Fundraising Firms Caught in Coronavirus Valuation Limbo

Funds that raised initial capital through a first closing face a slow road to the finish line as investors scrutinize the valuations of early deals

By Preeti Singh Updated April 30, 2020

Some private-equity firms that backed early deals while on the fundraising trail are getting caught in a valuation conundrum as the coronavirus pandemic deepens, according to investors and placement agents.

They say investors are hesitating to commit capital to funds with a few early deals done before the coronavirus pandemic hit, because investors don't trust the valuations for those investments. That hesitation promises to elongate fundraising periods for certain managers or even force others to ask investors that backed early fund closings if they can market the funds beyond a previously agreed upon time frame.

Private-equity firms have long benefited from backing early investments using money raised in initial closings for their funds. By doing so, firms sought to showcase those deals to woo other investors into later fund closings, according to Les Baquiran, founder of placement agent Alpine Capital Advisors. When markets were booming, sometimes those early deals even appreciated in value by the time the fund reached a final close.

As the coronavirus pandemic ripples through the global economy, however, "that's completely been turned on its head," Mr. Baquiran said.

Now, most investors don't want to commit fresh capital to deals backed before the pandemic, when purchase prices were high, even if those investments are likely to emerge unscathed from the crisis.

"All things being equal, you would rather commit to post-Covid deals that could be cheaper and have better terms," Mr. Baquiran said.

Investors coming into funds later pay back interest and don't get the fee breaks or better fund terms that are offered to early backers. And in the current environment, later investors can "take an immediate hit," said Mark Steed, chief investment officer at Arizona Public Safety Personnel Retirement System. "A lot of such GPs are getting hung in the due diligence process," Mr. Steed said, adding that prospective investors worry that GPs may be less willing to aggressively mark down values of investments in the funds they're still pitching.

As first quarter reports from private-equity managers trickle in, portfolios are already showing some pain. The value of Blackstone Group Inc.'s private-equity portfolio, for example, fell by 21.6% during the first quarter, driven largely by the firm's exposure to energy assets, The Wall Street Journal recently reported. Excluding energy, the firm's private-equity portfolio was down by 11.1% in the first quarter.

But even the industry's first-quarter results don't necessarily reflect the full extent of the damage, investors say. "Funds that have existing portfolios, maybe 10% or 15% of the NAV, are going to be really hard to get comfortable with in this environment because I'm just not going to trust the valuation on them," said John Haggerty, managing principal and director of private-market investments at consulting firm Meketa Investment Group.

Some firms that have already been in the market for a while face difficulties reaching their fundraising targets or hard caps, several sources said, although they declined to name any firms. For some of these firms, the delays have stemmed from ongoing due diligence by last minute investors, but the "Covid environment is definitely not helping," said Gabrielle Zadra, senior managing director at investment consultant Cliffwater LLC.

However, Ms. Zadra added that larger asset managers that have strong demand from LPs will be better disposed to attract capital.

Bigger funds with solid performance have a greater chance of hitting their targets or hard caps since they are positioned to accommodate the appetite of large institutions like sovereign funds and public pension systems that need to deploy large amounts of money to reach their private equity allocations, according to Mr. Baquiran.

"It really depends on the manager," Mr. Baquiran said.