Institutional Investor Profile: Michael Pohlen, Principal, Piper Jaffray - Private Capital Group

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Michael Pohlen on the exciting opportunities in cleantech investments, an impending shake-out in the Chinese private equity market, the shut-down of the IPO window and on the attractiveness of the LBO and VC markets.

Piper Jaffray is a global investment bank and asset manager with approximately $30bn under management. Founded in 1895, Piper Jaffray began investing in private equity in the early 1980s, before raising its first direct investment fund for outside investors in 1992. The Private Capital Group was established in 2000 to raise the firm's debut fund of funds. The investment team currently manages in excess of $500m in fund of funds capital.

Mike Pohlen was previously an officer for several years in Piper Jaffray's investment banking group, where he focused on mergers and acquisitions. Pohlen was also president of a small-cap equity fund, vice president in a lower mid-market leveraged buy-out group and co-founder of a small-cap portfolio group at a large multi-strategy hedge fund.

What type of investments do you look for?

'Piper Jaffray Private Capital's diversified fund of funds vehicles and co-investment funds expand upon strategic advantages and proprietary insights we hold in venture capital, leveraged buy-outs and cleantech.

Piper Jaffray has a long history in venture capital with particular internal expertise in the technology, consumer, healthcare and cleantech sectors. We focus on small, capital-efficient early stage funds and late stage opportunities. We like firms that bring operational capabilities and/or industry expertise to underlying portfolio companies.

Piper Jaffray also has a long history working with lower mid-market, mid-market and industry specialist buy-out firms. We leverage the expertise inside of Piper Jaffray and the experience of our team to gather unique insights into the strategies and capabilities of these firms. Consistent with our strategy in venture capital, we focus on buy-out firms that generate substantial proprietary deal flow and bring operational capabilities and/or industry expertise to underlying portfolio companies.

The Piper Jaffray Private Capital Group launched the first US-based cleantech fund of funds in 2005. We have a fairly broad definition of cleantech, which includes alternative energy and efficiency, water technology and advanced materials. We focus on "pure-play" cleantech managers and funds that have deep domain expertise in these sectors, as opposed to generalist managers who make cleantech investments as an ancillary part of their funds.

Within cleantech, we are diversified across the spectrum of early, expansion, late and growth stages, as well as buy-outs and infrastructure. We are currently emphasising investment opportunities in the late/growth stage where technology risk is significantly lower or non-existent and the path to liquidity is shorter. Significant opportunities remain in the late/growth stage and the best pure-play cleantech fund managers are seeing the highest quality deal flow.

We seek investment opportunities across the globe with a bias towards the US market. From a vintage year diversification standpoint, we aim to invest across two to three vintage years. We invest in eight to 12 managers/funds per fund strategy, which we believe is optimal in order to maximise returns to our investors. As a result, we are selective and only invest in the firms we believe will deliver outsized returns.'

Do you invest directly?

'Yes. We co-invest alongside the best cleantech firms worldwide.'

What size of investments do you make?

'We typically invest between $5m and $25m in any given fund.'

How does your investment process work?

'Before we begin fundraising, we structure a synthetic portfolio, building our investment pipeline and planning the diversification goals. We consult internal experts in investment banking and research, our investment committee members and others to identify the sectors, geographies and fund strategies that are the most promising. This process provides a "road map" as we look for specific investment opportunities.

We review our proprietary database to identify the highest quality firms we believe will be raising funds over the following 18 to 24 months. Our strategy is to establish relationships and a knowledge base of firms before they are fundraising and, over time, track the firms we have an interest in. This proactive approach enables us to maintain the most up-to-date information in our database and provides us with access to funds when they come to market in their fundraising processes. We also utilise our internal resources, such as investment banking and research, to gain insight into various firms and their strategies.

Once a fund is identified and is in the process of fundraising, we conduct thorough due diligence that includes conversations with partners and others at the firm, analysis of historical track records, attribution analyses by partner, deal-by-deal analyses, deal pipeline discussions, reference checks (internal and external), background checks and legal review.

After previewing the investment opportunity with our investment committee (often several times), we assemble a very comprehensive report (40-50 pages) regarding the opportunity, which we present to our investment committee. This committee consists of current and former division heads at Piper Jaffray with diverse backgrounds, decades of private equity experience and principal investment expertise.'

How many investments do you intend to make over the next year?

'We make approximately ten investments per fund of funds strategy over the course of two to three vintage years. This year, we expect to make ten to 12 investments in total across the three funds of funds (venture capital, leveraged buy-out and cleantech).'

How do you find out about good investments?

'We proactively identify the top firms according to various diversification classifications and track each firm's progress in our proprietary database. We then use this database to predict the fundraising timetables for each firm so we can visit managers and gain access to them before they are in the process of raising their next funds. It is all about having a great global intelligence gathering network and hard work. For example, we recently leveraged Piper Jaffray's extensive network in Asia and visited more than 20 funds in China over the course of a couple of days.'

What is your appetite for first-time funds?

'We are naturally apprehensive about making investments in first-time funds; however, we have a prospective approach to our investment process. We pride ourselves on our ability to identify firms we believe will be exceptional (De Novo Ventures and GGV Capital are good examples). It was particularly important to exercise this capability as we built our first cleantech fund of funds because of the infancy of the sector and the relative lack of expertise in the private equity market concerning cleantech at that time.'

Do you invest in distressed debt funds?

'Yes. Distressed and turnaround investments are made in our leveraged buy-out fund of funds. This is an area that should be very exciting in the near future and we are starting to see an up-tick in opportunities in distressed funds.'

Would you consider acquiring an LP stake in a fund from a fellow LP?

'We invest in secondaries, but strictly avoid auctioned deals (too competitive and over-priced). We are currently in the process of analysing a couple of proprietary secondary opportunities - one in cleantech and one in healthcare.'

What do you look for in a good private equity manager?

'A few factors stand out, including team cohesion and culture, as well as the investment success of the team and each of the individual professionals. We also look for managers that truly add value to their portfolio companies through operational capabilities and industry expertise. It is also important that managers maintain a consistent strategy, generate high quality proprietary deal flow, exhibit valuation discipline, display an appropriate aversion to risk, utilise capital efficiently and demonstrate strong knowledge of capital markets, for example, knowing when to enter and exit investments.'

What are the most interesting countries/sectors going forward?

'**Cleantech, if done right.** Smart, disciplined firms are going to earn outsized returns. Others are going to lose a lot of money.

Lower mid-market and specialist buy-out funds. Firms that bring operational, technical and/or industry expertise to their portfolio companies will add significant value and substantially enhance returns for investors.

Late stage and small, capital-efficient early stage venture firms. Capital needs of companies are increasing and there is a relative lack of liquidity in the public markets today. As a result, late stage and small, capital-efficient early stage venture firms are ideally positioned to excel in this environment.

Asia. China is particularly interesting as there are opportunities for managers who can add value to portfolio companies through operational expertise and industry-specific knowledge. A shake-out in the private equity market in China is likely to occur at some point and the pure "financial engineers" will suffer because they have unsustainable business models.'

What advice would you give to a new private equity investor?

'If you are truly new to private equity, you should use a fund of funds manager. Fund of funds managers have the expertise and resources to identify and access the best private equity investment opportunities and create a prudently diversified portfolio.'

What is the biggest issue in the private equity industry?

'Carried interest tax is certainly one big issue. Another big issue is the amount of capital raised by private equity funds and the associated rapid increase in size from one fund to another within a firm. This situation has many consequences. For instance, it can lead to a classic supply-versus-demand imbalance. If there is an overabundance of capital chasing a particular strategy (mega buy-outs for example), valuations will likely increase or equity-to-total capital will increase, resulting in lower expected returns. In addition, it often means a necessary change in strategy for the firm. For example, firms may have to move up-market in terms of deal size or modify their stage of investment focus. It may also lead to a need to do more transactions, which has human resources implications.

A second large issue is the closure of the IPO market. This has led to a lack of liquidity and longer hold periods for private equity funds. Similarly, the credit crunch has made access to leverage more difficult, resulting in (among other issues) fewer recapitalisation opportunities and a lack of liquidity events for private equity funds. On the positive side, the IPO window is open for strong cleantech companies, even today.'

How do you think the market will change in the future?

'One of the most exciting changes will be in cleantech. We are at a point in time where Wall Street, Washington DC and Main Street have embraced the concept of cleantech and the opportunities the sector presents. In addition, China, India, Europe and other areas throughout the world have realised the importance of cleantech. As a result, cleantech will become the third primary investment category in venture capital alongside technology and healthcare. As the sector continues to mature, buy-out opportunities will become more prevalent and distressed opportunities will begin to appear as well. Those with the deep domain expertise will win.

Another obvious change in the future will be a cycle reversal in the public offering and leveraged lending markets. At some point, these markets will re-open.'

How would you describe the market environment in which you are operating?

'Smart, disciplined cleantech firms are going to produce outsized returns given the size of the (relatively untapped) market and the momentum in the sector. We are excited about the LBO market, particularly in the lower mid-market. We are also excited about the environment for late stage and small, capital-efficient early stage venture firms. Given the lack of available capital in the public markets and the increasing capital needs of venture-backed companies, venture investment opportunities are plentiful.'

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