



Consolidation of the Private Equity Fund of Funds Industry

The private equity fund of funds industry has recently seen an abundance of merger activity, as both buyers and sellers of private equity divisions act on a range of motivating factors. [Jessica Duong](#) explores the ongoing process of consolidation that is hitting the fund of funds sector of the private equity universe.

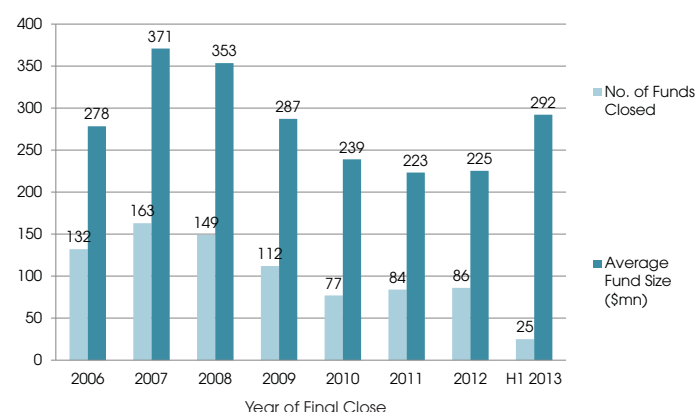
Funds of funds have long been utilized across all asset classes, primarily for their ability to achieve a broad diversification of investments, in addition to other investor benefits. These types of vehicles represent an important component of the private equity industry, but the sector is now undergoing a process of change. A consolidation of fund of funds businesses is becoming progressively apparent, with a number of possible explanations for this. For buyers, it may be part of a strategic increase in scale to improve the strength of the investment houses' offerings. For sellers, the mergers may be a response to a persistently challenging economic environment; with a difficult fundraising climate for fund of funds vehicles coupled with certain institutional investors facing regulatory pressure to reduce their exposure to the asset class, increasing numbers of firms are putting up their private equity divisions for sale.

The Contribution of a Difficult Fundraising Environment

The challenges of securing capital for funds of funds are evident in fundraising statistics for these vehicles. Preqin's [Funds in Market](#) data shows that over time, private equity funds of funds comprise a decreasing proportion of overall capital raised by the private equity asset class. As of the end H1 2013, \$162bn had been garnered by all private equity funds that held a final close in the first half of the year, but only \$6.4bn (4%) of this emanated from private equity fund of funds vehicles, as shown in Fig. 1. The decline in the proportion of capital secured by fund of funds vehicles over recent years is clear and steady, falling from 11% in 2009 to 7% in 2011 to 4% in 2013 YTD.

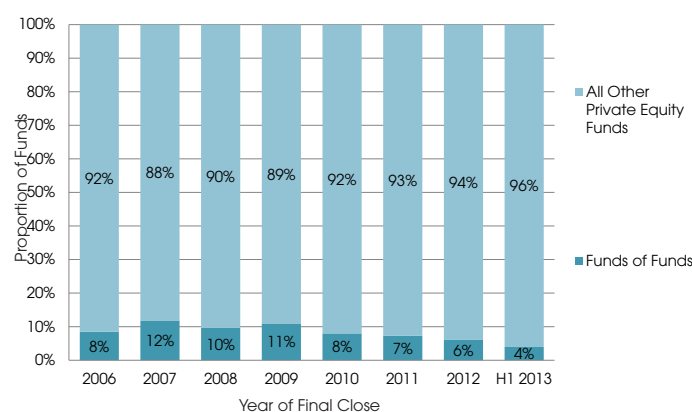
The number of private equity funds of funds that have reached a final close each year has been shrinking since its peak in 2007, when 163 vehicles closed with an average size of \$371mn, as illustrated in Fig. 2. The mean fund size has similarly declined at a steady rate since 2007, but has rebounded in this year. The average final close size of funds

Fig. 2: Annual Private Equity Funds of Funds Fundraising, 2006 - H1 2013



Source: Preqin Funds in Market

Fig 1: Annual Global Private Equity Fundraising: Funds of Funds vs. All Other Private Equity Funds, 2006 - H1 2013



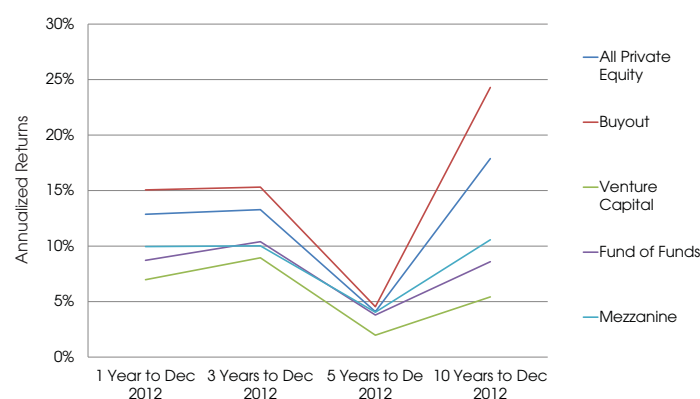
Source: Preqin Funds in Market

of funds that held a final close H1 2013 is \$292mn, the highest that it has been since 2008. However, it is likely that this statistic is skewed by the final close of the mega CNY 15bn (approximately \$2.4bn) vehicle, Guochuang Kaiyuan Fund of Funds, in Q1 2013.

Relatively Poor Performance

Fig. 3 shows horizon returns across different private equity strategies and indicates that as a whole, funds of funds have not performed as well as other strategies. Ten-year horizon IRR data to 31st December 2012 indicates that all private equity strategies generated a return of 17.9%, while buyout funds returned 24.3%. Funds of funds have only generated an average return of 8.6%; in other words, the benefits that

Fig. 3: Private Equity Horizon IRRs as of 31 December 2012



Source: Preqin Performance Analyst



funds of funds can offer in terms of diversification (and hence lower risk) have tended to come at the cost of relatively lower net returns than those offered by primary funds. Looking at private equity funds of funds benchmarks in Fig. 4, the median IRR for funds of funds of a 2007 vintage is 5.8%, whereas the median IRR for buyout funds of the same vintage is 10.4%. Part of the reason for this is that funds of funds involve a double layer of fees and therefore investors must decide if the diversification benefits of funds of funds warrant the higher costs.

Recent Cases of Consolidation

Given the combination of difficult fundraising conditions, weaker performance than other fund types and a deepening sophistication of investors, a reduction in investor appetite for funds of funds has led to a degree of consolidation of the industry across the globe, with transactions involving US, European and Asian firms. Naturally, the individual reasons behind each deal vary, with differing circumstances with regard to cause and effect.

In March 2013, French insurance company Groupama's private equity unit was put up for sale following pressure from regulators to improve its solvency ratios. Groupama had a real need for liquidity and to offset large losses incurred by its holdings of equities and Greek sovereign debt. It was announced that ACG Group would be the buyer of Groupama Private Equity (GPE) and by the end of April 2013, the acquisition was finalized. GPE's fund of funds arm Quartilium was included in the sale, which had €1.4bn of assets under management. As a result of the transaction, the merged group has around €3.5bn of assets under management and GPE changed its name to ACG Capital. Groupama will retain all of its investments in the funds managed by GPE.

A deal was closed in 2012 for US-headquartered StepStone Group's purchase of fellow private equity fund of funds manager, Parish Capital Advisors. It was intended that the acquisition will further enhance StepStone's competencies in investing in small private equity funds with focused strategies, as well as contribute to growing the firm's European investment capabilities, which is an important strategic goal for StepStone.

Also in 2012, Hong Kong-based Squadron Capital was sold to US firm FLAG Capital, in the first acquisition of a fund of funds in Asia's private equity industry. The acquisition gave FLAG a presence in Asia through an established platform and also captured one of the most experienced private equity fund of funds teams in the region. The name was changed to FLAG Squadron Asia and FLAG Capital was able to gain the funds and investment programs Squadron Capital managed for investors across the Asia region, as well as a relationship with Keva, a European public pension fund.

Perseverance of Large Fund Managers

It is apparent that despite the challenging fundraising environment for funds of funds, there are still numerous managers very active in the space and some particularly big names that continue to dominate the fundraising market. Figs. 5 and 6 list the largest fund of funds vehicles that reached a final close in 2013 YTD and those that are currently in market.

Guochuang Kaiyuan Fund of Funds closed on CNY 15bn in February 2013. It is part of a joint venture between China Development Bank (CDB) and Oriza Holdings that has an overall, long-term target to raise CNY 60bn through a series of smaller funds of funds. Its main objective is to provide capital for domestic private equity firms that have difficulty in raising funds. The fund's buyout activity will focus on relatively well-developed industries and enterprises, including medium to high-end manufacturers and financial institutions.

In March 2013, Portfolio Advisors Private Equity Fund VII closed above its \$900mn target, on \$1,090mn, for provision of a "flexible" structure that offers investors the option to select from among any number of its seven sector funds, including diversified buyout, venture capital, diversified special situations, Rest of World-focused mid-market buyout, US-focused mid-market buyout, distressed and co-investments.

HarbourVest Partners has two funds that fall in the top five funds in market, HarbourVest Partners IX – Buyout, which is targeting \$1.5bn and HarbourVest Partners IX – Venture, which is targeting \$1bn. The funds will follow a similar investment strategy to their predecessor

Fig. 4: Preqin Private Equity Fund of Funds Benchmark

Vintage	No. of Funds	Median Fund			IRR Quartiles (%)			IRR Max/Min (%)	
		Called (%)	Dist (%) DPI	Value (%) RVPI	Q1	Median	Q3	Max	Min
2010	33	33.1	0.0	99.5	8.6	3.4	-6.6	16.4	-30.8
2009	36	52.0	7.9	99.0	14.0	7.7	1.8	46.5	-6.0
2008	93	61.6	11.2	97.8	9.2	5.9	1.7	16.9	-12.9
2007	110	79.7	20.2	95.5	8.5	5.8	3.5	20.0	-13.3
2006	86	84.8	24.7	89.9	7.4	5.2	3.4	11.9	-5.9
2005	72	90.0	30.2	89.9	7.3	5.5	3.8	13.9	-3.7
2004	46	92.0	55.0	75.6	8.9	6.4	5.4	21.6	-20.0
2003	35	94.4	74.4	64.8	11.7	8.0	5.6	20.9	-1.7
2002	25	95.4	88.6	65.1	12.6	9.7	8.4	21.4	-0.8
2001	50	95.5	108.6	46.1	14.4	9.8	6.6	31.4	-8.3
2000	37	96.0	111.8	27.6	13.4	6.6	2.1	22.1	-8.9
1999	29	97.7	104.6	18.1	7.3	3.6	-0.8	17.0	-9.2
1998	19	95.9	131.7	9.2	8.4	6.1	3.9	18.3	-2.9
1997	12	96.8	136.0	3.9	18.9	7.4	4.8	63.8	2.6

Source: Preqin Performance Analyst



Fig. 5: Five Largest Fund of Funds Vehicles Closed in H1 2013

Fund	Firm	Vintage	Final Size (mn)
Guochuang Kaiyuan Fund of Funds	China Development Bank Capital	2011	15,000 CNY
Portfolio Advisors Private Equity Fund VII	Portfolio Advisors	2011	1,090 USD
Partners Group Global Value 2011	Partners Group	2011	680 EUR
Private Advisors Small Company Buyout Fund V	Private Advisors	2012	340 USD
SCM International Private Equity Select IV	SCM Strategic Capital Management	2011	250 USD

Source: Preqin Funds in Market

Fig. 6: Five Largest Fund of Funds Vehicles Currently in Market (As at 31 July 2013)

Fund	Firm	Target Size (mn)
HarbourVest Partners IX - Buyout	HarbourVest Partners	1,500 USD
Abbott Capital Private Equity Fund VII	Abbott Capital Management	1,300 USD
HarbourVest Partners IX - Venture	HarbourVest Partners	1,000 USD
Crown Premium V	LGT Capital Partners	700 EUR
GC Oriza Fund of Funds	Oriza Holdings	5,000 CNY

Source: Preqin Funds in Market

vehicles in the same series, both to be invested globally with a primary focus on US.

Abbott Capital Private Equity Fund VII, is the second largest fund of funds currently seeking capital commitments. With a target size of \$1.3bn, it will divide its capital equally between buyout, venture capital and special situations funds. It has a maximum allocation of 20% to secondary investments.

Benefits of Investment into Funds of Funds

Fund of funds vehicles will always offer a number of benefits to investors, particularly to those that lack the experience, expertise or resources to make direct fund investments themselves. Through a fund of funds vehicle, LPs are able to access investments that they may not necessarily be able to on their own. Exposure to certain fund managers and top performing funds that the investor could not access otherwise has often been cited as an incentive to invest in a fund of funds, with the minimum commitment size to a fund of funds often smaller than it is for top-tier fund managers.

A direct investment with a private equity firm can have a high concentration of investments, so if the returns for an individual investment are disappointing, it could have a significant impact on the performance of an entire portfolio. By diversifying investments, funds of funds are typically lower risk as they have exposure to a much greater number of investments. Furthermore, this can involve varied allocations to different fund types, geographies or strategy. A mix of these, as seen in many funds of funds, will reduce volatility of returns.

Conclusion

The examples of acquisitions of funds of funds highlight the varied motivating factors on both the buy and sell side. Desire to accelerate

company growth by absorbing assets or acquiring the expertise of a certain team can be reasons for a firm to buy a fund of funds business. Conversely, the need for captive owners (banks and insurance companies specifically) to dispose of non-core assets due to regulatory pressures is a possible motivation to sell, along with the attraction of a strategic alliance with a bigger firm in order to be better prepared to face the challenges that the current market conditions present for funds of funds.

Funds of funds will always have a place in the industry, particularly for investors looking for lower-risk investments through increased diversification. Smaller and less experienced LPs as aforementioned, will still utilize fund of funds vehicles in order to access the asset class, as will those that are looking for exposure to certain niche strategies or geographies that are beyond their realm of expertise. However, perhaps the fund type is not as significant as it once was, given the more challenging fundraising environment and the development of more sophisticated investors, that look more to direct fund investments for exposure. As a result, it seems we are in the midst of an evolution of the fund of funds industry whereby consolidation is occurring across the globe.

So far in 2013, there have been a number of announcements of more transactions whereby firms are merging private equity fund of funds arms of others into their own operations in order to create a single, larger scale fund of funds investment platform. Examples include Aberdeen Asset Management's acquisition of a majority stake in SVG Advisers, which was expected to be completed by the end of H1 2013 and the upcoming integration of Partners Group and Perennius Capital Partners following its announcement in May 2013. These case studies are but a few instances that further reinforce the pattern of consolidation witnessed in the private equity fund of funds industry, and also suggest that this trend is set to continue.

Data Source:

Subscribers to Preqin's [Investor Intelligence](#) can click [here](#) to view profiles for 296 private equity fund of funds managers worldwide.

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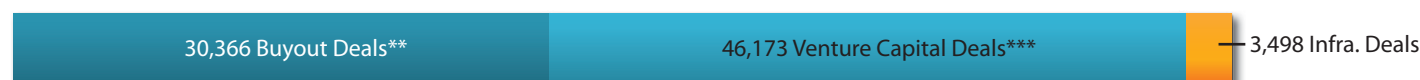
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