

Data Analysis in PE Markets

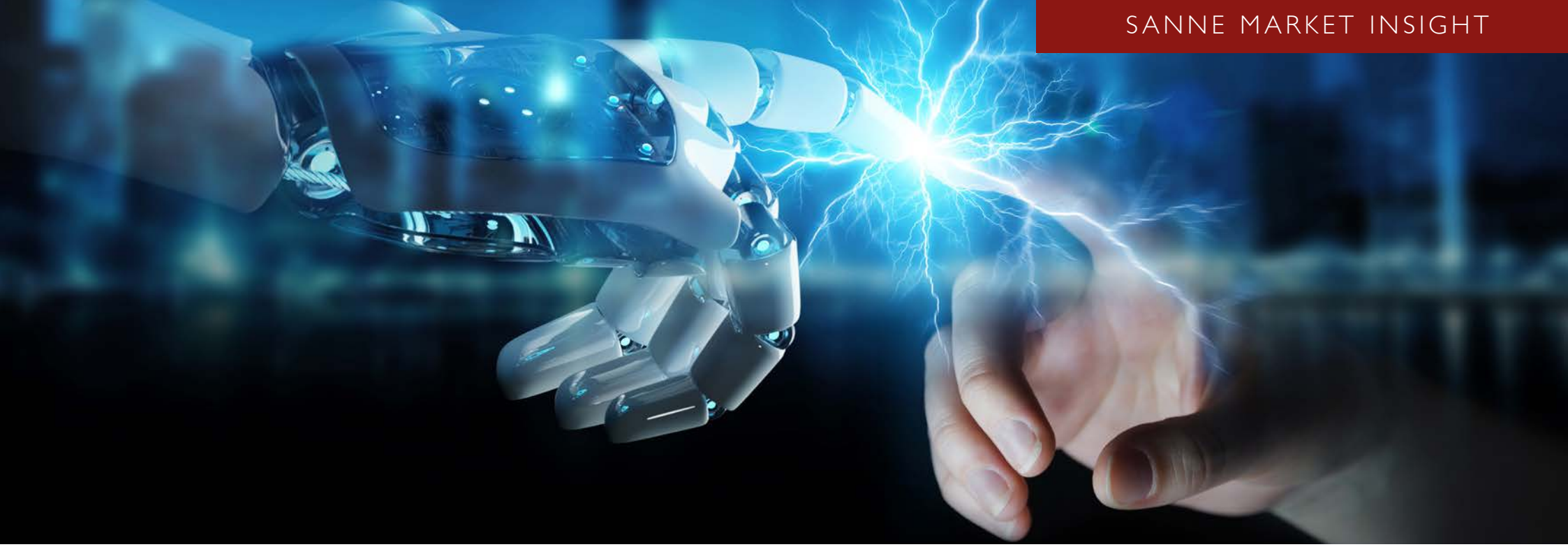
Market insight report

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It takes two to tango…

As LPs perform more data analytics, GPs look to strike the human/technology balance

Limited partners (LPs) are increasingly turning to data warehouses to improve the way they receive and analyse large amounts of data from private equity managers, to help overcome the challenge of non-standardisation.

Events over the last 12 months, as a result of the pandemic, have accelerated the need for LPs to gain an even deeper understanding of their PE portfolios. This has required general partners (GPs) to provide enhanced transparency through the dissemination of data, both at the Fund level and the individual portfolio company level, as LPs have moved quickly to analyse the effects of Covid-19 on private equity fund performance.

Though not without its challenges, advances in technology and the broad adoption of cloud solutions have made it easier for GPs to share data more quickly and efficiently. Over the coming years, this will likely lead to huge strides in the way institutional investors analyse their private equity investments. That being said, the way data is standardised and presented still has a long way to go, given that different PE groups are at different stages of evolution in terms of their data sharing capabilities.

The issue of how LPs are evolving their data analytical needs, and how GPs are responding in kind, was the focus of a recent webinar held by Private Equity Wire in collaboration with **Sanne Group**, entitled *How is data 'actually' being applied and analysed in Private Markets?*

The webinar garnered the views of the industry, from a GP, LP, fund services and global placement agent perspective.



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>
> Chris Thoume, Sanne Group

Data is nothing without insights

Quilvest Capital Partners invests in more than 300 private market funds across private equity, private debt and real estate. As such, data analysis plays a significant role in how the team manages its different portfolios.

According to Jean-Francois le Ruyet, Partner, Quilvest Private Equity, there are two ongoing data considerations; the first relates to pre-investment due diligence on funds, where a lot of data from GPs is needed before making a case to Quilvest's investment committee. The second relates to active investments, where Quilvest requires data to perform quarterly reviews of the underlying portfolio companies across all of its funds, to understand how each GP is faring.

No matter what the data might be, it needs to be shared intelligently, with insight. As Chris Thoume, Director, Product Development, commented: "It is about gaining insight on different parts of the GP/LP relationship and ultimately the underlying investments but it is really no good being transparent if it is being miscommunicated.

"GPs are having to be careful in terms of what they communicate and that their LPs are being properly supported. LPs are also very conscious about what level of information GPs can get access to from their portfolio companies. Is the industry actually keeping up with LP requirements? I think it is probably varied, given that GPs and their underlying portfolio companies are at different stages of maturity depending on where in the market they operate."

Opening communication channels

Over the last five years, investor relations executives have noticed a clear shift towards the provision of more technical, granular data. Whereas previously it was sufficient to send a quarterly report, and respond to the occasional ad hoc request in relation to a portfolio company, today the marketing deck needs to detail capital structures at entry, present day and exit (forecast), material financial movements in portfolio assets, changes in leverage, etc.

"We expect to provide true analysis on the portfolio and each of the PortCos in the AGM in order to explain why some investments are doing better than others in an holistic way to investors," said Gemma Braithwaite, Managing Director, Investor Relations at All Seas Capital, which provides equity and debt solutions to European mid-market companies.

In her view, increased data demands have helped to open up more transparent communication channels. "The move towards more transparency and understanding why a given strategy works has enabled me to understand a) which LPs are more likely to commit, b) which relationships to invest in, c) build better communication channels and d) make that initial conversation with an LP more efficient as I can cut to the data they are really interested in," commented Braithwaite.

Part of the reason for why LPs want more data relates to their desire to track GPs they don't have an investment relationship with "but would aspire to do so", according to Lucien Cipollone, Associate Partner, Capstone Partners, a leading global placement agent. "There is," he said, "a tendency for LPs to track managers over longer cycles – perhaps half of the fundraising cycle prior to the fund they want to commit to. This builds the relationship and provides a way for them to underwrite the GP, as part of the due diligence exercise."

LPs focus on portfolio company data

One of the key insights from the webinar was the fact that Quilvest requires data in two main buckets to perform the necessary analytics.

The first data set it looks at relates to the Fund: cash flow management, cash flow forecasts, future capital calls to plan for; that is, understanding the effect of the subscription line and when future capital is likely to be called

by the GP. The second data set relates to the underlying portfolio companies.

"We have a number of objectives: understanding quarter-on-quarter valuations, understanding multiples, and understanding adjustments to EBITDA," confirmed le Ruyet. "We need this data for valuation purposes and for risk management purposes. We like to understand the amount of leverage in the portfolio, what the various sectors are that we have exposure to, as a FoF investor. Having a better understanding of what the risks are, at the portfolio company level, in our PE portfolios is something I think more and more LPs will look for. It's certainly becoming more important for us, as investors."

When the global financial crash hit in 2008, there was a dearth of information being conveyed to investors as they sought to assess the impact. This left many investors burned by the process. Many lessons were learned, such that when the coronavirus crisis unfolded in 2020, GPs understood the importance of conveying as much data as possible on their portfolio companies.

Cipollone said that it was the "perfect setting" last year for managers to prepare multiple portfolio updates, very often on a monthly basis, on short-term liquidity requirements, impact on distributions to paid-in capital (DPI), on projected returns and so on. "This is all precious information that not only helps LPs with their forward planning, but also helps manage expectations, while reinforcing the long-term GP/LP partnership."

Data warehousing

Having more data on company leverage is helping LPs better analyse the impact on the fund's IRR. How easy it is for GPs to share this information will depend on the quality of reporting and IT systems, and the extent to which they can automate data management, thereby ensuring investors can access specific data sets; be they related to cashflows, leverage levels, ESG targets and so on.

At All Seas Capital, which provides both debt and equity financing to companies, emphasis is placed to clearly show where secured debt sits within the total balance sheet, and how this impacts the overall risk profile of the fund.

"Being able to explain positions on the balance sheet is fundamental to how investors understand our investment strategy," stated Braithwaite. "It is standardised in our quarterly reporting, where LPs can expect to see a forecast structure for every deal, at entry, at current and at exit.

"It is something we constantly discuss with our LPs so that they understand why we picked a particular structure i.e. inclusion of senior debt in one deal and not another, why we might think about a refinance halfway through a deal and release a bit of capital back to investors, etc."

LPs are responding to the data analytic challenge, internally – to ensure they can handle the extra data coming from their PE investments – by using data warehouses. "We are creating a warehouse for our data, which is close to 20 years' worth of data. We've been an investor for 45 years but until 2002 nothing much was done (from a data collection perspective)," remarked le Ruyet.

Sanne Group has noticed that a growing number of its clients, both GPs and LPs, are putting data warehouses in place.

"The cost of technology and the scale needed to access technology has reduced. We moved entirely into the cloud in less than six months to connect all of our systems and break down some of the historic barriers which restricted effective analysis of the large datasets we hold for clients," said Thoume.

Non-standardised data challenges

As investors look to their GPs to provide more transparency and bespoke reporting to better understand their liquidity needs, one of the ongoing challenges – as is increasingly cited in respect to ESG – is the lack of data



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standardisation. The Institutional Limited Partners Association (ILPA) released a **white paper** last June that looked specifically at how transparency and disclosures on the use of subscription lines of credit vary greatly. This is just one area of data analytics that LPs would find beneficial, if standardised reporting on subscription lines were to be used.

As ILPA notes in its paper, lack of visibility on how much of an LP's unfunded commitment has been deployed into investments but financed through a subscription line, as opposed to receiving a capital call, can make for a complex task when modelling liquidity exposure and the impact of subscription lines on net IRRs.

Le Ruyet pointed out on the webinar that it is important to look at the fund's IRR, in respect to the use of subscription lines, at the time of due diligence before investing in a fund. "It's the norm today," he said, adding that in order to overcome the wider issue of non-standardised data, Quilvest prefers it when GPs use investor portals:

"We find that portals are full of resources; case studies, articles, videos... you could spend days looking at all the data. Ultimately, this is why we have the data warehouse product, to try to handle all of the data coming to us in different formats and put it in one place for everyone to use.

"But it's a fine balance. Smaller managers don't have the same budget to a mega-cap manager (when it comes to sophistication of data delivery) so we have to understand there are limitations on some GPs to provide our wish list of data. At the end of the day, while data is important it is not 'everything'. Human interactions are key. This industry is based on partnership and trust over many years."

Curated data solutions

Part of the reason for why data is non-standardised is also down to the fact that PE firms often work with different silos of data within their organisations, as pertains to the finance team, the deal team, the investor relations team, etc.

This can make it quite a complex issue, when trying to collate all of those different data sets, before sharing them in a cogent, intelligent way with LPs. Those who rely on legacy systems, largely built around Excel and using non-automated workflows, can often find that getting the data in one place may sound simple in theory, but is a considerable task in practice.

Not all PE managers have the necessary scale of technology functions to access

these leading technologies, which is where a service provider like Sanne Group can step in and support smaller and first-time managers as they look to scale up.

"Ultimately, from an LP perspective, it comes down to the quality of information and understanding what each data point is. Whether it is the NAV inside or outside of carried interest, what the carry terms are in the fund, what individual company valuations are in the portfolio...these data points can be the difference between making a good decision and a bad decision. The important thing for us is to support managers in providing that information clearly and LPs in extracting that information.

"We give the GPs a curated data set to provide their LPs with a transparent message and insight. This allows the LP to carry out their analytics and enables them to get the transparency they want from their GPs," explained Thoume.

At All Seas Capital, Braithwaite is close enough to the deal flow to understand the idiosyncrasies, while on the finance side, she knows what the KPIs are that an LP is using to review the firm, "so that I can explain fund costs, or why an NAV might look odd in comparison to the investments made to date. I am the person who brings all of that different information together to provide a coherent narrative to the LPs," she said, when answering the question on data silos posed by a delegate.

She went on to say that one of the risks to GPs using portals is that the data simply gets plugged in, which can then make it difficult for an investor to understand why, for example, an investment delivered a 3x exit multiple as opposed to 3.5x.

"I like to have a bit more control over how we are sharing and explaining data. That said, we are considering using portals to host all of our data, so that investors can see what they've been provided with in the past and review it. That should help create consistency of data presentation.

"Ultimately, it comes down to quality of information and quality of insight; making sure we are providing the right answers so that the data given to our investors is both truthful and accurate," stated Braithwaite.

One of the key points made by le Ruyet was that how well a GP is able to provide data, for investors like Quilvest to perform analytics, is not related to where that manager is in their lifecycle; be it a new manager or a well-established manager. It is instead entirely dependent on the individual GP, and to some extent where they are located.

"Some geographies like the Nordics, for example, are home to managers that are more data-driven and organised compared to other regions," said le Ruyet.

"March/April 2020 was a time when we were looking a lot at how the unfolding crisis might impact the underlying portfolio companies in our funds. What is going to happen in respect to capital calls – are we going to be called more frequently to provide rescue capital? That was a period when we needed a lot of discussions and quality team with our GPs to understand what was going and what should be expected, from a cashflow perspective.

"I would say the vast majority of GPs in our portfolio are happy to share data because they understand why this data is being used."

Every cloud has a silver lining

One of the single most important developments in helping facilitate the way GPs share data with their investors has been the adoption of the cloud. None of the portals or data warehouses referred to above would exist were it not for cloud technology. Managers who have been around for 10, 20 years or more have vast repositories of historical data on their funds and their investors. But collating it to try and understand how the return profile of a particular fund vintage has performed over a specific period, for



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>
> **Lucien Cipollone, Capstone Partners**

example, is nigh on impossible if the GP is still relying on systems that are ill-suited to today's data management and analytic needs.

Just as established managers might struggle on the legacy system side of things, new managers struggle to afford the cost of putting cutting-edge IT systems in place. Rather that build things internally, it is becoming more cost-effective for these managers to partner with outsourced providers.

"We spend a lot of time with our clients putting them onto a fund administration and/or portfolio monitoring system and loading in all of the historical data to give them the track record and provide easy access to all of the firm's information. That's why we've created an investor portal and analytics portal in order to provide them with cloud-based capabilities," said Thoume.

"Take, for example, the importance of looking at whether it is a levered or unlevered IRR, and how that influences performance over time. Calculations like this can now easily be done at the click of a button. You can switch on and off the leverage on cash flows and see what the fund's IRR is, either over a defined period or from inception to date.

"The ability to give that information to GPs in a single portal and to their investors to monitor a fund's IRR, with out or without leverage, is providing a lot of transparency for LPs."

Capstone's Cipollone doesn't expect to see data standardisation becoming a default option over the short term but does concede it could happen over the medium term as more organisations adopt portals but the question this poses is, 'Would it still allow LPs to tailor information the way they wish?'

"Quite rightly every LP deserves, and asks for bespoke treatment because they want the data that is relevant to them. There is one major global consultant who has now asked all of its GPs to use its portal when reporting to LPs, both at the fund level and underlying portfolio company level," confirmed Cipollone.

In the end, it comes down to a trade-off

For now, although LPs like Quilvest agree it is worth striving to find some common ground, at the end of the day every LP is going to be slightly different; a pension fund is going to think about data analytics in a very different way to a single family office.

"Making the raw data more accessible would allow every LP to pick and choose the data that is most relevant to their needs. I think that is where the industry should move," said le Ruyet.

Braithwaite views the data analytics challenge as a trade-off: how much can be solved with technology and how much can be solved with the human mind?

"It's important to have people who can analyse the data, who know the story behind a portfolio company's development. It's a way of mixing the human and the technology together. Right now, I'm not confident about technology covering off and delivering the type of information I need an individual to check and analyse.

"People are monitoring GPs for longer and will require more data before they commit to a capital investment. Managing the reporting needs and making sure all of the data is correctly analysed and explained, in a consistent way, to investors to help them understand how the portfolio is moving, requires more brainpower than technological power," opined Braithwaite.

The upshot is that there is now a clear path towards improved data analytics within the private equity industry.

"As the underlying businesses that PE managers invest in digitise, and as financial services – and the world – moves to industry 4.0, everything we have talked about in this report will become easier. Friction points will start to erode, and this will allow for better partnership conversations between GPs and LPs," concluded Thoume. ■