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Fundraze

Institutional investors will still invest, but the fundraising market looks nothing like it did 18 months ago

By Avram Davis

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In the first week of October, *the Wall Street Journal* reported that JC Flowers & Co.’ marked down an unrealized loss of nearly $2 billion on its $6.5 billion fund. The news for limited partners was pretty grim, although some cheer could be found, as JC Flowers, less than a month earlier, held a $2.5 billion first close for its follow-up effort. It’s perhaps a sign that while the LBO world wallows, the fundraising market is not so easily shut down.

Indeed, according to data from Preqin, LBO firms were able to corral $415 billion in the first three quarters of 2008, a healthy figure, to be sure, but still about 7% off of the previous year’s pace. What buyout pros are wondering, though, is how well fundraisers will do post Sept. 15.

With that said, new obstacles are cropping up every day, and if a firm does not have a sufficient track record or a brand name in lieu of results, it is going to be tough sledding in the months to come. The challenge confronting limited partners is twofold. As stock investments deteriorate, the amount that LPs are able allocate to equity investments has also dropped off. Considering the volatility of the stock market, institutions also might be more inclined to leave some cushion, which would very likely come at the expense of their less liquid alternative assets.

Perhaps more poignant, several LPs are likely receiving letters from their general partners very similar to the note JC Flowers delivered. With credit drying up, many PE portfolios have suffered. This pullback is magnified by the fact that so much money was directed to large-market and mega-market funds, which have been hit particularly hard. Evidence can be found in the form of TPG Capital’s $1.35 billion loss on its investment in Washington Mutual, which fell apart less than six months after the infusion, or Cerberus Capital Management’s string of duds, including GMAC or Chrysler. Kohlberg Kravis Roberts, meanwhile, in a filing with the SEC, divulged that its portfolio lost $1.2 billion in the first half of 2008.

In light of how much money was directed to the upper ends of the asset class, the struggles there don’t reflect well on limited partners. “These institutions are generally laggards. They wait to chase whatever is hot until it’s basically over, and then whenever it comes down they get burned,” **Amit Chokshi**, managing member at **Kinnaras Capital Management LLC**, says.

But the struggles of the market have also forced investors to take a harder look at where they place their money, which means established players who can demonstrate a history of performance will continue to see interest.

Accel-KKR, for instance, in the second week of September closed on $600 million for its third fund. The firm, which focuses on growth-oriented plays in the middle-market technology space, had originally targeted $450 million for the vehicle, and was forced to apply a hard cap to the effort.

Ben Bisconti, managing director of **Accel-KKR**, believes LPs will be very discriminating and will look for established results. Regarding his own fund, Bisconti mentioned that Accel-KKR did not generate returns based on a structure that relied on leverage when the credit markets became unhinged last year. This sober strategy will no doubt become more prevalent in the coming years.

Speaking to the market, Bisconti does not believe the present storm will prove disastrous to competent GPs with a track record. Nevertheless, he warns, “New funds will have a more difficult time.”

Mike Kelly, managing director at investment advisory firm **Hamilton Lane**, believes fundraising will slow down in the coming year. “Not as many [private equity firms] will close [funds] at the amount that they were hoping for,” he says.

Kelly also expects that institutional investors will take their time in deciding which funds to back and he predicts they “will be narrower in their focus.”

Randall Fojtasek, a partner at **Brazos Private Equity Partners, LLC** echoes that sentiment. Brazos, which held a final close on $700 million for its third fund in September, targets closely held and family controlled businesses in the southwestern US. This narrow concentration, and the firm’s sector focus spanning