

# Private Markets Trends



FALL 2009

## PRIVATE EQUITY FUNDRAISING

Fundraising dropped during the third quarter of 2009. The \$23.4 billion of new commitments raised represents a 40% decline from the second quarter. The 81 new partnerships formed were down 39% from the 132 partnerships established in the prior quarter. With the expectation of a small year-end surge, 2009 will moderately exceed the \$100 billion fundraising mark. For context, the fundraising low point after the tech bubble burst was about \$45 billion in 2003, and the most recent peak was just over \$300 billion in 2007. It is a true “sign of the times” that both distressed and secondary (virtually all of the “Other” strategy category) partnership commitments are outpacing venture capital.

Fund-of-funds managers are beginning to signal that the longer-term partnership deal flow pipeline is slowing. A key factor influencing the slowdown is that many tenured general partners have now raised funds that will be deployed slowly. General partners that would like to raise new capital are delaying fundraising efforts for two rea-

### Funds Closed January 1 through September 30, 2009

Strategy	# of Funds	Amount (\$ mm)	%
Venture Capital	83	8,002	10%
Acquisition/Buyouts	97	36,111	47%
Subordinated Debt	11	1,374	2%
Distressed Debt	21	9,800	13%
Other	20	14,293	19%
Fund-of-funds	28	6,842	9%
Totals	260	76,424	100%

Source: *The Private Equity Analyst*.

sons. First, limited partners have indicated that they want general partners to show some evidence of success via realizations in recent funds before they are willing to commit additional blind pool capital. Second, the general partners are aware that limited partners have smaller commitment budgets and are taking a cautious approach.

Smaller commitment budgets are caused by the decline in total plan values, which increase the percentage invested in private equity (the denominator effect). The plan value decline also increase the significance of commitments already outstanding. Even with the recent rebound in the public stock and bond markets, selling public securities to fund private equity commitments is still an expensive proposition. New fundraising efforts now have a much higher risk of “losing momentum,” which would harm the private equity firms’ reputations.

## PRIVATE EQUITY MARKET ENVIRONMENT

Following the trend in the public markets, private equity valuations appear to be bottoming out. Barring any negative surprises, the key question is how long the economy

### IN THIS ISSUE

PRIVATE EQUITY FUNDRAISING

PRIVATE EQUITY MARKET ENVIRONMENT

PRIVATE EQUITY RETURNS

The *Private Markets Trends* is published quarterly by the Callan Investments Institute for professionals of the institutional investment community. The *Private Markets Trends* discusses the market environment, recent events, performance and other issues involving private equity.

For private markets inquiries, contact your Callan Consultant or Gary Robertson at 800.227.3288.

Author – Gary Robertson; Editor-in-Chief – Mary Schaefer; Publication Layout – Tanja Eisenhardt

---

#### **About the Callan Investments Institute**

The Callan Investments Institute, established in 1980, is a source of continuing education for those in the institutional investment community. The Institute conducts conferences and workshops and provides published research, surveys and newsletters. The Institute strives to present the most timely and relevant research and education available so our clients and our associates stay abreast of important trends in the investments industry.

---

#### **About Callan Associates**

Founded in 1973, Callan Associates Inc. is one of the largest independently owned investment consulting firms in the country. Headquartered in San Francisco, Calif., the firm provides research, education, decision support and advice to a broad array of institutional investors through five distinct lines of business: Fund Sponsor Consulting, Independent Adviser Group, Institutional Consulting Group, Callan Investments Institute and the Trust Advisory Group. Callan employs more than 170 people and maintains four regional offices located in Denver, Chicago, Atlanta and Florham Park, N.J.

and capital markets will bump along the floor before health improves and appreciable growth resumes. While it is a good sign that valuations seem to be stabilizing after a large downdraft, private equity transaction activity will remain in the doldrums until the availability of leverage returns in earnest.

## Buyouts

According to *Buyouts* newsletter, buyout-sponsored U.S. acquisitions in the third quarter numbered only 111 closed transactions, down 3% from the 114 closed in the second quarter. Deal count was down 47% year-over-year from the third quarter of 2008's 210 transactions. Similar to prior quarters, about half of the transactions (45% in the third quarter) were add-on acquisitions to existing portfolio companies, which means that truly new investment activity was much lower.

Buyout dollar volume was the same as last quarter with announced values totaling \$2.9 billion. The number of companies that announced values in the third quarter totaled 13, versus 22 in the second quarter. Dollar volume was driven by one \$1.8 billion deal—KKR's buyout of Oriental Brewery Company from Anheuser-Busch InBev. The next largest announced transaction fell to \$286 million, which was Golden Gate Capital's purchase of retailer Eddie Bauer out of bankruptcy.

Exit activity was up during the third quarter, but dollar volume remained a drop in the bucket. *Buyouts* reports 49 M&A exits, up from 29 last quarter. The announced dollar volume was \$2.0 billion, up from \$830 million in the second quarter.

The \$1 billion sale of a manufacturing plant by Carlyle's Vought Aircraft to Boeing accounted for half of the total.

Three buyout-backed IPO exits raised \$1.3 billion in the third quarter, up from two offerings totaling \$234 million the prior quarter. The largest offering was Avago Technologies Ltd.—a semiconductor company owned by KKR and Silver Lake Sumeru—which raised \$648 million. Medical billing company Emdeon, an investment of General Atlantic and Hellman & Friedman, garnered \$367 million. Finally, hospital operator Select Medical, owned by a consortium including WCAS and GTCR, raised \$300 million.

## Venture Capital

According to the National Venture Capital Association (NVCA), investment in companies by venture capital funds totaled \$4.8 billion in 637 rounds of financing in the third quarter of 2009. Dollar volume was up slightly from the second quarter's pace of \$4.1 billion, but deal count dropped from 657 rounds in the prior quarter.

By industry, data from the PricewaterhouseCoopers MoneyTree™ Report shows that the Technology sector received \$2.1 billion (or 44% of capital invested) in 345 rounds of financing. Life Sciences garnered \$1.5 billion (32%) in 182 deals. The Business/Industrial sector saw 80 companies receive \$994 million, and Consumer/Retail and Other collected about 4% of new capital with \$189 million in 30 investments. MoneyTree's top three industry subsectors absorbed 50% of the new investment capital. Biotech was the largest sub-

sector, receiving 19% of total funding, followed by Industrial/Energy getting 18%, and Software with 13%.

Later-stage investments garnered \$3.2 billion (or 67% of capital) in 353 rounds, and earlier-stage investments received \$1.6 billion (33%) in 284 financings. According to the NVCA, first-time financings decreased 20% with \$633 million going to 155 companies.

The NVCA reported that three venture capital-backed companies had IPOs totaling \$572 million. The largest was A123 Systems, a battery manufacturer that raised \$380 million. In the third quarter, the venture-backed M&A count totalled 62 transactions versus 64 deals last quarter. M&A dollar volume was released for 21 transactions and totalled \$1.2 billion, compared to 13 transactions representing \$2.6 billion in the second quarter.

With the severe contraction in both venture capital fundraising and investment activity, a couple of fund-of-funds managers have published opinion pieces expressing optimistic outlooks for the industry. The concentration of smaller available dollars with fewer and more experienced general partners is viewed as a positive. Similar to buyouts, the promise of recession-induced low company investment pricing coupled with an eventual economic expansion is also cited as being positive for venture capital returns.

## PRIVATE EQUITY RETURNS

### Second Quarter 2009

Private equity returns, represented by the Thomson VentureXpert Private Equity Database, turned positive in the second quarter after five consecutive quarterly losses. The All Private Equity Return advanced 5.7% for the quarter, more than offsetting the 3.6% decline in the first quarter. All Venture gained 2.8%, All Buyouts jumped 4.4%, and Mezzanine rose 2.7% in the quarter. For comparison to public equity, the S&P 500 Index climbed 15.9% for the second quarter.

#### Private Equity Performance Database

Pooled Horizon IRRs Through June 30, 2009

Strategy	1-Yr	3-Yr	5-Yr	10-Yr	20-Yr
All Venture	(16.4)	2.8	5.7	9.9	17.2
All Buyouts	(20.0)	(0.3)	5.9	4.7	9.1
Mezzanine	(21.2)	1.4	3.0	4.0	7.8
<b>All Private Equity</b>	<b>(18.8)</b>	<b>1.1</b>	<b>6.1</b>	<b>6.1</b>	<b>11.4</b>
S&P 500	(26.2)	(8.2)	(2.2)	(2.2)	7.8

Source: Thomson VentureXpert. Private equity returns are net of fees.

The new FAS 157 mark-to-market rules appear to have done away with the directional time lag associated with private equity. However, the volatility (magnitude of price movement) of private equity has continued to be less than public equity in both up and down quarters.

The financial markets appear to be stabilizing and private equity valuations may be bottoming. While there was a strong up-tick in performance in the second quarter, future volatility should be expected. As seen in the table, private equity returns

## PRIVATE EQUITY RETURNS | continued

remain largely positive for multi-year periods, and return spreads versus public equity have risen substantially above historical levels for all time periods except 20 years. If public equities continue to rally, the currently outsized spreads will quickly narrow.

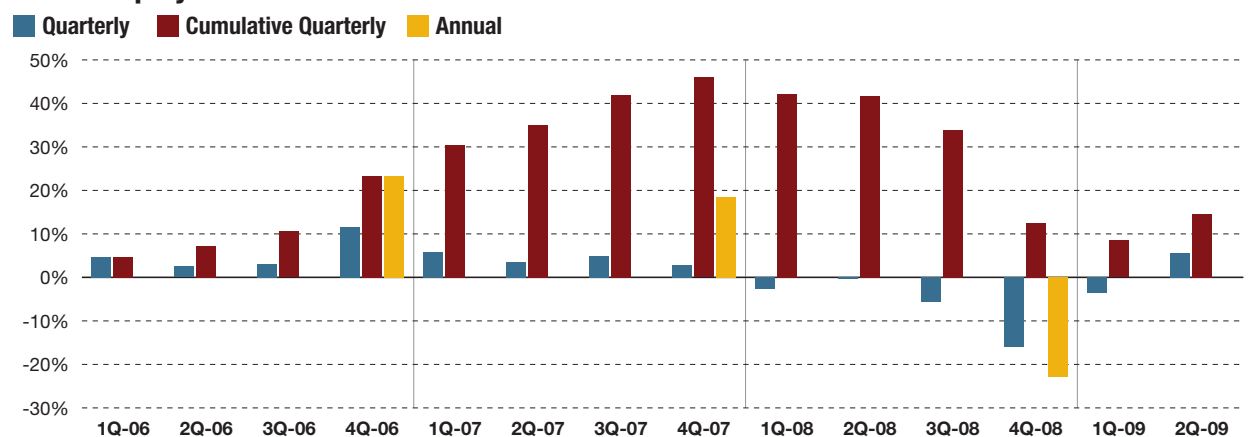
### Boom and Bust Returns

With the fear and uncertainty of the 2008 fourth-quarter meltdown receding, some perspective can be gained by examining the recent cycle. The adjacent bar graph shows the quarterly, cumulative quarterly, and annual returns for the VentureXpert All Private Equity database through the prosperous days of the leverage boom and the recent bust. The returns are time-weighted, so they represent the contribution to the overall fund return that plan sponsors with mature private equity portfolios would have experienced for the last 14 quarters, which capture the peak years of the leverage bubble.

Observations are as follows:

- The **blue bars** show individual quarterly returns. Of note, the first negative return occurred in the first quarter of 2008. The only large downdraft coincided with the implementation of FAS 157 mark-to-market valuations. During the infamous “perfect storm” fourth quarter of 2008, private equity fell 16%.
- The **red bars** show cumulative quarterly returns over the period. The since inception return peaks at 46.0% and declines to a low of 8.5% in the first quarter of 2009. While not shown in the chart, the annualized return for the period through the first quarter of 2009 low point is 2.5%.
- The **yellow bars** show one-year compound returns.

### Private Equity Returns



Source: Thomson VentureXpert.

## PRIVATE EQUITY RETURNS | continued

Private equity returns have been slightly positive over the very concentrated boom and bust period, although the asset class has not been looking very shiny of late. The negative 23% return for 2008 compares favorably to public equity since the Russell 3000 Index declined 37% and the EAFE Index lost 43%. The 2008 private equity loss of 23% also compares favorably to the results of Callan's total plan sponsor database where the 2008 one-year median return fell 25%.

If public equity continues to recover, private equity is expected to move in the same direction but will initially lag in magnitude. This occurred in the most recent quarter when private equity increased 5.7% versus 16.8% for the Russell 3000.

All things considered, the inclusion of private equity as a component of a diversified institutional portfolio has been beneficial throughout both the recent positive and challenging market environments. We expect that the positive return spread experienced between private and public equity in the recent (and unusually large) boom and bust cycle will be maintained in future market cycles.

### DID YOU KNOW?

Callan can act in an "extension of staff" capacity, assisting with strategic planning for private equity portfolios, and in administering the allocation's ongoing activities. Examples include: 1) developing or reviewing policies and procedures, 2) creating portfolio structures, 3) helping select and oversee private equity managers, 4) generating new ideas for improving a portfolio's risk and return characteristics, 5) tactically planning which areas of the portfolio should be addressed in the near term, and 6) conducting performance evaluation.

**For private markets inquiries contact your Callan Consultant, or Gary Robertson at 415.974.5060.**

---

THE CALLAN INVESTMENTS INSTITUTE IS, AND WILL BE, THE SOLE OWNER AND COPYRIGHT HOLDER OF ALL MATERIAL PREPARED OR DEVELOPED BY THE INSTITUTE. ALL CALLAN CLIENTS SHALL UNDERSTAND THAT THEY DO NOT HAVE THE RIGHT TO REPRODUCE, REVISE, RESELL, DISSEMINATE EXTERNALLY, DISSEMINATE TO SUBSIDIARIES, OR POST ON INTERNAL WEB SITES ANY PART OF ANY MATERIAL PREPARED OR DEVELOPED BY THE INSTITUTE, WITHOUT THE INSTITUTE'S PERMISSION. ALL CALLAN CLIENTS UNDERSTAND THAT THEY ARE SUBSCRIBING ONLY TO THE RIGHT TO UTILIZE SUCH MATERIAL INTERNALLY IN THEIR BUSINESS. ALL CALLAN CLIENTS SHALL UNDERSTAND THAT INSTITUTE MATERIAL IS FOR USE ONLY WITHIN THEIR FIRM, AND SHOULD NOT BE SHARED EXTERNALLY WITH SUBSIDIARIES, PARENT COMPANIES, OR ANY OTHER ORGANIZATION.

© 2009 CALLAN ASSOCIATES INC.



## **Callan Associates**

### **Corporate Headquarters**

101 California Street  
Suite 3500  
San Francisco, CA 94111  
1.800.227.3288  
1.415.974.5060

### **Regional Consulting Offices**

#### **Atlanta**

300 Galleria Parkway  
Suite 950  
Atlanta, GA 30339  
1.800.522.9782  
1.770.618.2140

#### **Chicago**

120 N. LaSalle Street  
Suite 2100  
Chicago, IL 60602  
1.800.999.3536  
1.312.346.3536

#### **Denver**

1660 Wynkoop Street  
Suite 950  
Denver, CO 80202  
1.303.861.1900

#### **New Jersey**

200 Park Avenue  
Suite 230  
Florham Park, NJ 07932  
1.800.274.5878  
1.973.593.8050

[www.callan.com](http://www.callan.com)