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FUNDS OF FUNDS DISTINGUISH THEMSELVES IN CROWDED MARKET

By Mark Cecil

As the march away from stocks and bonds brings new, well-heeled investors into the world of private equity, the positive story continues for funds of funds.

The asset class is attracting streams of new capital and amid the mushrooming marketplace, funds of funds have moved to distinguish themselves from the crowd.

"Certainly it's a great time for funds of funds. The whole private equity industry has so much drawing power right now," says **Kenneth Rosh**, a partner and fund-of-funds advisor at Fried, Frank, Harris, Shriver & Jacobson.

Indeed, in 1994, funds of funds raised just north of \$1 billion in capital, according to *Buyouts'* publisher Thomson Financial. This year, while it seems a bit slower than last, *Buyouts* has still tracked almost \$5 billion in new capital that has rushed into the marketplace in just the first six months. Industry sources even believe anecdotally that the amount of capital raised could be almost double that figure.

"It's that old fundraising axiom—you raise money when you can," describes **Carl Tippit**, a managing director at Cleveland-based **Peppertree Partners**. "People are throwing money at private equity and there's people there to collect it."

Part of the popularity for funds of funds stems from the arrival of new investors interested in getting into private equity for the first time. Many of these new LPs are often coming from overseas, with a knowledge base of zero. These new groups need a fund of funds to assist them in overcoming the learning curve.

Proskauer Rose private equity Co-chair **David Tegeler**, who has worked

with **Flag Capital Management**, among other managers, says, "Institutions like to get their feet wet...They'll do one or two fund of funds over the first five years, and then start to [invest directly into PE funds] themselves."

However, in the interest of keeping their limited partner base intact, many funds of funds have developed specialized strategies, which at the same time help funds of funds distinguish themselves from the growing crowd of rival firms.

Separation Through Specialization

Fund-of-funds investing is not reserved for the greenhorns. To attract institutional investors that have been investing in private equity over decades as opposed to years, there is a growing population of funds of funds that have established specialized vehicles as a way to give the more experienced investors exposure to specific niches.

Specialization is one way to attract both new and experienced LPs. And for an industry that targets the same "top-quartile" GPs, it can also help to distinguish specific fund-of-funds managers from their peers. This is key, as the industry tries to avoid becoming simply an index of the private equity space.

New specialist funds of funds crop up everyday. Among those currently raising capital are Singapore-based **Axiom Asia Private Capital**, which is raising a \$350 million Asia-focused fund; **Parish Capital Advisors**, which is raising \$550 million for emerging managers only; and **Piper Jaffray Private Capital**, which is raising Piper Jaffray Clean Technology Ventures LP.

Siguler Guff has been a long time proponent of specialization. This year it has raised two such funds, the \$1 billion Siguler



Maria Boyazny



Steven Costabile

Select FOFs

Sponsor	Fund Name	Target	Closed as of 2005	Closed as of Q2 2006	Placement Agent	Legal Counsel
American Beacon Advisors	American Private Equity Partners II	200	53	146	None	Haynes Boone
Bear Stearns *	Bear Stearns Private Equity Ltd.	60	3.25		Bear Stearns	
Brown Brothers Harriman	BBH Private Equity Partners IV	1000		1.5		
Camden Partners*	Camden Partners Equity Managers I					
Citigroup*	Europe Enterprise II Onshore	200	59			
Commonfund Capital*	Commonfund Capital Private Equity Partners VI	750	250	250		
Diversified Trust Co.*	DTC Private Equity II	100	85	125	None	Bass Berry & Sims PLC
Drum Capital Management	Drum Special Situations Partners II	500		200		Ropes & Gray
Dupont Capital Management Corp.*	Dupont Capital II	200	55	103		Bear Brauen
HRJ Capital	HRJ Growth Capital II	200				
HarbourVest Partners*	HarbourVest International Private Equity Partners V	2600	188	188		
INVESCO Private Capital*	INVESCO U.S. LBO and Corporate Finance Sponsorship Fund IV	500	242			
Lehman Brothers***	Lehman Crossroads Fund XVIII					
Mesirow Financial*	Mesirow Financial Private Equity Partnership Fund III	300	65			
Morgan Stanley	Morgan Stanley Private Markets Fund III			1000	None	
NCD Management	NCD Partners IV	100		30		
Pacific Corporate Group*	PCG Emerging Private Equity Markets Fund	500			None	Gibson Dunn & Crutcher
Pantheon Ventures	Pantheon USA Fund VII	2000		1079		
Paul Capital Partners	Paul Capital Partners IX (Secondary)	1000				
Peppertree Partners*	Peppertree Fund III	100				Thompson Hine
Portfolio Advisors	Portfolio Advisors Private Equity Fund IV	650		82	Fortress Group	Schulte Roth & Zabel
Private Advisors*	Private Advisors Small Company Buyout Fund III					
Quellos Group*	Quellos Private Capital Markets II	250				
Rumson Capital Advisors*	Rumson Silk Road Fund	250				
Siguler Guff & Co.	Siguler Guff Distressed Opportunities II	1000	500	1000		Ropes & Gray
Siguler Guff & Co.	Siguler Guff BRIC Opportunities Fund	350	300	600	None	Ropes & Gray
Siguler Guff & Co.*	Siguler Guff Small Buyout Opportunities Fund	300			None	Ropes & Gray
The Investment Fund for Foundations*	TIFF Private Equity Partners 2006			178		King & Spalding

Guff Distressed Opportunities II and the \$600 million Siguler Guff BRIC (Brazil, Russia, India, China) Opportunities Fund. It is also in the market with a \$300 million-targeted small market buyout fund, an area that the firm believes is being ignored by most funds of funds.

Specialization's Detractors

Not everyone is necessarily singing specialization's praise. Many pros say that being a successful fund of funds investor still basically comes down to access. When **Stephen Schwarzman** or **Henry Kravis** can't be reached, it's up to the funds of funds to provide investors with an in.

Adams Street Partners' Gary Fencik,

head of business development for the firm, cites, "It all gets back to discipline and access to relationships."

Steven Costabile, a managing director in the fund-of-funds arm at **AIG Global Investment Group**, agrees with Fencik to some extent. He believes that in some cases specialist strategies can get groups into trouble primarily because it creates demand for a market that may not even be there. For example, in looking at the distressed space, he cites, "A lot of capital has already been formed to take advantage of the distressed cycle, but it hasn't happened."

He further asks, "Is that capital going to be put to work in a suboptimal way?"

With that said, there are also those that

believe the industry needs to bill itself on more than simply an "in."

Siguler Guff & Co. Principal **Maria Boyazny** cites that funds of funds can't merely play the role of access-provider. She believes a successful fund of funds has to cater to larger and more experienced institutional players.

"We believe private equity is about targeted opportunities," Boyazny says. "It's about finding areas of capital starvation around the globe. Smarter LPs, endowments and foundations, they aren't looking for plain vanilla funds of funds. They need someone who's going to bring a cutting edge idea or open up a new market niche."

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