SEWARD & KISSEL LLP

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CAPITAL RAISING IN THE AGE OF THE CORONAVIRUS: A SPECIAL FLASH SURVEY REPORT

Introduction

Driven by our ongoing commitment to understanding the dynamics of the investment fund marketplace and bringing the latest industry color to our clients and friends, each year Seward & Kissel conducts various studies of the most important trends we are seeing that are impacting the investment fund community. In light of the current remote working situation, we wanted to understand how the capital raising environment has been impacted. Accordingly, we surveyed a diverse grouping of prominent allocators, bankers, brokers and third-party marketers within the industry who collectively have significant relationships with a large portion of the investment manager population, in order to gauge the current trends. This special flash report edition of *Front Page Focus* summarizes survey respondents' answers in the following key capital raising areas: (1) manager selection, (2) investment terms, and (3) investor communications.

1. Manager Selection

The inability to conduct on-site due diligence has had a dramatic impact on capital raising beyond merely lengthening the sales cycle. Survey respondents indicated that managers with whom there is already a strong existing relationship are reaping the greatest rewards, as well as top-tier managers with deep, well-tested infrastructures who have reopened their previously long-closed funds or are launching new products. In addition, the following areas and sectors have attracted the greatest interest (even for less established managers): credit/distressed/dislocated; low-net; market-neutral; municipal bonds; CLOs; healthcare/biotechnology; technology; and consumer. With respect to emerging managers, while many allocators continue to engage with them, it is premature to predict the timing and sizing of the allocations they may receive.

While in person due diligence is not currently feasible, allocators are nonetheless hyper-focused on certain operational areas as they conduct their modified forms of due diligence, including: business continuity plan effectiveness for managers, their third-party vendors and service providers; key person planning (including redundancies and back-up support); very strong reference checks; and cybersecurity protections. With regard to portfolio level due diligence, there is additional emphasis on: the use of leverage and credit facilities; risk of default; cash reserves; volatility positioning; exit timing and strategy; trading issues; and, even more specifically, valuation policies and procedures.

2. Investment Terms

   For established managers who have now reopened their funds or launched new products, fee terms have remained relatively unchanged; however, some of these managers are imposing greater restrictions on liquidity. With respect to managers who have had drawdowns, some have proposed reducing fees on existing capital, while others have proposed offering fee discounts and matching loss carryforwards on new capital contributions. With regard to other managers (including emerging managers), founders' classes are being utilized to offer attractive fee discounts for day one capital and for capital added within a certain time frame. In addition, there is an observed increase in side letters, especially for larger allocations.

3. Investor Communications

   The remote working environment has had a seismic impact on on-site investor due diligence, as well as on overall investor communications. In the absence of the ability to meet in person, investment managers generally have resorted to a greater level of client contact through increased calls, webinars and video conferencing, while at the same time trying to be mindful of new cyber and information privacy concerns. Some managers are filming virtual walkthrough videos of their offices or offering virtual office tours via Zoom or similar services, while others are conducting virtual road shows. For "on-site only" documents, investment managers have shared such documents via a shared screen on WebEx and others have considered uploading watermarked versions of such materials onto a document share web solution for a 24-hour review period.

   As part of our survey, we asked the participants to rate the frequency of usage of various methods of investor communication as observed by them (with a 5 meaning "used extremely often" and a 0 meaning "never used"). Based on this information, the average frequency of usage was as follows (ranked from highest to lowest): conference calls – 4.83; one-on-one calls – 4.83; Zoom – 4.42; WebEx – 3.08; webinars – 3.08; Microsoft Teams – 1.75; data rooms – 1.08; FaceTime – 0.92; BlueJeans – 0.75; and GoToMeeting – 0.17.

Seward & Kissel Takeaways

Even after the pandemic resolves, since remote working technologies have performed fairly well overall and continue to be improved upon, it is anticipated that investor travel and conferences will no longer take place at previous levels, especially at the early due diligence stages. Virtual visits and large webinars will become a much more prevalent part of the capital raising process. As such, if travel budgets become less of a constraint, we may see a levelling of the playing field to a degree, as allocators will be able to visit virtually with a much larger group of investment managers, including emerging managers and managers based outside of the U.S.