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**EXPERT AVAILABLE: KEY CHALLENGES FOR
THE PRIVATE EQUITY MODEL**

Will the Vast Capital “Overhang” Depress Returns for the Foreseeable Future?

BOSTON (May 3, 2010) – The financial downturn presented formidable challenges to private equity that continue to reverberate through the asset class. A key issue is the capital overhang – the huge amount of money raised by private equity funds that remains uncalled. It now stands at \$445 billion for U.S. private equity, according to Cambridge **Associates**, the provider of independent investment advice and research to institutional investors and private clients.

An important question for both investors and managers is the degree which, and for how long, the overhang will depress returns. A piece – just a piece – of the answer is that the smaller the fund and its market focus, the less likely the overhang will impact its returns, according to the authors of a new Market Commentary from Cambridge Associates called “**U.S. Private Equity: Sleeping Off the Overhang Hangover.**”

“The private equity industry faces a number of significant headwinds, and investors who are considering locking their equity up for a decade or more should set a high bar. Manager selection has never been more important,” said co-author **Andrea Auerbach**, Managing Director and Head of U.S. Private Equity Research at Cambridge Associates. “Of all the asset classes that went parabolic from 2004 to 2008, PE, or leveraged buyout, funds may have done the best Icarus impression. After attracting record amounts of money for three years starting in 2005, the number of buyout transactions plummeted as cheap financing dried up. Much of the money raised remains uncalled, which will probably impact returns for current and future investors for a long time.”

Ms. Auerbach is available to provide a big picture view of PE – and review key questions that investors and others should be asking. (Note: Cambridge Associates tracks, and publishes a quarterly commentary on, the performance of private equity as measured by the Cambridge Associates LLC U.S. Private Equity Index[®], widely considered to be the industry-standard benchmark statistics for this asset class.) Among the questions she believes are important:

- **Will the overhang impact industry performance?** If the overhang is not doled out judiciously by the funds that have this excess capital, and if it is used to complete investments that consume capital but are off strategy, the risks of diminished performance and inconsistent execution increase. Managers that “stretch” for performance may overreach and returns could suffer as a result.

- **Which funds are most affected?** Larger and more recent funds are the most affected. Half of the overhang is concentrated in funds with \$5 billion or more in commitments. And more than 75% is concentrated in the 2007-2009 vintage years. Thus, recent-vintage large buyout funds have the greatest opportunity and the greatest challenge in front of them—investing the overhang in such a way that results in compelling returns for investors.
- **Which funds will do best?** The overhang is less resonant in the middle market and lower middle market, with just 12% of the overhang concentrated in funds of less than \$1 billion. In addition, the transaction pace did not fall off as much in that market tier. Larger funds are unlikely to invade this space given the portfolio construction and resource problems presented by making many more much smaller investments to exhaust excess capital. Results of smaller funds could be better than their bigger peers.
- **Is a “tale of two funds” a real risk for investors?** It may or may not be a risk, but it is a reality. Certain funds were partially invested through height of the private equity market, and are likely to invest remaining capital at a much slower pace going forward. This will produce bifurcated results characteristic of each period. Limited partners need to understand this and factor it into their monitoring.
- **What are the unexpected opportunities today?** A continued credit squeeze might not be all bad for investors. Well-capitalized private equity funds – especially mid-market funds – might become a source of capital to credit-starved businesses unable to get financing elsewhere. Returns are difficult to quantify, but investors should remember that private equity doesn’t exist in a vacuum, and can adapt to the current economy.

“Problems in the large-fund buyout space are likely to persist for years, with episodic optimism when capital markets cooperate. In contrast, the middle market has less of an overhang to work through and has been more transactional throughout the downturn, demonstrating perhaps greater resilience,” Ms. Auerbach says. “Which warrants consideration for an investment allocation. As always, however, manager selection is key.”

To receive a copy of the Market Commentary and/or arrange a discussion with Andrea Auerbach of Cambridge Associates, please contact Itay Engelman at Sommerfield Communications at 212-255-8386 or itay@sommerfield.com.

About Cambridge Associates

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