

BIG CAPITAL OVERHANG CONTINUES TO BESET PRIVATE EQUITY, SAYS CAMBRIDGE ASSOCIATES RESEARCH

Overhang Continues to be Concentrated in Large Funds Over \$1 Billion -- Smaller Funds Have Less Overhang and Better Exit Prospects; Replay of Robust 2005-2008 Environment Required to Absorb Overhang

BOSTON (June 14, 2011) – While reduced from last year, a formidable capital overhang – the vast amount of money raised by private equity funds that remains uncalled – continues to challenge private equity returns, according to new research by **Cambridge Associates**, the provider of independent investment advice and research to institutional investors and private clients.

U.S. private equity funds raised \$915 billion from 2005 to 2010, of which about half had been called as of December 31, 2010, leaving a \$376 billion overhang net of fees, according to Cambridge Associates calculations. That is down from the \$445 billion overhang that existed last year. The reason for the drop is that funds greater than \$5 billion made investments in 2010 but raised little or no money. (The fund-raising that occurred in the last year -- \$53.3 billion – was for funds smaller than \$5 billion.)

Still, the overhang is concentrated mainly in funds with more than \$1 billion in commitments – 42% in funds of more than \$5 billion and 43% in funds between \$1 billion and \$5 billion. More than 60% of the overhang is in the 2007 and 2008 vintages, the top-two fundraising years ever. According to Cambridge Associates data, the two vintages are only 46% and 34% called, respectively.

“Despite a meaningful reduction in the overhang for large private equity funds, the overhang remains too large to be absorbed by anything other than a replay of the easy-credit-powered transaction environment of 2005 through 2008. From an investor’s perspective, smaller funds – ones with less than \$1 billion – are, in aggregate, more attractive, we believe. Not only is the overhang smaller for those funds, but they also have greater exit prospects,” said **Andrea Auerbach**, coauthor of the Cambridge Associates U.S. Market Commentary, “**Still Nursing the U.S. Private Equity Overhang Hangover.**”

Among the issues the Commentary addresses...

- **Putting the heated 2005-2008 transaction environment in perspective: How much of an anomaly was it, and will it return?** “It’s definitely worth asking to what degree 2005-2008 data should be considered an outlier, especially for the volume of deals greater than \$1 billion in size – particularly given the impact of the global credit bubble during that period – as opposed to representative of the new norm to which the environment will eventually return,” said Ms. Auerbach, Managing Director and Head of U.S. Private Equity Research at Cambridge Associates.

- **Monetary policy and the sustainability of the recent pick-up in investment pace.** The number of “mega-deals” – those defined as more than \$1 billion in enterprise value rebounded in 2010, though it was far below 2006-2007 peaks. “Sustained traction in mega-deals would temper our concerns about the overhang in the short-term. However, we must recognize that the recent improvement is due in large part to monetary and fiscal largesse. That favorable environment isn’t likely to persist if fiscal policy continues to tighten and central banks move toward normalizing monetary policy, as is expected,” said **Eric Winig**, Managing Director at Cambridge Associates.
- **A bright spot for investors: Many 2006-2008 vintage funds will provide exposure beyond those years, to a more favorable buying environment.** “Thanks to the overhang, commitments made to 2006, 2007 and 2008 vintage funds will offer exposure to current opportunities. Thus, investors that held back from new commitments in 2008-09 – the vast majority – don’t need to worry about being ‘out of the market’ during what seems to have been a good buying period. As the overhang is put to work, these investors will get exposure to different market cycles without making additional commitments to new funds,” she said.
- **A caveat about the 2010 and 2011 uptick in private-equity-backed IPOs.** “While in the past IPOs often functioned as true ‘exit’ events where private equity funds realized gains for investors, today most companies are using IPO proceeds to pay down debt or for general corporate purposes. In such situations, funds need to sell their ownership stakes – which are often substantial relative to trading volume – after the IPO,” Ms. Auerbach said.
- **Why careful manager selection gets more and more important.** “Given the parlous state of the economy and financial markets, as well as issues with the overhang, we expect the best managers to continue to distinguish themselves through better deal sourcing and due diligence and post-investment value add, while less talented managers struggle.”

Ms. Auerbach added, “We continue to believe private equity offers investors a legitimate investment option, but recommend that they set a very high bar for allocating money to this illiquid asset class.”

(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.)

To receive a copy of “Still Nursing the U.S. Private Equity Overhang Hangover,” 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

Founded in 1973, **Cambridge Associates** delivers investment consulting, independent research, and performance monitoring services to over 900 institutional investors and private clients worldwide. Cambridge Associates has advised its clients on alternative assets since the 1970s and today serves its clients with more than 180 professionals dedicated to consulting, research, operational due diligence and performance reporting on these asset classes. The firm compiles the performance results for more than 4,200 private partnerships and their more than 59,000 portfolio company investments to publish its proprietary private investments benchmarks, of which the Cambridge Associates U.S. Venture Capital Index® and Cambridge Associates U.S. Private Equity Index® are widely considered to be the industry-standard benchmark statistics for these asset classes. The venture capital data is used by National Venture Capital Association (NVCA) for its quarterly benchmarks. Cambridge Associates has over 1,000 employees serving its client base globally and maintains offices in Arlington, VA; Boston; Dallas; Menlo Park, CA; London; Singapore, and Sydney, Australia. The firm has plans to open an office in Beijing in the summer of 2011. For more information about Cambridge Associates, please visit www.cambridgeassociates.com.