DOWJONES | Private Equity Analyst

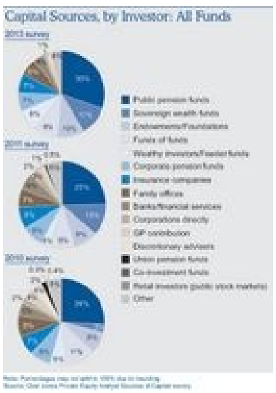
Improved Liquidity Brings Investors Back to the Table

Michael Wursthorn

May 29, 2013

Limited partners returned to the fundraising table in 2012, driving another solid year, as general partners saw ongoing shifts in their limited partner bases while solidifying relationships with their most loyal investors.

"Our market is just in a better place than it has been," said Alan Pardee, managing partner of placement agency Mercury Capital Advisors. "Most active LPs that have capital - most of the large ones that were in the market before the downturn - are back."



Public pension funds continue to act as the backbone of fundraising for both private equity and venture capital funds, according to Private Equity Analyst's latest Sources of Capital survey. Public pensions contributed 30% of all capital raised by general partners and placement agents in our latest survey.

That is up from both the 2011 and 2010 Sources of Capital surveys, which showed public pension funds contributed 25% and 26% of capital raised, respectively, although survey samples differed across the three years.

The strength of public pension funds has swelled since the economic downturn, as many seek the outsized returns private equity can offer, compared with other asset classes, particularly fixed income.

"If you're an institutional investor that has a targeted rate-of-return threshold, you are likely to take a strong look at private equity," said Chason Beggerow, a partner with consulting firm Altius Associates.

Meanwhile, endowments, foundations and wealthy individuals have reemerged from the liquidity crisis of 2009 and 2010 as more active sources of capital, while the Volcker Rule and other regulations continue to stem the flow of capital from banks and financial institutions, particularly to the buyout industry.

Shoring Up the Base

Locking in the support of existing investors remains more important than ever, as general partners seek fresh capital for new funds. Strong support from current LPs provides funds with early momentum toward a first closing and instills confidence to attract new LPs. If a large number of prior investors opt out of a new fund, it quickly raises concerns and impedes fundraising efforts, according to David Fann, president and chief executive of consultancy TorreyCove

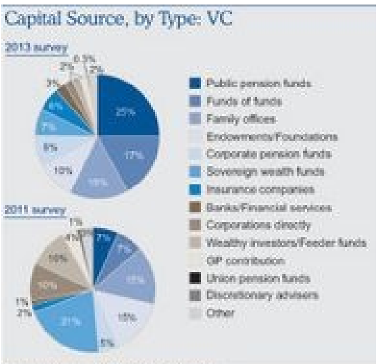
Partners.
Many limited partners also have less room for new relationships as they pare down the number of GPs in their portfolios.

Funds in our latest survey raised 66% of their total capital from existing LPs, with the remainder coming from new investors. That is a significant change from the 2010 survey, when GPs said prior LPs only contributed to 44% of the capital raised, with new LPs making up the majority.

One private equity consultant attributed the change to the massive funds raised during the so-called boom times and the need for new limited partners to help GPs reach those multibillion-dollar goals back then.

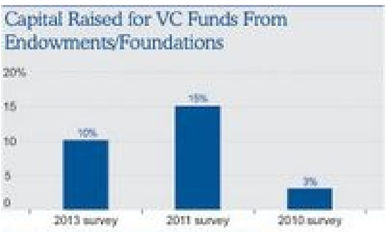
"More than 50% of the money came from new LP relationships because GPs were doubling their fund sizes," said Christian Kallen, a vice president of the fund investment team at **Hamilton Lane** . "You don't see that very often these days."

Venture Capital Sees Shift Among Backers



Note: Percentages may not add to 100% due to rounding.
Source: Dow Jones Private Equity Analyst Sources of Capital survey

Venture capital fundraising stayed at around the $20 billion mark in 2012, with capital flowing to a smaller number of firms. Against that backdrop, public pensions, family offices and fund-of-funds managers together captured a greater share of the VC fund pie last year, as endowments and foundations appear to have cooled in their enthusiasm for the subasset class.



Source: Dow Jones Private Equity Analyst Sources of Capital survey

Endowments and foundations, historically stalwart supporters of venture capital, contributed only about 10% of capital raised by venture funds in our 2013 survey, a significant decline from the 2011 survey, when 15% of capital raised came from those investors. Even in absolute dollar terms, endowments and foundations have lost some of their enthusiasm for venture in favor of buyout funds, although differences in survey samples may account for some of the shift.

"There are a lot of investors that haven't been able to generate decent returns in venture capital for 10 years," said Kell y DePonte , managing director of placement agency **Probitas Partners** . "There are a number of investors that aren't investing in venture capital anymore."

The **Ewing Marion Kauffman Foundation** , whose mission is to promote entrepreneurship and which conceived of the now-independent Kauffman Fellows program for aspiring venture capitalists, said as much in a study it released last summer, slamming venture capital for its lackluster performance.

"Our experience shows that since 1995, it is improbable that a venture fund will deliver better net returns than an investment in the public markets," the study said, adding that its own venture portfolio between 1989 and 2011 produced disappointing results. The foundation recommended trimming its relationships and giving more scrutiny to performance.

But with foundations and endowments pulling back, both family offices, a breeding ground for many venture firms today, and funds of funds continue to support the industry.

Family offices accounted for nearly 15% of the capital raised by VC firms in our latest survey, a steady continuation from our 2011 survey and up significantly from the 2010 survey, when those LP types were coming out of the economic recession and there were concerns over being too heavily weighted toward illiquid assets.

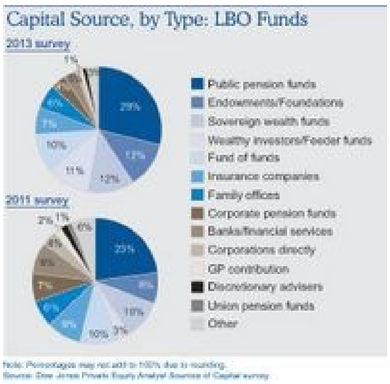
"Family offices are populated by people seeking higher returns and are willing to take on more risk," said Alan Kosan, senior vice president and head of alpha investment research with consultancy Segal **Rogerscasey** . "They're very much pursuing those outsized returns."

Consultants added that many of these family offices now have staff members who are younger and more aware of how new technologies can potentially be disruptive. In addition, new family offices have cropped up following the success of a number of technology bets by the venture community.

"A lot of the family offices that were recently created were the direct result of investments and managerial results in the tech industry," said Mr. Fann of TorreyCove. "Family offices aren't shy about the risk inherent in venture capital."

Funds of funds also remain a strong supporter of venture capital, although many fund-of-funds managers are stymied by their own fundraising pressures. In our latest survey, funds of funds contributed to 17% of the VC money raised, a significant sum in comparison with the other LP types as it ranks behind only public pension funds. That is down from our 2010 survey, however, when VCs reported that 23% of their capital came from funds of funds. "We see them becoming less of a player in the marketplace," said Segal **Rogerscasey** 's Mr. Kosan. "Investor pools are pulling away from them a little bit."

Buyout Firms Embrace the Little Guy



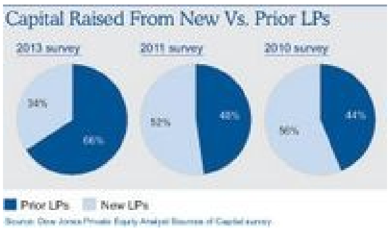
Although endowments and foundations may be pulling away from venture, buyout funds clearly are benefitting from the shift. Endowments and foundations helped private equity funds raise 12% of committed capital in our 2013 survey, up from 8% in our 2011 survey and 10% in our 2010 survey. "They're largely behind the worst of the downturn, plus a year or two after, when they found themselves to be very illiquid," said Mercury Capital Advisors' Mr. Pardee. "Over the last year or more, we saw the return of the endowment and foundation to the marketplace after a couple-year pause."

TorreyCove's Mr. Fann echoed Mr. Pardee's comments, saying that the fear foundations and endowments were imbued with following the economic downturn, after finding themselves to be overweighted with illiquid investments, has passed, thanks to distributions from funds and a better performing equities market.

Buyout funds also got a leg up from wealthy investors who retreated from the asset class during the economic downturn. Wealthy investors and feeder funds contributed 11% of the money raised by buyout funds in our latest survey, a significant jump from the 2011 survey, when they accounted for just 3%.

Like their institutional peers, wealthy individuals are chasing higher returns in a low interest rate environment, although it remains to be seen how long their enthusiasm will last. Probitas' Mr. DePonte said he has seen these investors in the market during every good period, beginning in the late 1990s, when technology investments were heating up. He saw it again beginning in 2006 through the economic downturn.

"The market becomes hot and people turn their attention to it," Probitas' Mr. DePonte said. "You have a number of high-net-worth people looking to get access to it."



Although banks and financial institutions typically provide the distribution pipelines to wealthy investors, fewer of them are backing buyout funds off of their own balance sheet, as they move to comply with the Volcker Rule. Banks and financial institutions, historically a stalwart capital source for buyout funds, contributed just 3% of the capital raised by buyout funds in the latest survey, down from 8% in our 2011 survey.

Asia, Latin America Continue to Grow in Importance

©istockphoto.com/ziggymaj

Although the U.S. remained the most fertile ground for fundraising last year, general partners that do take their road shows abroad have seen more capital come from new frontier markets in Asia and Latin America.

Outside of the U.S., Western Europe continues to account for the largest portion of capital contributed to firms in our latest survey, with 36% of capital from non-U.S. LPs coming from the region, roughly on par with our 2011 survey but down considerably from the 48% the region accounted for in our 2010 survey.

New regulations put into effect in Western Europe have forced some banks and insurance companies, mainstays of private equity in the region, to cut back on investments or wind down their programs, said Segal **Rogerscasey** 's Mr. Kosan.

However, LPs from other regions, including Asia (outside of Japan) and Latin America, are stepping in to fill the gap. In our latest survey, commitments from Asia represented 13% of capital raised from non-U.S. LPs, down from 14% in our 2011 survey, but up from 10% in our 2010 survey. Latin American LPs accounted for 6% of capital in our 2013 and 2011 surveys, up from 2% in 2010.

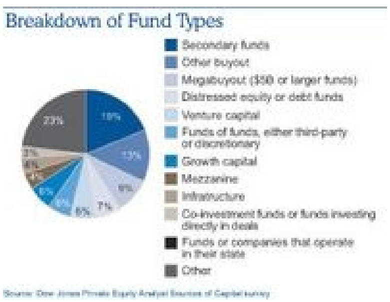
Sovereign wealth funds, such as the China Investment Corp. in China and Korea Investment Council in South Korea, have helped drive the growth in capital coming from Asian LPs. Many of them have large sums of capital to put to work and represent an entryway for possible investments into their own countries.

Pension funds and other types of investors in Latin American countries like Colombia and Peru represent a growing opportunity for U.S.-based GPs in fundraising mode. "As those investors become more experienced in the asset class and those countries develop systems and forward-thinking ideas, those pools of capital are going to increase," said Mr. Kosan.

Sources of Capital Survey Methodology

After a nearly two-year hiatus, we are pleased to bring back our Sources of Capital survey in 2013 as part of an effort to capture some of the shifts among investor flows into private equity funds.

We conducted the latest survey in March and April of 2013, focusing exclusively on funds that had raised the majority, if not all, of their capital in 2012. As in previous years, we sent the surveys separately to placement agents and general partners. The data were provided to us under the agreement that the individual firms that responded would remain anonymous and that we would only use the data to pull together industry-wide statistics.



A total of 34 general partners, including some that raised multiple funds, and 16 placement agents responded to this year's survey, representing a total of a little more than $56 billion in capital. By comparison, our prior survey in 2011 included responses from 121 firms and 12 placement agents, representing $36 billion in capital. The latest survey results reflect an overall trend in the industry in which more capital is consolidated in the hands of fewer firms.

As in years past, some differences in our survey results from year to year may be explained by the fact that each year, different responses come from different firms that have been in the market at the time, often with different investor bases. At the same time, some of the data slices, such as venture capital, rely on smaller sample sizes, allowing outliers to more easily influence the results.

Funds that fell in the "other" category, including industry-focused funds, accounted for the biggest single percentage of capital raised by firms in our survey, 23%, closely followed by buyout funds, which accounted for 22% of capital raised. Secondary funds represented 19% of capital raised, not surprising, given the record fundraising year secondary funds experienced in 2012.

The following table represents the breakdown of capital represented in this year's survey.

Document DJFPEA0020130529e95tdespm