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Private Equity

Private equity funds target the wealthy as the hunt for yield intensifies

Despite being an illiquid asset, private equity continues to attract investors

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Axel Geuer wanted to invest in big private equity funds but could not get past the door. The German entrepreneur had wealth but lacked the hundreds of millions required to gain access to the largest buyouts, through funds such as KKR and Carlyle in the US and CVC and EQT in Europe.

Despite this seemingly insurmountable hurdle, he was still keen to be exposed to some of the largest names in an industry that is riding a wave of huge demand in an ultra-low interest rate environment.

The appetite of Geuer and others like him for private equity represents a big opportunity for the industry. Falling interest rates have driven investors desperate for higher returns towards private equity, in search of a bigger allocation in an industry known for making riskier bets and being illiquid. This growing interest comes at a time when buyout executives have been pursuing their largest deals since the financial crisis — the $10bn acquisition by Sweden's EQT of the skincare unit of Nestlé, for example.

"Big names are not really accessible to investors with a couple of thousand dollars or [even] low single-digit millions," says Geuer, who used to work at consultancy Bain & Co. "It's not easy, because these funds don't want a fragmented portfolio of investors."

The financial wealth of high-net-worth individuals (those with at least $1m in investable assets) is estimated at $70tn worldwide, according to Capgemini's 2019 World Wealth Report. Yet less than 5 per cent of this wealth is invested in alternative asset classes, including private equity.

Private equity groups are also increasingly buying large listed companies, such as the recent £6bn acquisition of UK leisure business Merlin by a group of investors led by New York-based Blackstone, and the £4bn purchase of UK defence supplier Cobham by Advent International of the US.

Amid rising demand from rich individuals to access top-tier private equity funds, new, smaller firms are emerging to meet it. Berlin-based Moonfare is one such new venture. With a minimum investment of €100,000 — well below the hundreds of millions large institutions usually place — investors can access blue-chip funds such as Carlyle and UK-based Cinven.

Among Moonfare's shareholders are former executives at US buyout giant KKR and London-based BC Partners.

Moonfare's Alexander Argyros © Moonfare

The business has attracted more than 300 investors in large funds in the two years since it was set up. Clients include bankers, chief executives, family offices and entrepreneurs such as Geuer. It charges half the management fees of a traditional fund of funds and is highly selective in the funds it offers on its platform. Within 15 minutes of investors deciding to place their money, it can be invested in between 10 and 15 funds with an internal rate of return (a closely watched indicator of performance) of at least 18 per cent.

Alexander Argyros, co-founder of Moonfare and a former KKR executive, sees significant momentum in broadening access to private equity. "Friends-and-family programmes at many private equity firms have a minimum investment of $1m," he says. "We estimate 5m wealthy individuals don't have access to private equity today."

As for the buyout giants, some are looking to tap wealthy individuals as investors, having exhausted their networks of institutional investors. Blackstone, for instance, began seriously courting this group of wealthy investors during the financial crisis a decade ago, explains Joan Solotar, senior managing director and head of global private wealth solutions.

"We did not, at the time of the financial crisis, have fundraising employees outside the US. Everyone was based in New York and it was small," she says. "We determined that we needed to diversify the source of funds. Today we're at scale in Europe and Asia."

Blackstone's growth in fundraising has lured in an increasing number of wealthy individuals as a proportion of its business: 14 per cent ($78bn) of the private equity group's assets under management are held by its private wealth division, says Solotar. "After the financial crisis, several countries [said] alternatives [were] risky investments, but if you look at performance through the financial crisis these were the best-performing assets," she says.

Blackstone's ambition is to increase the private wealth arm's share of assets under management. "I am very confident it will be multiples of what it is today," says Solotar. There are, however, hurdles to achieving that goal. Regulation, particularly in Europe, makes it difficult for funds to market their products. "In some European countries, for example, we are not allowed to call you as an investor in our funds. You need to have heard about the fund somewhere and call us," explains Solotar.

Private investors are often wary of the risks associated with investing in an illiquid class, many preferring to hold easily tradable assets or even cash in the bank. "If you are an adviser who has not traditionally allocated your clients' assets to alternatives, until you understand the structure and the asset class, and the risks fully, you are rightly not confident in making that allocation," says Solotar.

She says, however, that attitudes are starting to change. Citing an example of someone who has £5m invested, she says that putting all that money into low-interest bonds, for instance, means the investor is missing out on potentially high returns over time.

Axel Geuer

One problem has been paperwork, but that is changing, says Solotar. "We are now at an inflection point in the technology," she says, noting firms' increasing use of e-signatures, for example. "Ease of use makes a big difference to an adviser, who may have to process dozens of forms without compromising high standards of service."

Another hurdle for the private equity industry's fundraising efforts is that returns are predicted to fall, because funds — armed with record amounts of capital — are paying high prices for assets. This, in turn, could lead to lower returns once these companies are sold. "Private equity has become a very crowded field. There is more competition, so prices tend to be higher for assets. That means you will make less money," says Peter Rockefeller, senior managing director at investment bank Brock Capital, which advises companies on finance strategy.

He still believes private equity will remain an attractive asset class for investors. "An investor looks at the landscape today and where they can make the best returns. Returns in private equity are not as good as they were 30 years ago, but it is still a good place to put some of your capital.

"Investors have always been attracted to private equity, because it has really good adjusted returns over the years. The challenge has always been the willingness from private equity to look at individuals."

Figures from data provider Preqin show that top-quartile funds raised in 2016 have returned over 26 per cent on average, compared to 11 per cent for bottom quartile funds and 16 per cent for the sector as a whole.

Meanwhile, as more and more people look to invest in the top-performing funds, some buyout groups have been increasing their management and performance fees. Ludovic Phalippou, professor of financial economics at the University of Oxford's Saïd Business School, believes declining returns in the sector are a result of exorbitant fees paid by investors. "I do not see a drop in private equity returns just yet," he says, "but I would expect it for future returns, due to silly fee structures agreed during the boom."

Others argue that private equity will continue to produce better returns than their historical average and other assets. "The beauty of private equity is that you don't have the option to buy and sell like you do with stocks in the public market," says Emile Zakhia, a partner at Quilvest Private Equity, which manages the wealth of families and individuals. "It pays much more when you stick with your investment."

As for Geuer, he intends to pile into private equity investments in the coming years. "You have to be mindful that you have enough liquidity to make investments in this asset class. There is also risk and volatility," he says. "I would be satisfied if my net return for private equity is close to 10 per cent [per year]. It pays off to wait."