Private Equity

March 2017, 2 min read

# European PE returns structure evolving

*The waterfall structure is becoming more flexible a backdrop of low interest rates.*

The private equity waterfall is changing in Europe, mirroring a trend seen in the US, according to market sources.

“Over the past six months or so we’ve seen some funds launching with hurdle rates under the traditional 8 percent,” Michael Halford, partner at Goodwin told pfm.

In the majority of cases the funds have strong track records, and are likely to be oversubscribed, although some stem from managers that already had lower hurdles who are coming back to market, or are brand new, he added.

“Being able to change the economic terms of the fund that are beneficial to the GP, has of course been the focus. We’ve also seen lower hurdles (in some cases without catch-up) combined with higher carry rates,” Halford said.

CVC cut the hurdle rate on its latest buyout fund after it attracted more than double the amount of capital it sought to raise, while Advent launched its last fund without one. Walburg Pincus has never assigned a hurdle rate to its funds.

But others point to regulatory issues which prevent this in some jurisdictions. “It has happened in a very small minority of funds. Revised UK tax laws relating to carry recommend hurdle rates should be at least 6 percent,” Eamon Devlin, managing partner of MJ Hudson told pfm. He highlighted other changes to the waterfall structure that had become evident, however.

“Elements of deal by deal distributions are becoming more commonplace, especially for newer managers, and others are introducing a ratchet structure,” he said. These may include 2x money returned for 10 percent carry, or 4x money for 20 percent carry, he added.

*Article written by Claire Wilson, PFM, 14th March 2017*