OPALESQUE

PRIVATE EQUITY STRATEGIES

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In This Issue

Welcome to the latest issue of Private Equity Strategies. This month we are taking a closer look at the recent uptick in investor interest in Latin America. Our lead feature includes an interview with Cuba Avanza Partners, a new firm focused on investments in Cuba. Later on we highlight the latest LP survey from the Latin American Venture Capital Association which shows a strong interest from LPs inside and outside the region.

In addition to our normal Regs Watch column we have a piece looking at the potential for new enforcement actions from the SEC.

Private equity real estate funds are booming in 2016 and we caught up with New York-based Dome Equities to learn more about where they are seeing opportunities in the market - the answer might surprise you if you've been paying attention to the latest economic data.

Attorneys from Proskauer walk us through the complex web of fund restructuring,offering ideas for how to manage common conflicts that arise during that process.

Finally, we alert you to the launch of Bayshore Capital's second private debt fund, which relies on a unique multi-manager approach.

I hope you enjoy the issue. If you have any story ideas reach out to mccann {at} opalesque.com

LatAm Spotlight: Investors Head For Cuba

Bailey McCann
Private Equity Strategies

Latin America is once again in the investor spotlight when it comes to private equity. In this issue, we wanted to highlight new investor data on allocations to the region and in our opening feature wanted to highlight Cuba.

As relations have normalized between the US and Cuba, investors have moved quickly to find opportunities and funds that could get them exposure to this reinvigorated economy. Enter Cuba Avanza Partners.

Cuba Avanza is launching a fund specifically focused on investments in the country. The firm has a four person investment team along with two operating partners. The Cuba Avanza Opportunities Fund will be targeting $250 million for a handful of investments in the country. "We expect to see investments in areas like infrastructure, energy, telecommunications, to hotels, to ports. We'll also be looking at companies that can service the growth of the country as well," explains Michael Andrews CIO, Co-Managing Partner, in an interview with Private Equity Strategies. "We're going to be working with several operating partners in Cuba who have the experience on the ground already."

The investment team at Cuba Avanza, which includes Andrews as well as Co-Managing Partner Victor Hugo Rodriguez and Partner Ted Kanarek, circled around to the idea for the fund through conversations they were having about how to invest in Cuba and also regionally, throughout Latin America.

Alongside the normalization of relations with the US, the Cuban government is also

launching development zones to incentivize foreign investors like Cuba Avanza. The Special Economic Development Zone of Mariel, located near Western Havana, will offer special incentives to foreign investors that bring cutting-edge technologies that are environmentally sustainable into Cuba. The initial focus in Mariel will be on the development of industrial, agro-food, biotechnology and alternative energy sectors.

"The Cuban government has fully realized the need to attract foreign capital, and I think that issue is even bigger now when you look at what is happening in Venezuela," notes Kanarek. "They are fully aware that they have to work to develop new capital relationships."

The Cuban government remains a primary asset owner and a significant owner in many businesses throughout the country, but the team at Cuba Avanza thinks that the potential risks that come with high levels of state ownership can be effectively managed.

Potential investors seem to agree. "Everyone wants to have a conversation about Cuba," Andrews says. "We're really looking to help grow the economy in Cuba - we want it to be to the benefit of Cubans. We want to see the growth of a middle class there." The fund is institutional grade but has also captured the attention of family offices that are interested in frontier markets.

"I think a lot of investors are looking around and asking themselves what do we make of the last emerging markets - the frontier markets - and within that, Cuba has become an attractive target," Rodriguez contends. "It's very important to remember how close Cuba is to the US. It's going to be a very good relationship competitively for Cuba, to be so close to a very large investor base in the US."

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Regs Watch: SEC Cracks Down On Unregistered Broker Activities By Private Equity Firms

by Anthony Geraci | Geraci Law Firm

The Securities and Exchange Commission (SEC) granted a settlement offer on June 1 concerning violations by a Maryland-based private equity firm and its principal, Murry Gunty, of Section 15(a) of the U.S. Securities Exchange Act of 1934. Specifically, the allegations involved the breach of restrictions on providing unregistered brokerage services in addition to violations of Sections 206(2) and 206(4) and Rules 206(4)-7 and 206(4)-8 of the U.S. Investment Advisers Act of 1940 concerning fraudulent activity and material misrepresentation by financial advisers. The settlement resulted in the adviser disgorging the compensation he received as a result of his unlawful activity in addition to interest and a civil penalty.

The case, In the Matter of Blackstreet Capital Management, LLC, (SEC Release No 34-77959), represents the first instance in which the SEC has brought an action against a registered investment adviser for not formally registering as a broker, and as a result of their acceptance of capital garnered from transactions related to services provided to fund portfolio corporations.

Blackstreet gave advice regarding the acquisition and disposition of its funds' portfolio organizations, which periodically encompassed buying and selling securities, soliciting potential business arrangements, selecting clients, planning financial arrangements, and processing transactions. The subsequent fees for these services were undeniably lawful and duly reported in the governing financial reports. However, the adviser collected more than $1.8 million of transaction-related payments without ever registering as a broker, thereby breaching the broker-dealer registration mandates of the Securities Exchange Act of 1934 and prompting the SEC to seek enforcement action.

The settlement potentially foreshadows the SEC taking the position that in certain situations, transaction fees may not be collected by private equity funds unless they are registered broker-dealers, despite the fact that equity funds have historically claimed their services related to facilitating portfolio company transactions does not involve activities that would mandate their registering as an official broker.

The Securities Exchange Act of 1934 prohibits a broker to "effect any transactions in…any security…unless such broker or dealer is registered," and defines "broker" as "any person engaged in the business of effecting transactions in securities for the account of others." It follows then that a fund would only be required to register as a broker-dealer if it "engaged in the business of effecting a transaction" in securities for a third party. The Securities Exchange Act, however, is silent as to what constitutes being "engaged in the business of effecting transactions," the only guidance within the industry being SEC press releases, or enforcement actions and federal court decisions on the matter.

The SEC initially hinted at their impending investigation of unregistered brokerage activity in an April 2013 speech by David W. Blass, SEC Chief Counsel of the Division of Trading and Markets. He said his staff was "putting an increased examination focus on private fund advisers," specifically instances in which "the private fund adviser…receive transaction-based compensation for purported investment banking or other broker activities…[and] inappropriately claiming to rely on exemptions to avoid broker-dealer registration."

Following the SEC's successful enforcement of unregistered broker activity against Blackstreet, there is industry-wide speculation as to whether private equity advisers should cease collecting similar fees or should instead completely offset them against the management payment. Current market data trends indicate these fees are routinely being offset, either in part or in full, against the management compensation afforded to advisers. As a result of the Blackstreet settlement, investment advisers could avoid similar potential prosecution by examining any transaction-related fee agreements to determine if they constitute services requiring broker registration.

Regs Watch: Brief Updates on Changes in Regulation for Private Equity

As journalists like me and lawyers have written ad nauseum, new and ever more regulations are in the pipeline for private equity and alternatives as a whole. Here we will hit on some of the cases of note and provide links to new guidance over the past month.

SEC's Focus on Private Equity Firms Continues with Recent Action

The SEC is continuing its enforcement actions against private equity firms over a whole host of issues including fees, expenses, and operations. Read More.

SECP grants first licence for private equity fund

The Securities and Exchange Commission of Pakistan (SECP) has approved the first application filed by a non-banking finance company (NBFC) under the newly promulgated Private Fund Regulations 2015 for undertaking private equity and venture capital fund management services. Read More.

Private equity: European Parliament's amendments to new Prospectus Regulation

The European Parliament has resolved to adopt amendments to the European Commission's legislative proposal for a new Prospectus Regulation. Read more.

Does Self-Regulation of Private Equity go Far Enough?

The Securities and Exchange Commission has settled with three private equity firms about their alleged disclosure of fee arrangements, and in at least one case the SEC was alerted to the transgression by the firm itself. Read more.

Final U.S. Debt-Equity Regulations Are Not as Sweeping as Feared

On October 13, 2016, the Treasury Department released final regulations (and related temporary regulations) under section 385 (Final Regulations).1 The Final Regulations recharacterize certain issuances of related-party debt as equity for U.S. federal tax purposes. Read more.

House Passes Bill to Curb Private-Equity Rules

House lawmakers on Friday approved a bill to ease regulatory requirements on private-equity managers, legislation that the White House has threatened to veto. Read more.

Regulatory risk is the growing roadblock for Canadian takeover deals

The rise of regulation has now added to deal risk. Read more.

Private equity: AIM Regulation statement on MAR

AIM Regulation has published an Inside AIM statement confirming its position on the issue of the 30-day closed period requirement, together with some FAQs for AIM companies and their nomads on the disclosure obligations within MAR and the AIM Rules. Read more.

Listed private equity funds set for a comeback

The Financial Times reports that, listed private equity funds are moving back into the mainstream for individual investors after years in the wilderness.

The funds have traded on big discounts since 2008, when they were largely deserted by smaller investors. They have since spent the best part of a decade trying to win them back.

Utz Gets $146M Cash Infusion from Private Equity

A private equity firm has invested more than $146 million in Pennsylvania snack food company Utz. Metropoulos and Company announced their investment Wednesday.

The Rice family, which owns and operates 95-year-old Utz, will remain majority shareholders. Utz, based in Hanover, Pennsylvania, has made a number of acquisitions in the past five years, including Good Health pretzels and veggie straws and Zapp's potato chips.

Movers & Shakers: Dome Equities Zeroes In On Multifamily Rentals

by Bailey McCann
Private Equity Strategies

Private equity has been booming for the past few years, but record distributions back to investors have left many LPs with cash to burn. In this environment, private equity real estate funds and other real estate investments are becoming more popular. Institutions, family offices and individual investors alike are looking for income generating investments and real estate can be one option.

New York-based Dome Equities, a $1.27 billion private equity real estate firm is making a big bet on multi-family properties. Construction of multi-family units has been spotty this year, a recent Commerce Department report showed permits for the segment unexpectedly dropped in September. But permit numbers can vary month-to-month and some analysts expect numbers to start going up again in the fourth quarter.

"One of the dislocation points in the market is that the supply side is not delivering enough rental units so there is scarcity, which impacts rental prices," says Eric Jones, CIO at Dome Equities. He says that a combination of demographic factors are likely to keep demand for multifamily units strong even if there are episodic drops in permits for new buildings.

Why is that? "We've seen that the group of people who are primarily renters has grown significantly since 2008 and we expect that trend to continue," Jones says. "Millennials are buying homes much later in the life if they are buying them at all. Others have discovered that home ownership doesn't always work out."

Millennials have also been flocking to cities in favor of a lifestyle less dependent on long commutes that are common to the suburbs. Cities often hold better job prospects and other benefits that appeal to this age group. As a result, Jones says, cities like Atlanta, Denver, Nashville, and other mid-sized cities are having to ramp up production of multifamily rental units considerably in order to meet increased demand. Jones says occupancy rates are up nationwide which can mean higher rental prices - a boon for investors in properties.

"We see this as a trend that will continue for at least the next five years," he adds.

Dome's strategy for finding investable properties centers on these growing markets. Jones and his team rely on financial models that rank local risks against local demographics in order to find the strongest targets. Unlike developers that only want to start fresh, Dome will also invest in properties that need updating or repositioning . The investment team then engages a partner network to update those buildings and make them available as rental properties.

As an example of its turnaround strategy, earlier this month, Dome acquired Vista Pointe, an institutional grade apartment community located in the Valley Ranch master-planned community of Irving, Texas.The community was built in 1996 and consists of one, two, and three bedroom units. Dome plans to update the 20-year-old apartments with new interiors and fixtures and will work with a Dallas-headquartered multifamily operator to manage the property.

"Irving is a diverse, strategically located city in an above average growth metropolitan area. Managerial and professional service growth are leading this economy on the back of a number of major corporate relocations," Jones says by way of explaining the deal. "A high concentration of corporate headquarters, technology businesses, banking, distribution infrastructure, and above-average population growth are leading sectors longer term."

For properties like Vista Pointe, Dome's average holding period is 3-years while the building is updated. The modest holding period makes for a relatively dynamic portfolio compared to other private equity strategies. Looking forward, Jones says he expects to see this opportunity set remain strong, potentially expanding to more mid-sized cities as more people opt to become lifelong renters.

Data Snapshot: LPs Increase Allocations to PE In Latin America

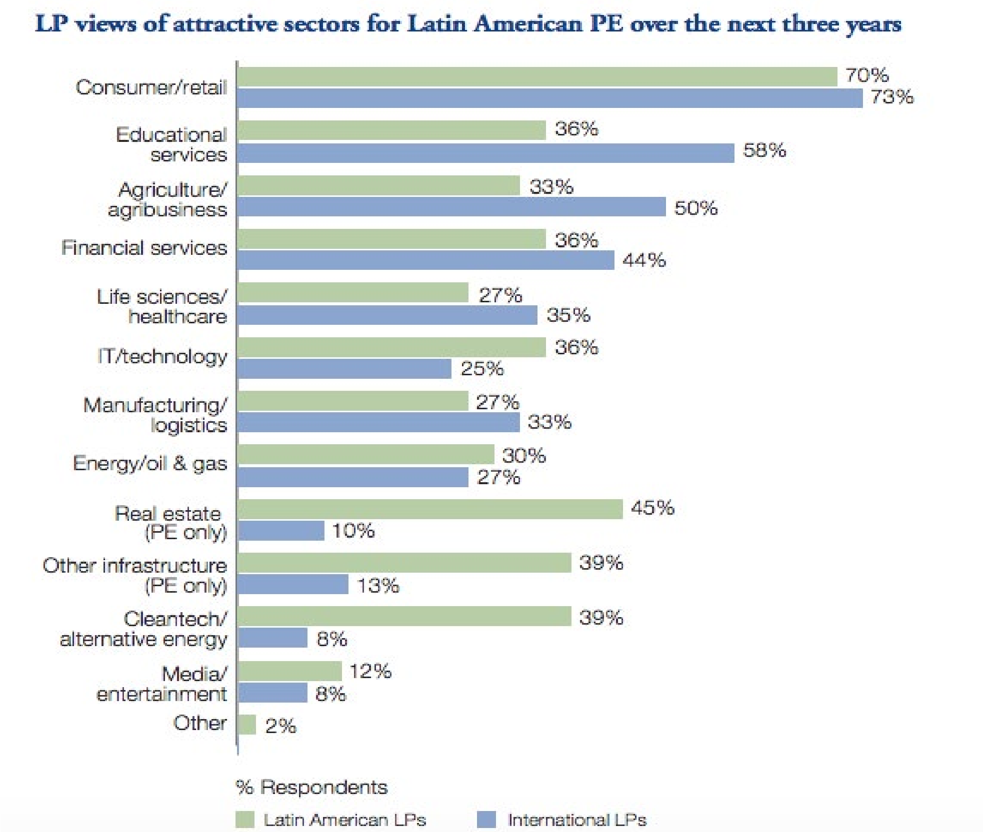
by Bailey McCann
Private Equity Strategies

Continuing with our LatAm spotlight - LPs in a recent Latin America Venture Capital Association (LAVCA) study said that they plan to increase their target allocations to private equity and venture capital in the region. Over two-thirds of Latin American LPs and about half of international LPs are planning to increase their target allocations to PE and overall alternative assets in the next 12 months. The LP study was completed by LAVCA and Cambridge Associates.

44 percent of Latin American LPs also anticipate increasing exposure to real estate and private debt. What's the reason? According to investors, entry valuations and deal flow appear more attractive in Latin America than in other emerging markets. Investors also say that the macroeconomic picture across Latin America is more attractive than other emerging markets which have less diversified economies.

But, not everything is rosy when it comes to the region. LPs are concerned about currency volatility and political risks - both of which have already been exhibited in countries like Argentina, Brazil, and Venezuela.

To get around pockets of risk, pan-regional funds are still the most popular vehicles among LPs that want Latin America exposures. Nearly 80% of international LPs and over half of Latin American investors expect to access Latin American PE via pan-regional funds in the next three years, according to the study. Investors are also showing a preference for buyout and growth capital strategies. The graph below highlights sector exposures that investors are interested in -



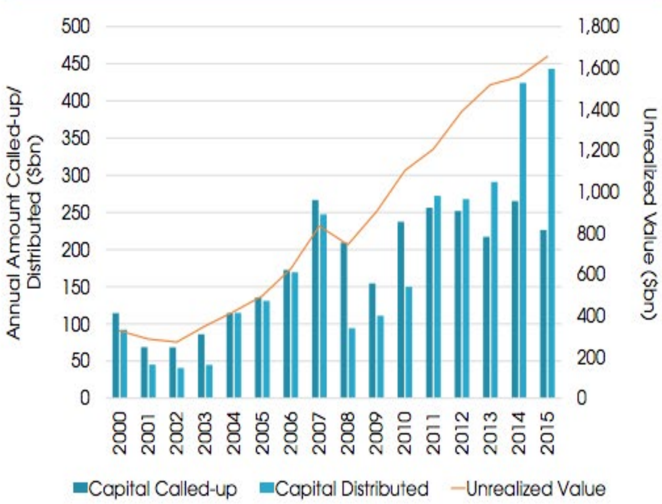
Data Snapshot: Private Equity Equity Firms Distribute Record $443bn

by Bailey McCann
Private Equity Strategies

According to new data from Preqin, private equity has completed its third year of record distributions to investors. The industry gave back $443 billion to investors over the report period, marking a slight increase from the $424 billion they distributed in 2014. This is compounded by the falling level of investor capital that fund managers called upon through the year, which fell from $265 billion in 2014 to $226 billion in 2015. Overall, the total net cash flow for the private equity investors was a record $217 billion, accounting for the majority of the combined $335 billion in net capital flowing to investors across the private capital industry.

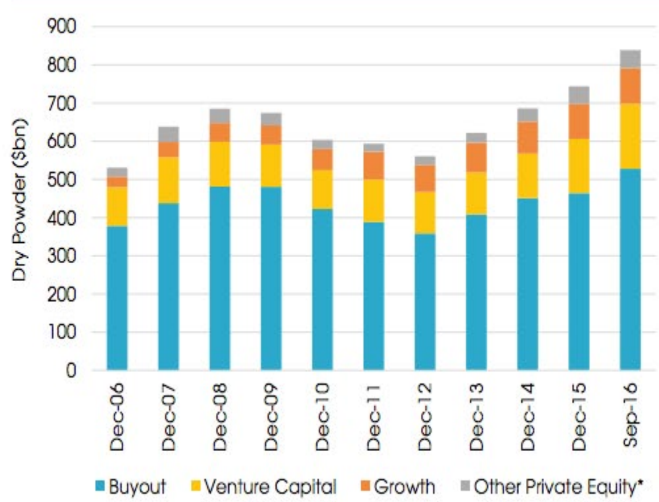
However, the lower levels of capital called up from investors has spurred the total level of capital waiting to be deployed by fund managers to new record highs. As of the end of 2015, the private equity industry held a total of $2.41trillion in assets, of which $1.66 trillion was the unrealized value of investments still held by fund managers, and $757 billion was dry powder. As of the end of Q3 2016 however, the total dry powder in the industry has risen sharply to $839 billion, far above any level previously seen.

Fig. 1: Private Equity: Annual Amount Called-up, Distributed and Unrealized Value (As of 31 December 2015)



Source: Preqin Private Equity Online

Fig. 2: Private Equity Dry Powder by Fund Type, December 2006 - September 2016



Source: Preqin Private Equity Online

Fund Restructurings: How to Navigate a Conflict-Rich Environment

by Michael Hackett, Timothy Mungovan
Proskauer

The number of private equity fund restructurings is likely to rise in the coming years. The current economic expansion will inevitably come to an end (at 87 months and counting, this expansion is already the third longest post-WWII) making exits more challenging, just as the terms expire on funds raised during the "golden era" (2003-2007). At the same time, some managers will seek to continue managing certain portfolio assets, by extending the terms of the funds and/or restructuring the funds to bring in new capital and provide liquidity to existing limited partners.

On a simplified basis, a restructuring often involves the manager forming a new fund (with a combination of new LPs and continuing or "rolling" LPs) and the new fund merging with or otherwise acquiring the remaining assets of the existing fund. The influx of new cash from a secondary buyer creates liquidity for some existing LPs to cash out. The purpose of the transaction structure is to give the manager additional time to maximize the value of the portfolio, while providing liquidity to those investors who prefer an immediate exit.

While a completed restructuring, when done correctly, has the unique ability to re-align the incentives and objectives of managers and LPs to create long-term value, the SEC has signaled that it has concerns that certain aspects of some restructurings may be abusive. In particular, the restructuring process can be highly complex and fraught with conflicts of interest. As such, restructurings require extraordinary prudence in planning and execution.

Fund restructurings almost always occur when things have not gone according to plan. The fund may be at or past its term, portfolio assets may be illiquid in whole or in part, the sponsor may be facing a clawback or not receiving management fees, or the prospect of carry may be unrealistic. Despite these circumstances, the manager believes not only that certain assets in the fund have substantial upside, but also that the manager is in the best position to achieve that upside. Meanwhile, some LPs may desire liquidity or a cessation of management fees. Other LPs may see value in the portfolio on a longer-term basis and would be willing to forgo liquidity and maintain (or even increase) their commitment for additional follow-on financing.

Restructurings often are rife with actual and potential conflicts of interest. Most – if not all – of those conflicts involve the manager. Given that the manager owes a fiduciary obligation to the existing fund and the new fund, and the manager owes duties and obligations to the LPs (both current and new), prudent managers should work to identify all of the potential conflicts and address them head-on.

There are at least six relationships that could involve a conflict of interest in a restructuring:

Within the Sponsor/Management Company: The sponsor should be mindful of a restructuring's impact on alumni (of the sponsor), particularly where sponsors owe continuing duties to alumni or alumni owe continuing duties to the sponsor (g., clawback obligations). A restructuring that involves a "roll" to a new fund may strip alumni of future economics, or a restructuring may delay liquidity for certain alumni. Depending on obligations and expectations, alumni may object and even attempt to block a restructuring. Alumni may also object to clawback payments that may be required as a condition to restructuring.

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Sponsor and Cashing-out LPs: To effectively restructure the fund, the sponsor and/or secondary buyer may need or want a certain percentage of the existing LPs to cash out (to make room for new investors and/or reach a certain minimum threshold for the secondary buyer to engage in the transaction). Nevertheless, the sponsor should ensure that cashing-out LPs understand that they will not participate in any potential "upside" in the portfolio.

Sponsor and Rolling LPs: The sponsor and/or secondary buyer may need or want a certain percentage of existing LPs to "roll" into the new fund. The sponsor should generally treat existing LPs as "new" investors – even if they are familiar with the portfolio and the risks and opportunities. As such, the sponsor must disclose all of the "risks" of the transaction, including unique risks applicable to the new fund. In addition, sponsors must be careful about imposing additional obligations on LPs who want to roll, such as an additional financial commitment to the new fund. Such "stapled financing" – where it is obligatory to "rolling" with the asset – could be viewed as coercive and a conflict of interest.

Sponsor and New LPs: Similar to rolling LPs, the sponsor must disclose the "risks" to new LPs. In addition, the sponsor should maintain an arms-length relationship with new LPs, especially where the sponsor is viewed as needing the new LPs to restructure the fund and re-set the sponsor's economics. The disclosures to the new LPs should be the same as to the existing LPs.

Sponsor and Portfolio Company: Where the sponsor has designee(s) serving on the board of directors of portfolio companies, the sponsor must be cognizant of the fiduciary duties that its designees owe to the shareholders of the portfolio company. Depending on the percentage of the company that the fund owns, and the stock restrictions in place, the company and its stockholders may be better off pursuing a different transaction. In addition, the sponsor must comply with the restrictions and limitations set forth in the stockholders agreement, such as a ROFR. Finally, where the portfolio company is publicly traded, the sponsor must be mindful of reporting obligations and liability risk for short-swing trading under Section 16 of the '34 Act. Surmounting this multiplicity of conflicts requires careful planning and execution, along with close coordination with experienced legal counsel.

In closing, the key for sponsors to limit their risk is to ensure that all parties are provided the full and fair disclosure necessary to make an informed decision of whether and how to participate in the restructuring.

This is the first in a series of blog posts discussing risk avoidance and management in fund restructurings. In future posts, we will explore some of these topics in further depth.

Bayshore Capital Advisors Launches Second Private Debt Fund

by Bailey McCann
Private Equity Strategies

London and Tampa, Florida-based, $250 million investment advisory firm, Bayshore Capital Advisors is launching its second private debt multi-manager fund. The Global Alternative Income Fund is an actively managed multi-manager fund that will invest in short to moderate duration loans and other cashflowing assets. The fund is targeting a 9-11 percent return, according to fund documents reviewed by Opalesque.

The fund will launch on the Montlake platform with $20 million in initial capital.

The core strategies of the fund include direct leveraged lending; specialty finance; asset based lending and trade finance. The average loan term for its short duration loan strategy will be 12-24 months.

The fund will be constructed of six managers. Three will focus on asset-based lending globally, another will manage a North American-based speciality finance sleeve and the remaining two strategies will be North America based direct leveraged lending and global trade finance.

The Global Alternative Income Fund is following the strategy laid out in Bayshore's first private debt fund - the Alternative Income Fund I, which is closed to outside capital. That fund has provided an 8.4 percent annualized return since inception and is up 4.7 percent year to date.

According to sources familiar with the launch, Bayshore has assembled the multi-manager strategy in order to focus on short duration assets with higher yields. Bayshore predicts that the market for direct leveraged lending is poised to continue its growth trend in the US and soon, the market will start to take off in Europe as Basel III puts new pressure on traditional bank lending.

Managers included in the fund specialize in niche opportunities across the entire universe of private debt. Through those managers, the fund expects to amass a loan book of more than 125 loans.

Quick Hits

Bought: German bandage and plaster cast maker BSN Medical has attracted interest from a number of peers and buyout groups in a deal potentially worth about 3 billion euros.

Fund News: Blackstone Group LP is looking to use a $3.3 billion permanent vehicle—a pool with an indefinite fund life—raised in 2014 to buy ownership stakes in hedge-fund managers and to take minority stakes in established private-equity firms, said people familiar with the situation.

Sold: Eastern Europe's largest e-commerce platform has been bought by a group of private equity investors in a $3.25bn bet on the rise of internet retail in the continent's emerging economies.

People: Thomas Carella Joins Warburg Pincus as Managing Director. Carella joins from Goldman Sachs, where he was a Managing Director in its Merchant Banking Division.

Fund News: Neuberger Berman closes $750m private debt fund, increasing the asset manager's private-credit business to $2.3 billion and rivalling existing players in the field.

Fund News: AlpInvest Plans $1.5 Billion Fund to Take Minority Stakes in Private-Equity Managers. Dutch firm joins several high-profile entrants.

Fund News: Kenyan private equity house Fanisi Capital is looking to raise $75-100 million for its second fund to invest in firms in East Africa, it said on Wednesday.

Fund News: ICD and Gabon to launch SME-focused private equity fund. The ICD will support the DCF to launch an investment fund that will have a positive impact in Gabon and Central Africa.

Fund News: Grand Rapids-based Auxo Investment Partners, has announced commitments for about half of the $50 million fund it is raising to invest in 10-15 small businesses over the next five years.

Fund News: Carlyle raises $3.6bn for debut long-dated PE fund. Launched two years ago, Carlyle Global Partners highlights fund managers' desire to pursue investments requiring longer hold periods than traditional 10-year funds may allow.

Events

Private Equity Investing in Healthcare Support Organizations

October 25, 2016 | New York
Hosted By: Capital Roundtable

Private Equity Investing in Transportation & Logistics

November 17, 2016 | New York

Best Practices for Sourcing Private Equity Investment Opportunities

November 29, 2016 - New York, NY
Hosted By: Capital Roundtable

Opalesque

Private Equity Strategies

PUBLISHER
Matthias Knab
knab@opalesque.com

EDITOR
Bailey McCann
mccann@opalesque.com

ADVERTISING DIRECTOR
Greg Despoelberch
gdespo@opalesque.com

www.opalesque.com