UPDATE

MAY 2020

Funds – Reflection and Projection, a Global Perspective

Update prepared by Frances Watson (Partner, Guernsey)

'The investment funds sector globally has experienced significant growth in recent years, despite being confronted by increasing regulatory requirements and a challenging geopolitical and economic landscape.'

Following the recent publication of our Global Funds Report, 'Global Funds through an Offshore Lens 2020', with contributions from 18 of our funds partners globally, we explore some of the key themes.

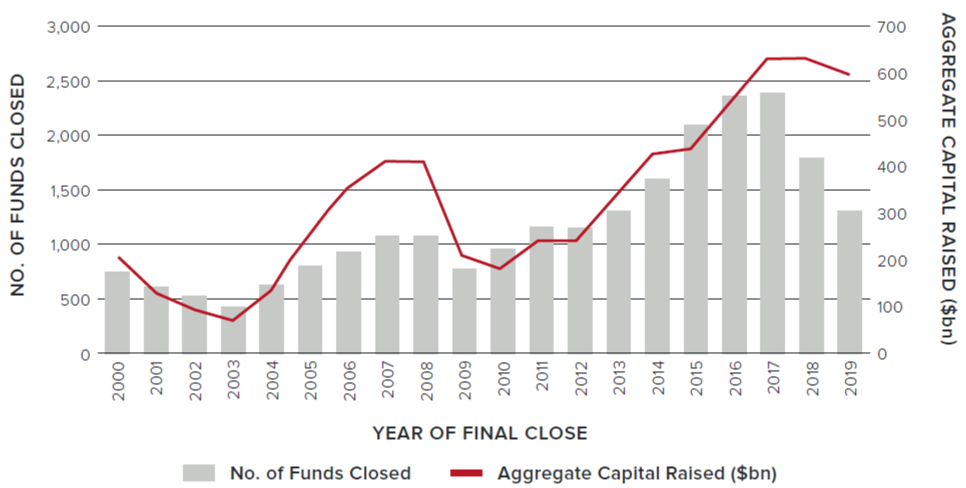
Introduction

In our Global Funds Report, we have drawn upon our experiences across our multiple jurisdictions, filtered through an offshore lens, to provide a global reflection upon the trends observed in 2019 and also to share our projections for 2020. In this summary we touch upon some of the key themes.

Fundraising – did capital flow in 2019 and other trends

As 2019 came to a close, data from Preqin painted a fascinating picture of global PE, notably a considerable fall, in recent years, of the number of funds closed offset against a relatively stable aggregate capital raised. This certainly reflects the experiences of our Mourant fund teams across our jurisdictions, with the data showing a clear correlation between the wider economic pressure in the early noughties, the period of the global financial crisis and market conditions beginning to turn during 2019.

FIG. 1: Global Private Equity Fundraising, 2000 - 2019



Source: Preqin Pro

Whilst the fundraising environment has proved challenging for small or first time managers, the large established managers have continued to dominate the market. In terms of Guernsey's share of this trend, most notably, 2019 saw Permira VII, a Guernsey domiciled closed-ended fund, successfully raise EUR 11bn on closing.

More generally, there has been some concern surrounding the impact that continued Brexit uncertainty may cause; however, the Channel Islands have proven to be well placed (already outside of the EU) to continue to offer a stable funds environment for managers looking to raise funds. As a result the private equity industry in Guernsey has continued to grow.

Reflecting on fundraising trends, in Guernsey we have noticed growth of private capital as a source for PE funds including club deals, co-investments and funds of one. As economic uncertainty increases, the use of these structures allows investors to pool capital and market expertise, which allows for innovative collaboration and expansion into different sectors with lower financial risk.

We have also seen continued investor interest and confidence in environmental, social and governance (ESG) funds, as witnessed by the successful $1bn fundraise for the Generation IM Sustainable Solutions Fund III. Arguably investment in PE is more aligned to ESG due to its longer holding periods and control over investments than one might find in shorter investment horizon fund styles.

The Guernsey Green Fund, launched in 2018 has continued to attract interest from managers looking to capitalise on the growing trend for green investing and promote ethical investment vehicles. Guernsey continues to see growth in this area, with green funds holding a total net asset value of £2.7bn[1] within the total for Guernsey funds by the end of the fourth quarter of 2019.

Fund Finance – the role leverage is playing

The use of traditional subscription line facilities has accounted for the majority of fund financings we advise on and at all levels of the market.

Whilst subscription financing remains mainstream, in the US market in particular we have seen an increase in the use of asset-back (NAV) facilities at both commitment/investment period stage and during later stages of the lifecycle of the fund (through hybrid facilities).

In addition across the US and Asia markets we have also seen an increase in working capital loans offered to general partners or managers of funds, typically secured by the general partner/manager's rights to receive management fees and/or fees actually received.

From an investor perspective, general partners are increasingly aware of the need for transparency with their investors and the need for investors to be comfortable with the lending relationship. LPs not only want to know about leverage disclosures at fund level and the impact on IRR but also how GPs are financing themselves.

Downstream Investment and M&A Activity – where is the money going?

Our corporate teams across our jurisdictions enjoyed a broad range of PE deal flow during the course of 2019. Healthcare, technology (including fintech) and energy were amongst the busiest asset classes globally and this was reflected in the transactions we saw.

Deal-making in the wider healthcare sector in 2019:

£533bn ↑

26% up from previous year

M&A in the technology sector in 2019:

£529bn

↑ 4% up from previous year[2]

[1] https://www.gfsc.gg/industry-sectors/investment/statistics

[2] https://fortune.com/2019/12/31/super-mega-mergers-deals-2019/

2021934/77930328/1

In addition, our Channel Islands offices continued to see strong deal flow in the commercial real estate sector, despite initial concerns that Brexit may slow the demand. This may have been aided by the UK legislative changes surrounding capital gains tax in April 2019 which led to a number of restructurings in favour of the Channel Islands.

Regulated financial services businesses offshore have continued to be of interest to private equity investors who have been driving continued consolidation in the offshore fund servicing and broader fiduciary services markets, most notably in the Channel Islands.

Projection – What are we expecting to see in the year ahead?

- Fund raising. Undoubtedly there are challenges ahead. Owing to the current geopolitical and economic uncertainty there are record levels of, as yet un-deployed investor funds, estimated by Preqin to be $2.44tn at the end of June 2019[3].
- Even though our report was commenced before the COVID-19 pandemic, our outlook for fundraising in 2020 was that markets are becoming tougher, with firms looking to fundraise ahead of any potential downturn. This has been our experience to date in 2020. The best in class are still successfully closing funds ahead of headwinds, and our Guernsey funds team has been involved in a number of $bn closings including iCON Infrastructure Partners V which closed at $1.9bn in March only three months after commencing fundraising.
- The COVID-19 effect. PE has long been used to seeking opportunities in Black Swan events. Whilst it is too early to gauge how significant and how long term the disruption of investment opportunity will be as a result of COVID-19, we are seeing contractual terms being tailored to target consequences of market disruption and price swings as well as steps being taken to ensure that transactions are not de-railed by practical impediments.
- Fund Finance. With the potential for LP liquidity issues amid the economic impact of COVID-19, we expect that some managers may look to re-finance existing facilities in order to avoid potential defaults. This opens up opportunities to lenders to either re-inforce their existing relationships by showing flexibility or for new lending to be won.
- Increased role of technology. Whilst adoption of technology arguably has been slower in the funds industry compared to other finance sectors, in our view the role of technology will become more prevalent during these uncertain times and businesses will need to embrace technology more than ever.

  Indeed governments and regulators in our jurisdictions have already acknowledged the importance of embracing financial technologies, including recent changes implemented in Guernsey to recognise the legal effect of smart contracts. Furthermore, the Guernsey Financial Services Commission (GFSC) is a founding member of the Global Financial Innovation Network (GFIN) a network of international regulators and related organisations committed to supporting financial innovation. It will be interesting to see how this initiative develops particularly in light of the COVID-19 crisis and the challenges this has created for 'normal' business operations.
- M&A activity. We expect 2019's slowdown in M&A activity to continue into 2020. Global economic and political uncertainty, COVID-19 and the potential for a global recession pose risks to deal flow. However, out of depressed markets we are likely to see keener pricing terms for good assets, as well as distressed investment opportunities for viable businesses.
- Restructuring and Insolvency. We have not yet seen a rise in restructurings and insolvencies in the investment funds industry; however, given the current climate, commentators are predicting a significant rise in the number of cases. From an offshore perspective we expect to see increased business in this area over the coming year.

  Fund managers should ensure that they are well placed to react quickly and appropriately to any significant macroeconomic shock or liquidity event. A review of the fund's documents from an insolvency/restructuring perspective may help to ensure that all of the necessary tools are available, should they be needed later on.

[3] https:www.ft.com/content/2f777656-9854-11e9-9573-ee5cbb98ed36

As a firm with a global perspective we will continue to monitor the broad funds universe closely, with particular regard to the offshore market, and will advise clients on the opportunities and challenges accordingly.

Please see our Global Funds Report in full.

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