a shift from fundraising in pre-Covid times, where sponsors would often wait until they had a significant portion of the target size before holding a first close. In addition, we also saw an increasing number of rolling closes, with investors being closed in as and when they were ready rather than sponsors holding fewer and larger closings.

After the initial rush, we did see the pace of fundraising slow down a bit, in large part due to a number of LPs suspending investment approval while the impacts of Covid were still unclear and adjusting to a new way of engaging with sponsors. However, this was fairly short-lived and things did start to pick up again by the summer as it became clear that this was the new normal, at least in the short term. While the operational obstacles caused by Covid (including the inability to conduct onsite diligence) resulted in some delays in the fundraising process, particularly for new LP relationships, our experience has been that most LPs are now comfortable with a virtual fundraising environment.

Has the pandemic led to changes or shifts in fund structuring at all?
Smith: I wouldn't say the pandemic has necessarily led to shifts in fund structuring, but we have seen sponsors seek to introduce increased flexibility into their fund documents to allow them to more easily react to the impacts of Covid. In particular, we have seen an increasing use of NAV facilities, both as a defensive mechanism to aid portfolio liquidity and as an offensive mechanism to bridge LP liquidity. We have also seen sponsors looking to remove caps on follow-ons to provide greater capacity to deploy additional capital into businesses that may have been slightly harder hit by Covid, or seeking waivers of diversification restrictions for the same reason. Other changes in terms include the inclusion of non-core buckets for additional flexibility (e.g. public equities, debt distressed and similar assets), revisiting pacing or annual deployment limits and broadening post-investment period investment restrictions.

King: Where I'm sitting, Covid has been more impactful on the operations than the fund structuring. The speed of reaction and ability to coordinate is the aspect that is most notably different from say last February to this February. Whether it's an operation of the fund structure, or even a closing process, which is also much more organised and structured, it's just so much smoother and quicker. Right from the coordinating that the city law firm does, through to the AML process, etc. Everyone is on it because there's a checklist as a control for everything. I think there's more transparency to the whole process now, which can only be a good thing.

How important has pre-marketing and the use of placement agents been in setting up a fund since the pandemic?
Bentley: We've just closed a fund that has been fully virtual. And by fully virtual, I mean, they've never met any of their LPs, not once ever. This is a first-time private fund for a group that have a a great track record from the public arena and the fact is that all the LPs who committed have relied on that exceptional record to get through investment committee stages. Especially for first-time funds, it's the texture of the relationship and the rapport that you have to generate to gain trust that underwrites the commitment, and that's really difficult to generate virtually. It really helps

LPs when they are figuring out how much they trust a GP to meet them. If a meeting is not possible, then LPs have to rely on referencing. One of the things we've really encouraged people to do is to ask LPs to refer to other LPs, or if LPs are looking at something and they don't know the manager so well, and it' fully virtual, to spend some time with LPs who have met them before.

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This actually goes slightly against the fundraising rules of don't coalesce your LPs together because you don't want them to worry each other, but in some cases it's really helpful to get the LPs to talk to each other so you can build that chain of trust. A good placement agent will give a lot of market context to the LPs about their manager and its strategy and explain what LPs will find in the DD process, and our introduction, I think, has got increased value in these times.

Welo: I still think pre-marketing is very important. There's an old saying that you're always fundraising as you're always out there talking to your customers. Although we have LPs on board that we've never met in-person, clearly most of them had a relationship with us already and so we have been able to build on that virtually. On the question about placement agents, the reason for using one is threefold; number one is advice, number two is to have people on the ground and number three is project management. I think especially on that advice from entering uncharted territory, as we did with the pandemic, most placement agents have managed to adapt quickly to the new environment and give good advice to their clients.

Going back to the point Andrew made about being proactive and using existing LPs as a reference point. Is this something you are seeing more of in the market?
Bentley: Many GPs find it difficult to ask an LP 'what other LPs would you suggest who would like my strategy?' because it risks showing weakness, but there are some mission-driven managers who should be doing it, and we're encouraging them to do it. LPs like to make referrals to other LPs, they just need to be asked.

King: It goes back to the point made earlier about everyone being more available. It's so much easier for an LP or a promoter to contact someone to get a reference, and I've definitely noticed an uptick in access to people within our company, or across our network, when it comes to due diligence from clients that are launching funds and their investors who want to know a bit more about it. So, it's made life probably more transparent again.

Welo: What I've seen over the last nine months is the number of LPs that have never heard of us, proactively reaching out to us now. It seems like, due to the pandemic, LPs are talking a lot more to each other and referencing each other because we cannot meet them face-to-face or at physical conferences. We've had a number of LPs reaching out saying 'I've talked to another LP and I've heard about your fund, are you out in the market? When are you coming out?'. Those types of requests have exploded over the last six to nine months versus the last three years.

Tikkanen: For us, it's been a bit harder to dissect if that's pandemic-driven because the Nordic Capital funds have had a quite significant uptick continuously year-on-year on our investment performance for the last ten years, and I think performance hit some sort of a hurdle level a couple of years ago that really catapulted the Fund X fundraise.

The pandemic has highlighted the industry's reliance on technology. How are you using technology to set up a new fund and what are the advantages of using these digital tools?

Tikkanen: We're using SharePoint instead of file servers and Microsoft Teams-based collaborations and chat tools. We've also integrated some more value-added aspects on the legal side that sits on top of Microsoft Outlook and SharePoint that helps with document handling. When the pandemic first started, we'd already started moving in this direction and Covid just accelerated that trend. Having embarked on this digitalisation journey, we're starting to see a lot of interesting Artificial Intelligence (AI) tools. One we are looking at allows you to run an engagement letter through the platform and it will highlight where it deviates from our policy.

Smith: We are increasingly using technology in order to streamline fundraising processes, including the use of electronic subscription agreements, side letter compliance software etc. However, the technology that is currently available in this area is still fairly new so I think it will take some time before we see it used in the mainstream. I don't think these developments are necessarily Covid-driven, but Covid has led to a greater acceptance of technology and the role it can play in the fundraising process, so I expect we will see an increased use of it over the next few years.

Welo: The technology shift we've seen during the pandemic is here to stay. For us, where technology has been most beneficial is in running quarterly updates online and we record them so it's on our webpage. This means LPs can watch the recording or download it and we can track this activity. Same for the AGM. So, I think leveraging data in investor relations going forward will be huge. It also means, for any future fundraising, you have the data ready to really track who has actually done their homework before you meet with them versus before, where it's almost a bit more of a different discussion. So I think the technology shift has really helped in that respect. In terms of tools, I think Zoom has been excellent because of the breakout rooms where the LPS can meet with CEOs, different partners or principals.

Considering these efficiencies, what is your view post pandemic in terms of investor roadshows and AGMs? Will you go back live or run hybrids?

Welo: It's a good question. I think with an environmental and ESG hat on, we will never go back to what we had before. Instead of flying from Tokyo to the one day AGM in Oslo or in Stockholm or Copenhagen or Munich, they will come on a weekly trip each year where they meet everyone one-to-one instead of coming to every AGM. I think that will change forever. It's interesting because we got the best AGM feedback ever last year, that was totally virtual. Of course, I think it's also because it was two hours instead of six hours; that was really helpful. But if you can give LPs on-demand videos of the portfolio companies and they can sit in their own time zone when they have time, instead of sitting on the flight, I think that way of doing things is history to be honest.

As the market gets more competitive at the moment, how can GPs differentiate a new fund coming to the market and attract investors?

Bentley: Differentiation is everything in fund marketing and many GPs understand that but some don't. For those that don't, they believe marketing should be about performance and if you're a good, solid manager you should be able to raise money. But for LPs, the reality is it's a question of what does this add to my portfolio? And it's got to add something. Very few LPs are just seeking quantum of exposure to a broad market basket, so funds have to add something in style or attraction. The only way, therefore, to keep the attention of an LP is to highlight the areas in which your fund can add something new or different. GPs also often misjudge which other GPs they are competing for capital against. LPs look at the market in a very different way to a target company looking for financing. And that's what fundraising for new investors is all about. I don't think the art of establishing ones differentiation is any different today than it was a year ago, but what the market is looking for has changed. Every GP today needs to be a tech GP because the standard of tech fluency that LPs are requesting from their GPs has significantly stepped up. Today growth investing is much more sought after so the axis between buyout and growth has become much more marked this year. For years and years, people wondered whether sector specialist funds were relevant and now sectors have been endorsed and people are even going into sub-sector specialisations in healthcare and technology. We're seeing that proliferate as LPs want more specialisation.

Tikkanen: Andrew, I think you're spot on with growth investing. We tilted the Nordic Capital funds into the growth

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model five or six years ago, and we were questioned for quite a while by a lot of LPs, especially in Europe, who were more in the value mindset. But now, I definitely feel a tailwind for growth-style investing. I mean, the average aggregate revenue growth in our model portfolios right now is quite high and I can clearly tell that this is also behind some of the inbounds we're getting. People are getting more comfortable about high entry multiples in relation to true underlying growth and I think in a very high-value environment, people are starting to look at the PEG ratios, looking at earnings growth in relation to the multiples paid.

People are more comfortable paying a 20x Ebitda multiple for something growing earnings at 20 per cent per year, than going for a classical value investment 12x multiple for something growing earnings at 6 per cent per year.

There's been a big push toward ESG-considerations in the wake of Covid. How much are you seeing LPs having that as a prerequisite in terms of the funds they invest in and is that a distinguishing factor in the marketing process?

Bentley: It's such a good question because ESG has been important for a while but it's importance has really accelerated over the last year with LPs quickly turning from Covid resilience back to more questions on ESG. The difficult thing with ESG though is whether it is possible to truly differentiate yourself with it when everybody's got to do it. I think there are firms who have differentiated themselves well on it historically, but harder to today now that it is a prerequisite for all firms.

Welo: A handful of LPs came into our last fund because of our ESG strategy and I think it's good to operate in our part of the world because we are fairly advanced. Clearly, your return is the number one criteria, so you need the return as a starting point but if you also do ESG well, it makes you even more attractive.

Tikkanen: I'm not convinced if this is a true deal breaker or not for LPs. But Nordic Capital are doing it because it's the right thing to do and it creates value in our portfolio companies.

On the margin, I don't think the investment committees actually allocate based on purely ESG factors, however LPs want to push GPs towards sustainable investing. I do think that the scoring and the independent verifications out there are improving. When they first showed up, I felt it was just greenwashing. But now, I do think many of them are helping push real change and sustainability.

What do you think the fundraising process will look like post-Covid? And, what pandemic induced changes do you think should be maintained?

King: In terms of technology, the use of Teams/Zoom, electronic signatures particularly and electronic documentation and data delivery have now been far more widely embraced across the industry.

One of the most important changes to come out of the pandemic, however, has been the flexible working conditions. I think that's here to stay and those who embrace it will do far better.

Smith: From a legal perspective, I don't think the fundraising process will change all that much post-Covid. The pandemic has definitely resulted in an increased reliance on technology which comes with positives and negatives. I personally have enjoyed the increased use of video conferencing over conference calls, but equally feel there is a lot of value in face to face interaction.

I expect where we will end up is a mix between the two - given the increased focus on ESG and in particular, the impact of travel on the environment, I expect more of the fundraising process will be conducted remotely than pre-Covid.

Tikkanen: I believe that the world is moving into a hybrid in that we will do much more virtually. But I also think we will resume traveling again, although our goal is for the whole firm to travel a quarter of what we used to. We need to resume traveling for cultivating those relationships, and I think our next fund will be bigger, so we need new money and there's really no substitute for sitting in the same room. On the other hand, I think due diligence will be mostly virtual, so I think there will be some sort of a hybrid going forward.

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