PRIVATE EQUITY SPOTLIGHT

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January 2006 Volume 2 Issue 1

Welcome to the January edition of ***Private Equity Spotlight***, the monthly newsletter from Private Equity Intelligence. This special edition of Spotlight focuses on fund raising, with a detailed Executive Summary from our 2006 Global Fund Raising Review, published this week.

2005 - BREAKING PREVIOUS RECORDS

2005 was widely expected to be a great year for fund raising, but few commentators anticipated that it would be the record-breaking year that it turned out to be. No fewer than 479 funds achieved final closes during the year, raising a massive $261 billion.

PERFORMANCE SPOTLIGHT

Performance drove the fund-raising market in 2005. Even though buyout and other funds called up increasing amounts of cash from their LPs, the tremendous pace of distributions back to investors meant that most LPs enjoyed a positive cash flow from their private equity programs - driving their appetite for new funds.

2006 - FUND RAISING

2006 starts out with a record number of new funds on the fund-raising trail: 681 new funds are currently on the road, with a combined target of $220 billion. Looking ahead, they are set to be joined imminently by further new funds, ensuring a ready supply of investment opportunities for LPs.

No. of Funds on Road	US	Europe	ROW	Total
Venture	161	70	65	296
Buyout	116	57	32	205
Fund of Funds	53	41	10	104
Other	44	15	17	76
Total	374	183	124	681

INVESTOR SPOTLIGHT

Analysis of our Investor Intelligence database confirms that despite two strong years of fund-raising, most LPs are well below their target allocations.

Many intend to close the gap, and as a result a majority of LPs intend to invest more in 2006 than they did in 2005.

2006 - ANOTHER RECORD YEAR?

With a ready supply of new funds coupled with strong LP appetite, 2006 looks like being another great year. But the strong market brings its own perils - and LPs need to take care.

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Publisher: Private Equity Intelligence Ltd
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2005 - Breaking Previous Records

After a strong performance in 2004 (when 419 new funds raised $165 billion worldwide), 2005 was widely expected to be a good year for private equity fund-raising. However, the sheer scale and pace of the market exceeded expectations. No fewer than 479 new funds achieved final closes during the year, raising an aggregate $261 billion between them – passing the previous record established in 2000.

"As in previous years private equity firms based in the US accounted for the lion's share of all new funds, raising $172 billion, or almost exactly two-thirds of the global total.**"**

(Please note that these figures are correct as at 15th January, and are subject to upwards review as additional data on further closes during 2005 filters through. In addition, they are based upon *final* closes only, and exclude the many funds that achieved significant interim closes during 2005, including mega funds like Blackstone V and Apollo VI).

Figs. 1 and 2 show the number and value of final closes during 2005 as compared with 2004.

- Buyout funds were the big success story of 2005, with 139 new funds raising $134 billion between them – 60% more funds than in 2004, and raising just over twice as

Fig 1: Final Fund Closes, 2005

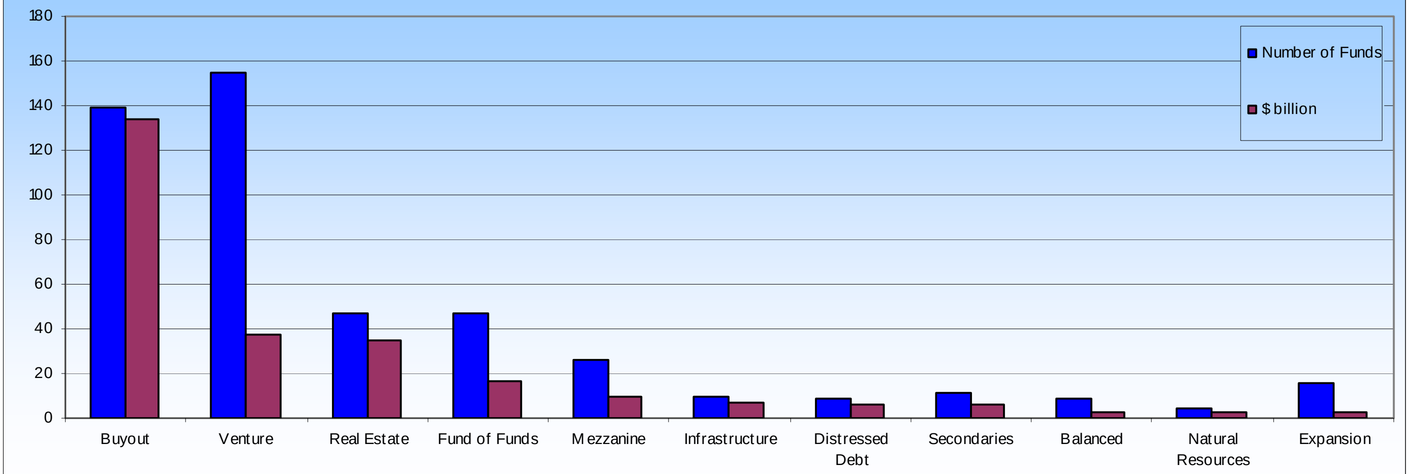
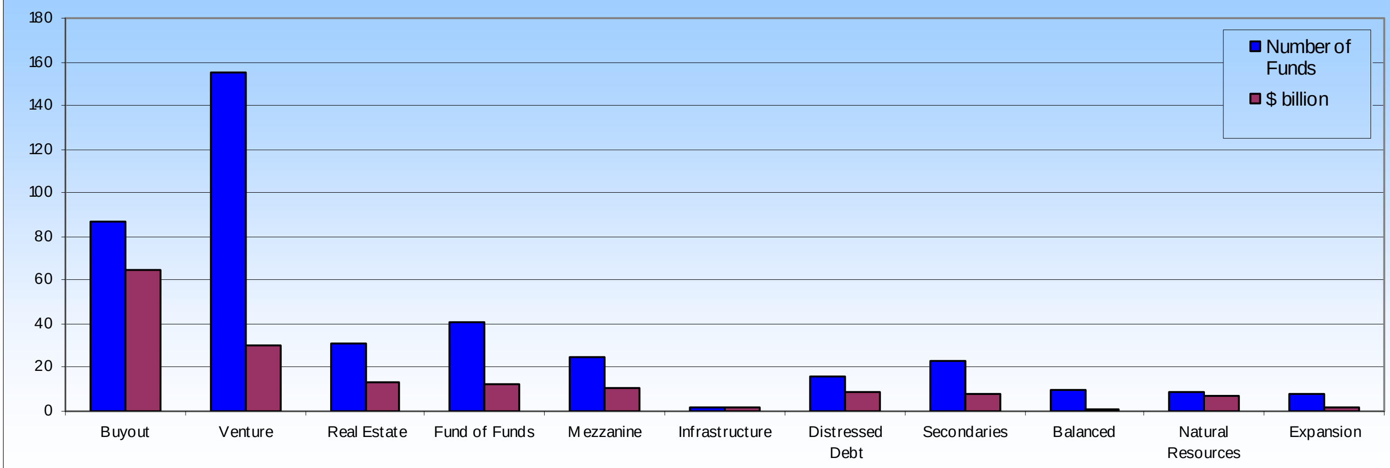


Fig 2: Final Fund Closes, 2004



much money.

- Venture had a reasonable year, with 155 funds raising $37 billion globally – the same number of funds as in 2004, with total commitments up by 23%.
- Real Estate private equity funds had a great year, with 47 new funds raising a total of $35 billion, increases of 52% and 155% respectively on 2004.
- Fund-of-Funds saw steady growth, with 47 new vehicles raising $16 billion, an increase of 28% in total commitments.
- Mezzanine had a quiet year, with 26 new funds raising $9 billion, a 10% reduction on 2004's total.
- Infrastructure funds had a great year, with $7 billion raised by 10 new funds, nearly a five-fold increase on 2004.
- Nine Distressed Debt funds raised an aggregate of $6 billion, which was a 29% decrease on 2004's total, despite the widespread speculation in the market that the buyouts boom will create more distressed opportunities.
- Eleven focused Secondaries funds raised $6 billion between them, a 30% decline on 2004's $8 billion.

US and UK Leading the Way

As in previous years, private equity firms based in the US accounted for the lion's share of all new funds, raising $172 billion, or almost exactly two-thirds of the global total. The UK came next with $49 billion, 19% of the total. Australia, France, Germany, Hong Kong, Italy, Switzerland, Japan, Denmark and China accounted for most of the remainder, with firms from these countries raising $32 billion across 98 new funds.

A feature of fund-raising in 2005 has been the growing importance of large funds, most of which invest across a broad geographic remit. Thus while the majority of funds (by number of funds) invest in their own region, a growing proportion (by value) invest across several regions or even globally. The US still accounts for the focus of 40% of funds raised during 2005, with Europe the focus for 30% and the Rest of the World accounting for 10% (especially Australia, India, China, Japan and Israel). Funds with a global investment remit accounted for just under 20% of funds raised during 2005.

2005 FUNDS CLOSED LISTINGS / ANALYSIS

Further detail available in **2006 Global Fund Raising Review:**

⇒ Listings of all 479 funds raised in 2005
⇒ Target and final close size
⇒ Placement agents acting
⇒ Sample LPs
⇒ Analysis of key trends
⇒ Patterns shaping the market

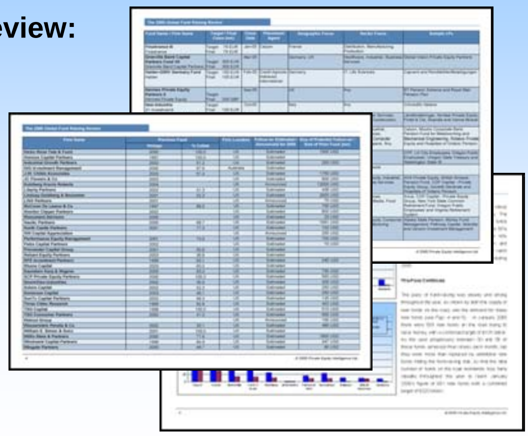
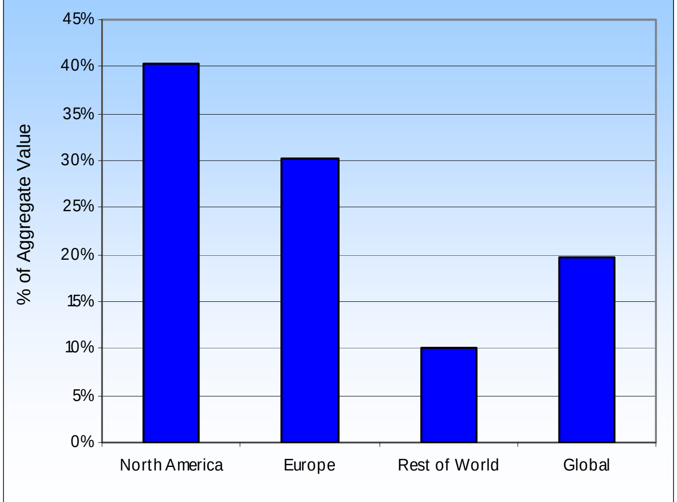


Fig 3: Geographic Focus of Funds Raised in 2005

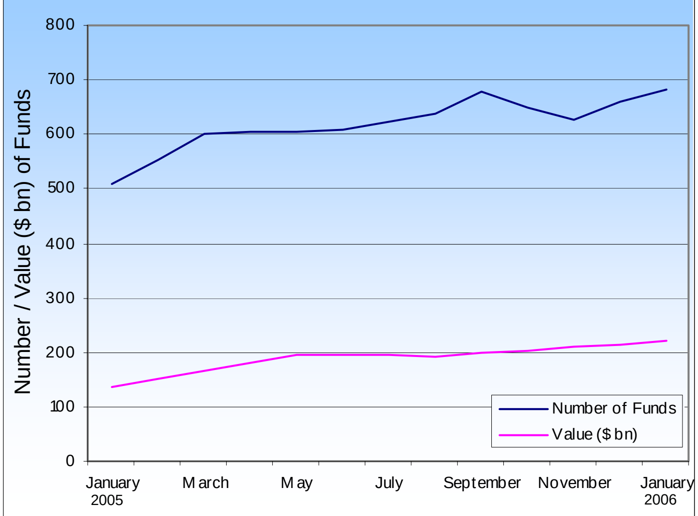


The Pace Continues

The pace of fund-raising was steady and strong throughout the year, as shown by both the supply of new funds on the road, and the demand for these new funds (see Figs. 4 and 5). In January 2005, there were 509 new funds on the road trying to raise money, with a combined target of $137 billion. As the year progressed, between 30 and 50 of these funds achieved final closes each month, but they were more than replaced by additional new funds hitting the fund-raising trail, so that the total number of funds on the road worldwide rose fairly steadily throughout the year to reach January 2006's figure of 681 new funds with a combined target of $220 billion.

The rate of fund-raising remained strong throughout the year, with each month seeing between 30 and 50 funds achieve final closes, raising a total of $15 billion to $30 billion per month. (Please note that the final closes figures for the last three months of the year are subject to upwards revision as data on additional final closes filters through during January and February).

Fig 4: Funds on Road during 2005-2006



The Year of the Mega-Fund

2005 quickly became the year of the mega-fund, as several very large buyout funds hit the fund-raising trail. Where 2004 had seen only one buyout fund of more than $5 billion raised, no fewer than 6 buyout funds of $5 billion or more achieved final closes during 2005, raising an aggregate of $44 billion between them, or exactly one-third of the total buyout funding raised in 2005. (And remember, these figures exclude Blackstone and Apollo, which are awaiting their final closes, but have already raised $22.5 billion between them).

Fig 5: Final Closes by Month, 2005

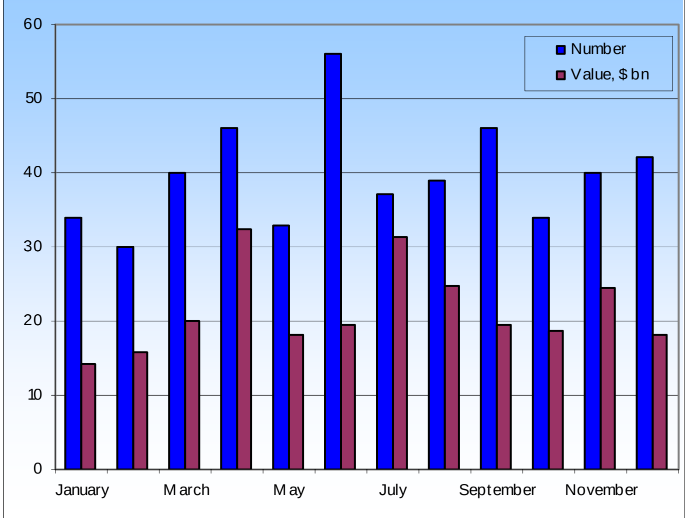


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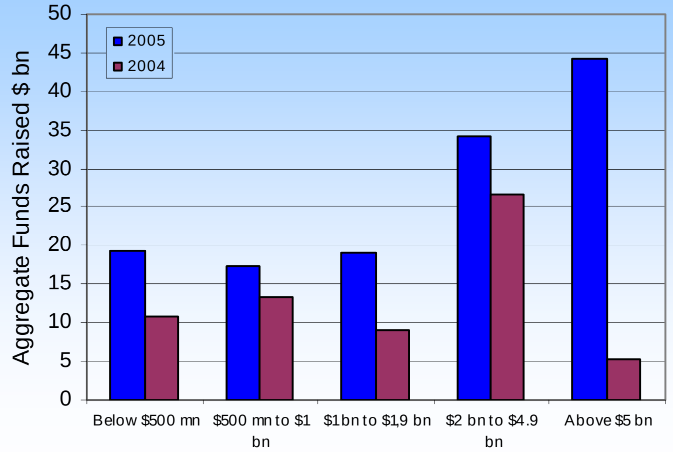
Fig 6:
Buyout Fund Final Closes - 2005 vs. 2004

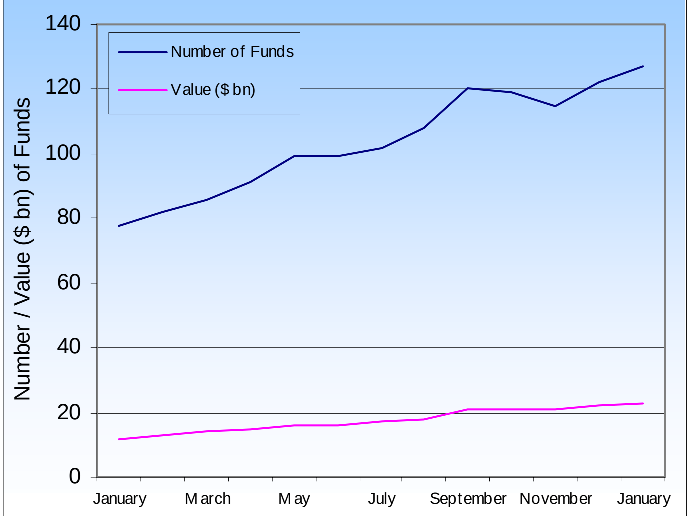


Extending the threshold down to $2 billion gives a total of 17 buyout having raised a combined $78 billion, or nearly 60% of the total global buyout funds raised. These figures provide welcome support to the view that the buyout industry can invest these large sums of money without necessarily driving down returns: the larger global funds are investing in new segments of the market and acquiring much larger individual assets than buyout funds have before, so the increased funding is aimed at a correspondingly larger pool of assets.

Increased activity in Emerging Markets

While US and European buyouts grabbed the headlines, there has also been a clear increase in activity in emerging markets, with 10% of all funds raised being focused outside Europe and North America (not to mention the 20% represented by global funds). During the course of 2005 an increasing number of new funds aimed at investing outside Europe and North America were launched, as shown in Fig. 7.

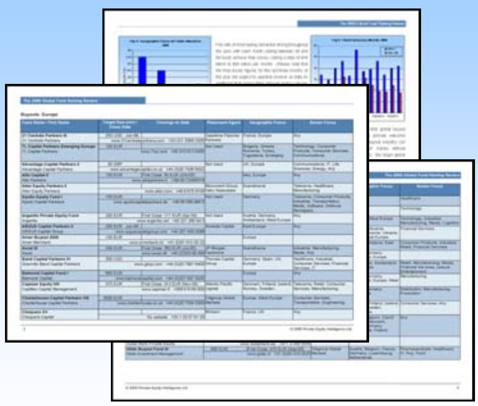
Fig 7: Rest of World - Total Number of Funds in Market 2005



MARKET LISTINGS / ANALYSIS

Further detail available in **2006 Global Fund Raising Review:**

- ⇒ Listings of all 681 new funds currently on the road
- ⇒ Target size and investment focus
- ⇒ GPs, Placement Agents, closes to date
- ⇒ Vital listings of 324 new follow-on funds likely to launch but not yet on road
- ⇒ Analysis: which segments will be most crowded in 2006? Where is LP appetite strongest?



Role of Placement Agents

Placement agents continued to play a vital role in the fund-raising market during 2005. We estimate that placement agents were used in 25% to 30% of all funds raised during 2005, i.e. for between 120 and 140 new funds. We have detailed placement agent information for 91 of these funds, i.e. around two-thirds of the total market. Detailed listings and league tables appear in the body of the Review, and several patterns emerge:

- Relatively few funds of below $200 million use placement agents, presumably as a result of the unfavourable economics of these smaller funds for the agent. Conversely, usage of placement agents is widespread across medium and larger fund sizes, right up to funds of $2 billion and more (however, no funds of above $5 billion were recorded using placement agents).
- Placement agents were also used widely by both first-time funds and by firms raising their second or subsequent fund, right up to firms having raised five or more funds. However, the most experienced private equity firms – those having raised ten or more funds previously across all fund categories – were much less likely to employ a placement agent.

Thus, while there is clear evidence that the very large and experienced firms are more inclined to manage their fund-raising in-house, the role of the placement agents seems secure across the bulk of the market.

Prospects for 2006 – the Supply and Demand Balance

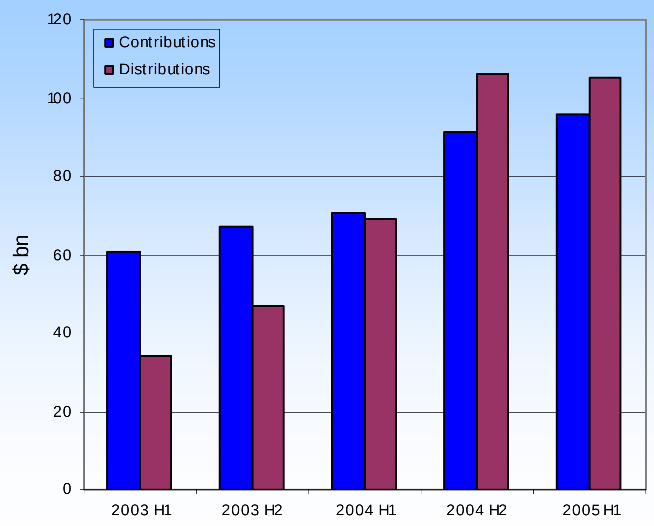
2004 and 2005 have been good years for fund-raising, with a combined 898 new funds having raised $426 billion in commitments – a major turnaround from the bleak conditions of 2003. After two such good years, what are the prospects for 2006?

The key to both fund supply and LP demand is cash flow: the rate of cash calls for existing funds measures both the ability of GPs to invest their existing funds, and the rate at which their unused commitments are being used up. Equally, the rate of cash distributions is a key factor in driving LP appetite for private equity, as well as the key determinant of when they need to ‘replenish’ their existing fund interests with fresh commitments.

We analysed aggregate cash flows globally, using our Performance Analyst database of fund returns data. This shows that cash calls have been growing rapidly across all fund types and geographies, and especially so in buyouts. Fig. 8 shows the aggregate cash that private equity funds of all types have called up from their LPs over the past two and a half years, and also the total distributions that LPs have received back from these funds. Two key points emerge:

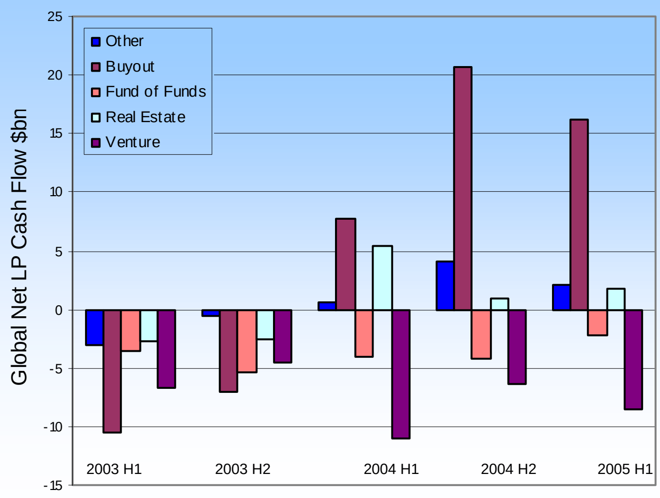
- Firstly, private equity firms have called up increasing amounts of cash for their new funds – in other words, the huge amounts of capital committed over the past few years are being called up and invested. As a result, the 'stock' of uncalled commitments has barely grown over the past year, and currently stands at approximately $595 billion worldwide – between three and three-and-a-half years worth, a normal figure for the industry.
- Secondly, the pace of distributions has accelerated even more quickly, and passed the rate of contributions some time in early 2004. The implication for LPs is that, despite their major commitments to new funds over the recent past, distributions are running ahead of contributions (this analysis shows the aggregate position across for all LPs – naturally individual LPs' experiences will differ based upon the maturity of their private equity program and individual fund choices).

Fig 8: Aggregate LP Contributions and Distributions - All Fund Types, 2003 - 2005



The importance of cash flow is further borne out by Fig. 9, showing the *net* cash flows for LPs (i.e. distributions less contributions) by major fund type. Buyouts, real estate and the 'other' fund types (including distressed, mezzanine and special situations) have seen especially strong cash flows, with distributions ahead of contributions - and correspondingly strong LP interest in fund-raising. Venture and fund-of-funds have yet to see distributions overtake contributions – and fund-raising has correspondingly been more of a challenge in these areas.

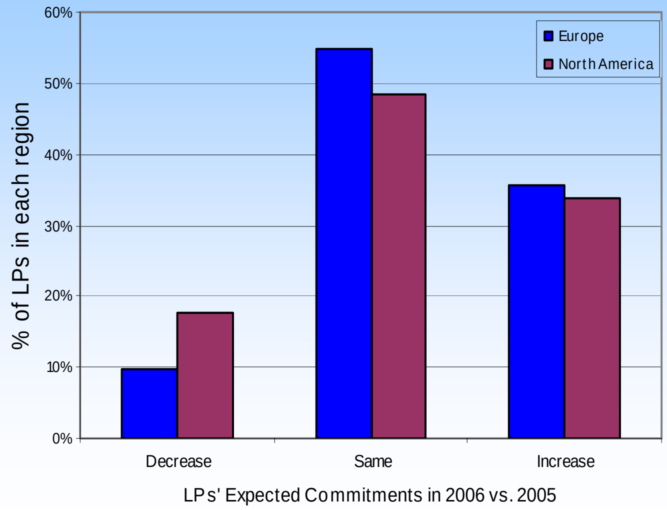
Fig 9: Aggregate LP Net Cash Flow by Fund Type 2003 - 2005



The cash flow picture is further compounded by the fact that most LPs are currently significantly below their target allocations to private equity - with the typical LP at around 80% of their target investment level. Combined with the net cash flows, this has driven the extremely favourable fund-raising conditions in the market: even though LPs have committed record amounts to new funds, the distributions are so strong that they are not actually getting any closer to their targets.

As a result, a majority of LPs are intending to increase their commitments to private equity funds during 2006. We analysed the intentions of several hundred LPs from our Investor Intelligence database to compare their current investment intentions for the coming year now with what their intentions had been a year ago, in late 2004. As fig 10 shows, a clear majority intends to invest more this year than they did at the same time last year – and the increase is more marked for European LPs than for North American LPs.

Fig 10: LPs' 2006 vs. 2005 Investment Intentions - North America and Europe



2006 – Another Record Year?

The prospects for fund-raising have rarely been better than they are in early 2006:

- Supply: more new funds are on the road than at any time in the recent past, with 681 funds targeting $220 billion. They will doubtless be joined by many further new funds, as GPs continue to call up the committed capital in their existing funds at a rapid rate.

- Demand: most LPs are well below their target allocations to private equity, and the strong net cash flows (especially in buyout and real estate funds) are taking them further away from their targets. A clear majority of them expects to invest more in 2006 than they did at the same time last year. Finally, the real measure of LP appetite – the rate of final fund closes – remains strong.

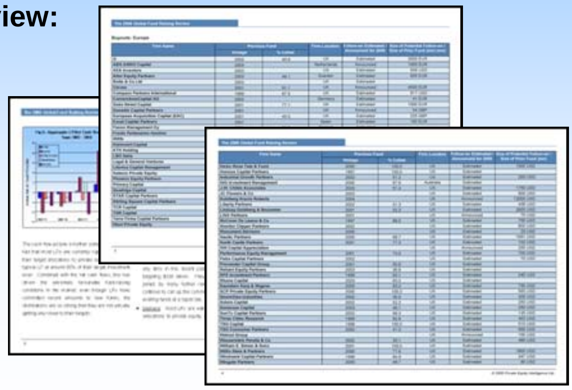
Some commentators have expressed doubts that the fund-raising market can continue at its recent hectic pace. We beg to differ: as long as distributions are as strong as they have been, and absent any major catastrophes, the conditions for fund-raising will remain extremely favourable, and we expect 2006 to match or come close to 2005's record: we are therefore forecasting $220 – 280 billion in final fund closes this year.

Naturally, conditions will vary significantly across different fund types and geographies, and the main body of the 2006 Global Fund Raising Review provides detailed forecasts by fund type and geography.

No review like this would be complete without a modest note of caution, and the 2006 Global Fund Raising Review is no exception. While the vast majority of new money raised will go to the larger funds run by the most experienced firms, there is a noticeable increase in the number of fund offerings from newer firms, and those without clear track records of sustained success. As might be expected, this is most prevalent in the buyout area, where fund-raising has recently been so strong. While the experienced top tier firms can be relied upon to invest wisely, the same may not be true for all firms, and if irrational exuberance is to appear, then it is outside the top tier that problems may arise.

OUTLOOK AND FORECASTS / ANALYSIS

Further detail available in **2006 Global Fund Raising Review:**



- ⇒ Forecasts for fund raising in 2006
  - Detail by fund type and geography
- ⇒ Key factors driving the fund raising market in 2006

The 2006 Global Fund Raising Review

Detailed analysis and review of global fundraising in private equity:

- List of all funds closed in 2005, with fund details, LPs investing in the fund and placement agents used
- Funds on the road Jan 2006 and likely new follow-on funds
- Listings of the 200 top LPs with their investment plans for 2006
- Lists of all major placement agents worldwide, with funds worked on during 2005 and 2006, league tables
- Analysis of dynamics driving the market
- Forecast for 2006

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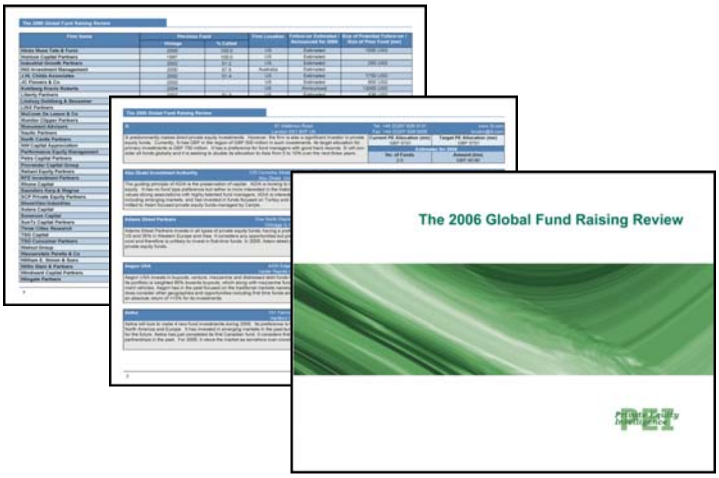

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