



Private Equity Zombie Funds

“When there are no portfolio realizations, the dead will walk among us” – Jessica Duong takes a look at the ever growing number of zombie funds and their impact on the industry.

There is growing concern in the private equity space for funds raised several years ago that are slowly becoming the ‘living dead’. Preqin data indicates that there are \$116bn worth of private equity assets trapped in funds past their typical holding period, and the GP has no clear plans to raise a successor fund. Dubbed as ‘zombie funds’, it is unlikely that the GP will see any returns from the assets that they are holding. The funds continue to charge management fees in spite of this, and tie up the LPs’ cash for longer than any party initially intended.

Poor Performance

Firms plagued by poor performance face being shut out of raising capital for several years. Preqin’s [Funds in Market](#) estimates that there are around 1,200 funds that can be described as zombie funds. How can you identify a zombie fund? The methodology used by Preqin to identify these funds is to look at active firms managing a fund with a 2001-2006 vintage, which have not raised a follow-on fund after 2006. Looking at performance is also key. Preqin’s [Performance Analyst](#) shows that zombie funds have a much lower median distribution to paid-in capital compared to their peers, demonstrating the lack of returns investors in these funds have received. As shown in Fig. 1, for all private equity funds with a 2003 vintage, 99% of paid-in capital has been distributed back to investors, whereas zombie funds with a 2003 vintage have only distributed 39% of paid-in capital back to investors.

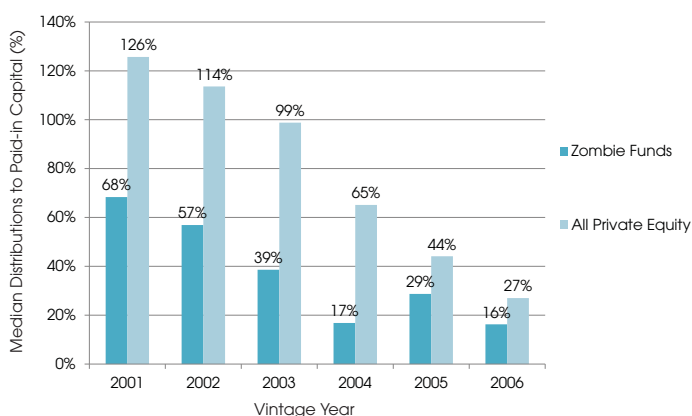
Unrealized Investments

Using Preqin’s [Buyout and Venture Deals Analyst](#) products, we have identified approximately 1,732 portfolio companies currently held by zombie funds. As shown in Fig. 2, \$116bn worth of assets have yet to be realized. These portfolio companies may prove interesting opportunities for fund managers and other potential acquirers looking to purchase assets at a discounted price.

Secondary Buyouts

The secondary market offers some solution to both GPs with zombie funds and LPs that are investors in such funds. Through secondary purchases, a fund manager can take over the assets of a zombie fund,

Fig. 1: Median Distributions to Paid-In Capital by Vintage Year: All Private Equity Funds vs. Zombie Funds



Source: Preqin Performance Analyst

thereby creating an exit opportunity and liquidity for the primary vendor. An example of a firm that does so is Vision Capital. The London-based GP specializes in acquiring mature portfolios of mid-market European companies. Its latest fund, Vision Capital Partners VII, closed in 2009 on €680mn, almost double the size of its predecessor. The fund series has a preference for control positions with transaction sizes of €50mn to €1bn.

The Fundraising Market

No one is a winner when zombie funds are involved and it presents a clear misalignment of interests between the fund manager and investor. Consequently, GPs should be eager to realize investments and return capital to investors so that there is not any reputational damage that adversely affects their ability to raise a follow on fund. The secondary buyout market goes some way in offering a solution to return capital to investors.

This situation however is not having a detrimental impact on investors’ appetite for new investments in the asset class. Investors as a whole are satisfied with the returns that they are receiving from their private equity portfolios and are looking to continue investing in the asset class. Preqin’s [Funds in Market](#) reveals from 2012 to 2013 YTD, 1,148 private equity funds reached a final close, securing an aggregate \$506bn. A significant 87% of investors interviewed in December 2012 planned to maintain or increase their allocation to private equity in the next 12 months.

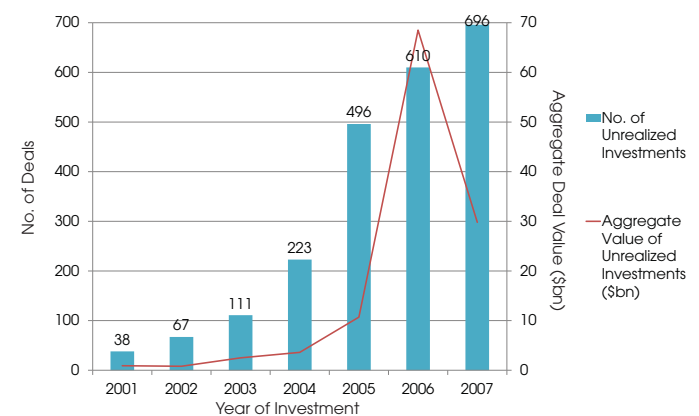
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Which funds fall within the definition of ‘zombie fund’? What portfolio companies do they hold, and do they represent potentially attractive investment opportunities?

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Fig. 2: Number and Aggregate Value of Unrealized Investments Made by Zombie Funds, 2001 - 2007



Source: Preqin Buyout and Venture Deals Analyst