

### Placement Agents: Raise the Bar to Raise the Capital

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**The key to being a good placement agent is to help managers build better fund offerings.**

2004 is shaping up to be one of the busiest capital raising years in recent private equity history. A range of well-credentialed managers, including DB Capital Partners, GS Private Equity and Hastings Funds Management, have information memorandums in the market, or have signalled their intention to go to the market this year. In addition, attractive new entrants, such as Ironbridge and ABN AMRO are targeting larger, \$300 million plus, funds in the MBO/ LBO sector.

By late January, managers had signalled their intentions to raise over \$1.2 billion in new capital. An additional \$600 million to \$800 million in new raisings is likely to emerge during the year as AMP, Gresham Private Equity and Quadrant consider re-entering the market. This level of fund raising activity will place significant pressure on the resources of the concentrated gatekeeper community.

Many managers believe that, by international standards, the Australian gatekeeper process is slow and drawn-out. While there may be an element of truth in this impression, it is certain that the current spate of new offerings will do little to ease congestion. With the gatekeeper evaluation cycle taking up to 18 months to complete, many managers argue that investment returns are suffering as key fund transaction executives are drawn away from the investment coal face to perform the fund raising "dance".

One manager's response to the crowded domestic capital raising environment has been to search for over-

seas investors, as these investors can often provide a manager with a more immediate response to a funding request than their domestic counterparts. However, raising capital from offshore investors presents its own set of challenges, with the most trying of these not being long hours spent sitting in airport lounges and late night conference calls.

Another response to the challenging fund raising environment is to increase the likelihood of a successful raising by employing the services of a placement agent to professionally manage the process.

Fundamentally, placement agents help managers raise capital. "Raise the capital" may seem like a clear-cut role, but the reality is that attracting capital to a manager offering is a lengthy and complex process. It is not simply about having a Rolodex of investors; much more important to successful capital raising is excellent product design and development.

Institutional buyers of funds management products have very specific needs, tend to have sophisticated decision-making processes, and are generally very well informed. As such, there is little room in the market for offerings that do not match investor requirements.

Helping managers match the characteristics of their offerings to the needs of investors, while improving the quality of offerings, is at the core of the placement agent service. The fact of the matter is that getting the offering right is the only way to successfully raise capital.

In practice, good placement agents work with managers from the commencement of their capital raising cycles. This means working with managers to, inter alia: formulate an appropriate mandate and fund structure; define terms to meet market expectations; refine investment processes; ensure adequate resourcing and transac-

tion capacity; scrutinise team capabilities; draft an information memorandum; and prepare detailed and relevant due diligence material that is compatible with gatekeeper requirements.

Only once an offering is appropriately prepared will the placement agent set up meetings and presentation schedules with institutional investors.

While they are paid by managers, a good placement agent will always operate with an investor-centric mindset and a philosophy that aligns their interests closely with those of investors. Clearly, placement agents that put investors first have better relationships with the investing community and can therefore achieve better results for their manager clients. As a senior European placement agent remarked recently in *Private Equity International* (July/August 2003, Page 73):

"No investor is going to thank us for selling them a fund that fails to deliver and that can shut off a key prospect for future client funds. We need to deliver as clear a picture possible of a funds strengths and weaknesses [to an investor]."

In building long-term, quality relationships with investors, placement agents have little incentive to promote managers who are not ready for the institutional marketplace. Investors can take comfort in knowing that if a manager is represented by a good placement agent, the placement agent will be convinced of the quality of its offering. Quite simply, good placement agents are a quality filter for the good managers.

As any manager knows well, the time involved in preparing an offering for market is considerable. Placement agents alleviate the pressure on a manager's investment team, freeing it up to do what it is supposed to: earn money for investors.

Managers raising their second, third or fourth fund are particularly concerned with the loss of focus on investment portfolio management and exit issues which capital raising inevi-

tably produces. The use of a placement agent is seen simply as a prudent risk management tool. Investors benefit through an improved focus on the underlying investments, and managers, for once, pay the fees!

The Australian private equity industry has been slow to adopt the placement agent model. This contrasts with the international experience, where placement agents have driven private equity capital raising for more than 10 years.

Placement agents in Europe and the US charge managers a base fee plus around 2 per cent of capital raised. Up to 75 per cent of managers in these regions use placement agents, which suggests that many managers believe that placement agents add sufficient value to justify this level of fees.

As with other private equity fees, Australian placement fees are currently lower than their international equivalents, as the relatively concentrated private equity market has temporarily driven fees down. Once the market matures and international investors come to recognise the opportunity represented by the better Australian private equity managers, management fees and placement fees will adjust under global, rather than purely domestic, market forces.

The predominance of first time funds in Australia, small fund size, tight fees and some gatekeeper resistance have probably combined to delay the full emergence of placement agents here.

Some market participants have ar-

gued that gatekeeper resistance to professional placement agents may be due to a misconceived sense of threat or challenge. Placement agents aim to support the gatekeeper function by getting managers to better appreciate and comply with investor needs. There is no way placement agents can replace gatekeepers.

Those domestic gatekeepers who manage international private equity programs on behalf of Australian institutional investors are already very familiar with the placement agent function. These gatekeepers have developed an understanding of placement agents and now know how to sort the competent, value-adding placement agent from the opportunistic sales rep or spruiker.

The development of the domestic placement agent industry is being facilitated by a second set of forces: International private equity managers increasingly see Australia as an important source of long-term, knowledgeable private equity capital.

The trickle of well-credentialed managers of recent years, such as Bridgepoint, Energy Investors Fund and Trust Company of the West, is swelling to a more sustained flow. Growing local knowledge and manager selection skills will see falling reliance on the fund of funds "bundled" solution, and more inclination to select managers directly. Domestic placement agents are well placed to play an important role in the process by acting as a quality filter and providing global and regional managers with an understanding of the needs of

Australian investors as they "come on down".

2004 looks set to test whether placement agents have a place in the Australian market, as several domestic managers are opting to use the services of domestic and international placement agents. Where placement agents genuinely add value, presumably they will survive and prosper and a "market clearing price" for placement agent services will be established.

The year ahead presents more than the usual range of challenges and opportunities for Australian private equity managers and investors. The emergence of well-credentialed and capable placement agents in this market will hopefully help investors achieve superior returns, by requiring managers to improve their offerings and concentrate their scarce resources on deal doing, value creation and profitable exits.

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