



CLIENT COMMUNICATIONS: BEST PRACTICES
FOR PRIVATE EQUITY

Rationale

Strong client communications programs are meant to drive the process of building and maintaining relationships with investors. They can also be viewed as part of the fundraising process even though most of the activity is taking place at points when a fund manager is not actively fundraising but rather setting the table for future fundraising. The goal of such a program is the following:

- Highlight fund successes to increase market reputation
- Limit the impact of negative news by minimizing surprises and providing thoughtful explanations
- Maintain contact with investors in order to understand potential strategic changes that might affect future commitments
- Build and maintain strong individual relationships with investor staff that can be crucial during future fundraising or periods of performance or other challenges
- Reinforce a message of delivering as promised in order to build trust with investors

Fund managers need to be aware that there is often significant turnover on the staff of institutional investors over the normal three- to five-year period between raising private equity funds, making the communications process between fundraising even more important.

Transaction Announcements

Public announcements

Whenever a portfolio company is acquired, divested, or has a significant event such as an “add-on” acquisition or debt restructuring, limited partners should be informed. Often when a transaction is completed, a news release is agreed to among all relevant parties and sent to wire services for general release. This news release should also be sent directly to all investors simultaneously, usually by e-mail for instant delivery, either duplicated in its entirety in the body of the e-mail or sent as an attachment. The fund manager should also include a couple of explanatory paragraphs touching on points of particular interest to the investors that would not be included in the news release (such as approximate drawdown or distribution dates, estimated return on distribution, strategic fit of new investment, etc.).

Direct LP communications

In cases where there is no public news release regarding a portfolio company transaction, the fund manager should create an internal memo to the investors describing the transaction briefly so that they are informed of it prior to the next quarterly statement. The same holds for new investments made without a public news release. The format of such communication should follow the outline of a news release.

In addition, during the fundraising process investors should receive notification not only of the final close, but also of interim formal closes (unless rolling closes are used).

Note: Though many fund managers include descriptions of transactions about to be funded in drawdown notices, they should be aware that these are often directed to back office accounting staff not in charge of the fund manager relationship. It is useful to craft a separate communication strictly focused on the transaction and not the drawdown to be sent to the staff members at the investor in charge of the fund managers’ relationship.

Communication strategy for write-downs/write-offs in the portfolio

In the cases where an investment has been sold at a loss, a fuller explanation of the circumstances should be included. In addition, in the case where a substantial loss has been incurred, the fund manager should set up either a conference call for investors or contact the investors individually to discuss the situation. Members of the Advisory Board should be contacted directly, first and their advice should be sought on the best way to communicate this to the investors.

Regular Reporting: Quarterly and Annual Reports

Quarterly reporting to investors on the status of a fund is required by most partnership agreements. Though “bare bones” reporting can fulfill the requirement, a more extensive report will help educate investors not only on the specifics of the fund’s portfolio but also the market and economic environment while having the added benefit of enhancing the image of a fund manager and their franchise. This approach reinforces the perception of the fund manager as a genuine partner.

In very general terms, the format for quarterly and annual reports should include:

- Overview of fund news
 - Performance summary
 - Significant staff additions or departures/opening or closing of offices
 - New investments made during the prior period
 - Investment exits during the prior period
 - Significant valuation events (for example, an IPO that did not result in a distribution of cash or stock)
 - Current investment level and remaining allocation
 - Current investment pipeline (in general terms)
- Market/sector/geographic overview
 - More extensive in an annual than a quarterly report
- Portfolio company overviews
 - Original investment thesis and progress
 - Management changes
 - Summary financial performance
 - Projected exit timeline if under active discussions
- Fund financial statements
 - Audit letter (often only the annual statements are audited)

The format selected by the fund manager must reflect not only the sector and geography that they invest in, but their investor base as well. For example, a fund investing in growth capital opportunities in China with a substantial number of North American or European investors may need to concentrate more on providing information on the investment landscape beyond its portfolio companies, especially in its annual reports.

However, concentrating on value-added content for a report should not come at the expense of timeliness. Most institutional investors compile a quarterly report summarizing performance for their whole portfolio for their boards (or, for Funds-of-Funds, their clients). They usually expect to have quarterly reports 30 to 60 days after quarter end and annual reports 45 to 75 days after year end. Delays in reporting to investors can impact their ability to report in a timely fashion and can negatively impact your relationship.

The Institutional Limited Partners Association (“ILPA”) has a position on what it perceives as best practices on quarterly reporting, including standard templates. These formats have not yet become industry standard but provide a useful perspective on what a number of large investors are seeking for quarterly reporting. Details can be found at the following link. <http://ilpa.org/quarterly-reporting-standards/>

Annual Meetings

Annual meetings provide an opportunity to connect personally with investors and enhance relationships. They are also usually the setting for face-to-face Advisory Committee meetings (see separate section below). An overview of annual meetings follows:

Attendees

Invitations are often provided to multiple staff members for each investor and may include the head of private equity, the staff member in charge of the relationship, as well as others that may have been involved in the due diligence. If the investor used a consultant to assist with due diligence, senior staff from the consultant should be invited as well. Certain investors may have separate consultants who assist in monitoring their portfolio that may be invited, although this is more unusual.

At times, institutional limited partners who have not invested with a fund manager previously may be invited to attend as part of the pre-marketing process for the next fund. However, a fund manager should be judicious with these invitations so that they do not detract from the process of serving the needs of current investors.

Format

Annual meetings are usually handled as a series of meetings at a conference hotel, with separate lunches and dinners as required. Agendas often follow along the outline of an annual report, with presentations on the following:

- The fund's overall performance and availability of dry powder for future investment
- Strategic initiatives about to be undertaken or progress of previously announced initiatives
- Market environment for private equity, and when appropriate, the general economy as well
- Portfolio company performance
- Current investment pipeline (in general terms)

The biggest difference between the data provided in an annual report and an annual meeting is that CEOs or CFOs of selected portfolio companies are often asked to make brief presentations of 30 to 45 minutes on their companies in order to provide investors a more in-depth look at portfolio company products and performance. In emerging markets, for funds with a large international investor base, it is not unusual for a visit to a local portfolio company or two to be arranged following the formal annual meeting.

Fund managers who manage a series of funds with the same strategy often run meeting sessions as a series of annual meetings, with separate sessions for the investors of each fund. However, if there is a large overlap of investors in the series of funds, it is not unusual for the meeting to be held as a single event for all investors.

Depending on the topics that need to be covered, an annual meeting could last as little as half a day (for a first time fund manager without legacy funds and a small portfolio of companies early in its investment period) to two or three full days (for an established fund manager reviewing multiple funds with large portfolios). Cocktail receptions, lunches, and dinners are provided as necessary and are key for providing informal opportunities to connect and build relationships.

Location

Annual meetings are usually held in the home country of a fund manager, though they are sometimes held on a rotating basis overseas if there are a significant number of foreign investors in a fund. They are usually held in a conference hotel that has the facilities to serve such a meeting. However, due to various recent concerns, especially at public pension plans, scheduling an event at a luxurious resort hotel is likely to generate negative feedback and may prevent certain public sector investors from attending.

Rehearsal

An annual meeting is like any major investor presentation — it needs to be rehearsed in order to run as smoothly as possible. Not only the presentations but also responses to potential questions need to be practiced, especially if there are current issues or major initiatives or changes under way at a fund. The need for rehearsal also extends to portfolio company management that will present. The selection of companies to participate in an annual meeting should be driven not only by the attractiveness of the firm and the investment opportunity but also the presentation skills of the company management.

Note: A single bad presentation can negatively impact the tone of the entire meeting, and rehearsal is necessary to avoid this. Further, without proper practice, sessions can go on too long, disrupting the overall schedule and leaving too little time for the discussion of other issues that need to be addressed. This can make a fund manager appear either disorganized or uncommunicative on key points.

Entertainment

In the past, some large fund managers scheduled elaborate entertainment at annual meetings, such as high profile musical group performances or golf outings at high profile courses. This type of entertainment is now becoming controversial and can negatively impact the fund manager's reputation, especially with public sector investors. Certain fund managers have relocated annual meetings from resort hotels, while others have limited their entertainment choices so as not to be depicted as inappropriate in the media.

Advisory Committee Meetings

The Advisory Committee (sometimes called the Advisory Board) is typically composed of selected investors in a fund. The Advisory Committee members as a group and as individuals are meant to review certain key issues, such as potential conflicts of interest, and serve as a sounding board for the fund manager on a range of items. The Advisory Committee usually has regularly scheduled quarterly meetings, mostly by teleconference though usually in person in conjunction with the annual meeting. Thus, it is typical for the face-to-face Advisory Committee meeting to be held just before the full annual meeting. In addition, ad hoc Advisory Committee meetings can be held at any time to cover issues requiring immediate response.

The ILPA has a full description of how it believes an Advisory Committee and its members should function — although not all fund managers agree with all of the points outlined by the ILPA. (Advisory Committee material is included in Appendix A of the ILPA Principles, and can be accessed at <http://ilpa.org/principles-version-2-0/>.)

In addition to this formal role, fund managers often rely on specific members of the Advisory Committee with whom they have a particularly good relationship to act as a sounding board and select their opinions on how other investors or the formal Advisory Committee might react to certain initiatives or issues, such as:

- Senior staff departures
- Cross-fund investing
- Investing temporarily above fund concentration limits
- Timing of future fundraises
- The launching of a new business line (a new fund not of the same strategy as the current fund)
- Deviating from the fund's expressed investment strategy in a prospective investment
- Any issue that would trigger the need to seek an investor waiver of provisions in the fund partnership agreement, such as Key Man provisions

Sponsors/Observers

Fund sponsors that have an ownership position in the Management Company of the fund may be restricted from participating formally as voting members of an Advisory Committee because of their link to the fund manager. They are more likely to participate as observers. Observers can attend Advisory Committee meetings but cannot vote on issues brought to the Committee.

Ad Hoc Investor Meetings

Many fund managers try to meet with their major investors individually in the investor's home office once a year or so in order to develop and maintain a more personal relationship with the staff. These meetings include informal portfolio and market reviews and though the content of the meeting would not be materially different from a quarterly report, the objective is to maintain the personal relationships and provide an opportunity for more direct one-on-one questions.

Capital Call and Distribution Notices

Though more technical in nature, a number of investors are asking fund managers to provide them these types of notices in a specific format in order to lessen the burden on their back office of dealing with varying types of notices. The ILPA has proposed formats for these notices as well (<http://ilpa.org/capital-call-and-distribution-notices-template/>).

Written Communications and Disclosure

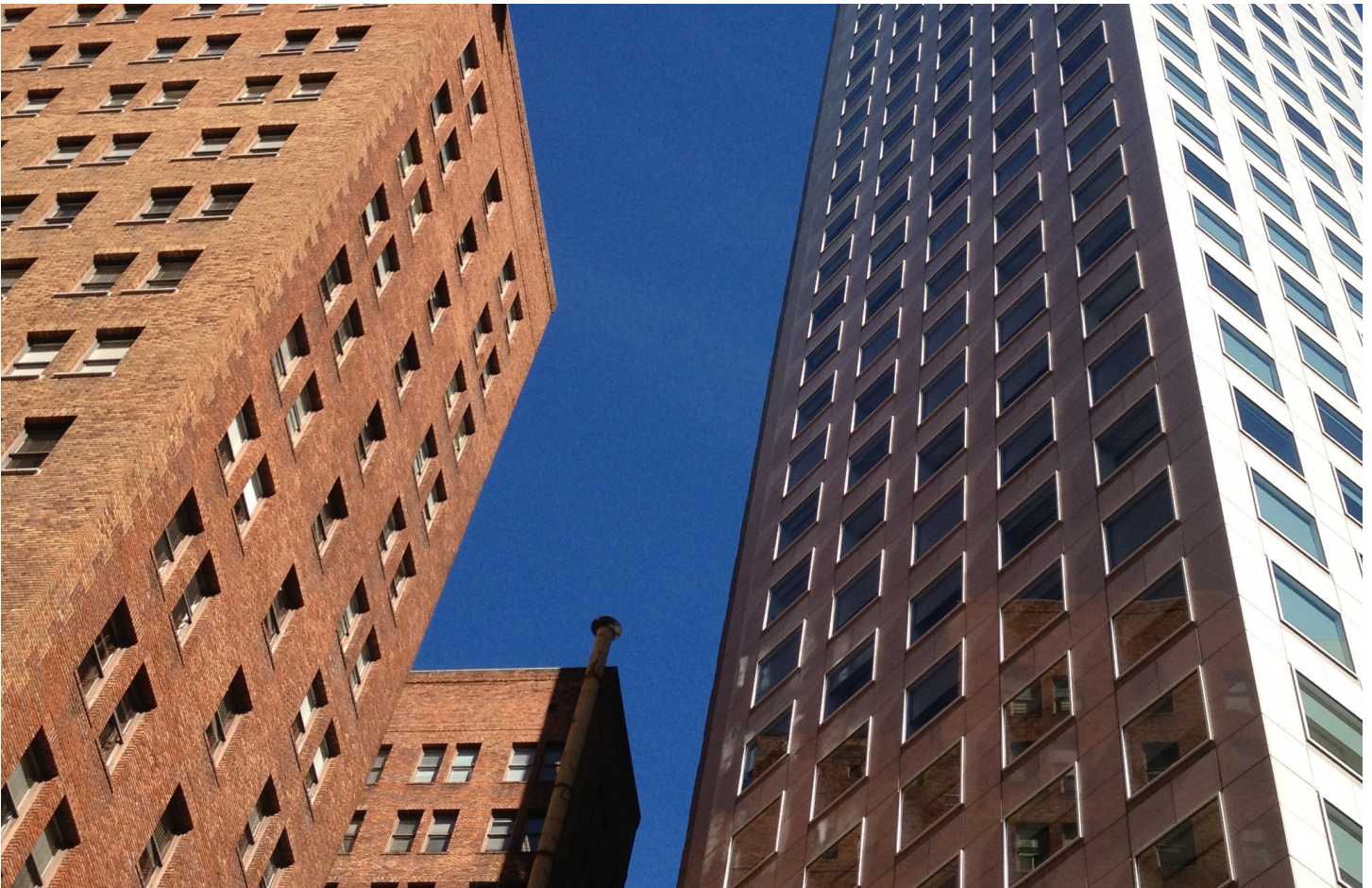
In certain countries, written communications with public sector investors are subject to disclosure, such as in the United States with the Freedom of Information Act. Unfortunately, these regulations are often at odds with the desire to clearly communicate with investors while maintaining confidentiality. Non-public information on portfolio companies is of most concern. Fund managers should consult with their fund formation counsel regarding what information should be shared with investors and what steps can be taken to protect truly confidential information that is disclosed to investors.

Any disclosure policy should cover all documentation provided to investors whether in hard copy or soft copy format, as these documents may be subject to discovery and disclosure.

General Advice

The foregoing is a guide to regular communication with investors and how to leverage that communication to fortify and enhance relationships. In the course of most funds, issues arise that as honest and forthright partners, fund managers must communicate to their investors. In such cases, there are a few common-sense rules to follow:

- You must communicate bad news or issues in a timely manner. If investors learn about issues or challenges from third parties, or worse, from the media, a fund manager's integrity is at risk, and the trust you have sought to build up will evaporate.
- Even in a rapidly developing situation, you must have a fully vetted, clear and well-prepared message and action plan; nervousness, hesitancy, or worse, a dramatically changing message can create more damage.
- You need to go to your most trusted relationships first to deliver bad news, to pressure test sensitive issues or ideas, and often to provide informed feedback necessary to develop plans. As thought leaders for your investor group, you need them on your side.
- If you are addressing sensitive issues or delivering bad news at an upcoming annual meeting or Advisory Committee meeting, you need to reach out to your strongest supporters and the Advisory Committee members in advance of the formal meeting. Surprise is a bad thing for investors. Further, if the news is particularly bad, even though you will see investors shortly, face-to-face meetings in advance of the annual meeting or the Advisory Committee meeting may be required, especially if you are not clear on the action plan and wish to seek advice from your most trusted relationships.



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