

SEE WHAT'S NEW AND NOTEWORTHY IN PRIVATE EQUITY THIS WEEK /// ISSUE 57

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PE EXPOSURE TO ZOMBIE FUNDS COULD BE GROWING



Image source: The Wall Street Journal

There are a growing number of pension funds and other large LPs with exposure to near-dead or “zombie” funds, according to an article published in the [WSJ](#). The value of deals in this market has grown to an estimated USD30 billion from USD3 billion in 2002, according to advisory firm Triago. The article explains that zombie fund are like the name suggests, they are funds that persist over a contracted “life span” of 10 to 12 years, forcing LPs to continue to pay management fees, even though the assets offer little hope of returning a decent profit.

The WSJ report says that as much as USD100 billion of the USD1.5 trillion currently invested in private equity is exposed to zombies, citing “industry estimates” and it could grow to USD500 billion over the next several years, according to Triago. The article discusses the rumor that California Public Employee Retirement fund is selling in the secondary market USD200 million in zombie funds that hold venture-capital investments in start-ups, as a recent example.

FAST GROWTH IN RUSSIAN EARLY STAGE INTERNET DEAL VOLUME

Funding for hi-growth internet ventures is notoriously difficult to assess anywhere, but in Russia informed guesswork due to the high number of undisclosed or unpublished deals, may be as good as it gets. Fast Lane Ventures, a Russian equity and business development firm, [released some figures and interpretations from their research](#) on transactions between 2010 and 2011.

They point to the following trends:

- A busy early-stage sector: The number of companies having received seed funding from private investors quadrupled, from 22 in 2010 to 91 in 2011, with seed capital totaling USD 8.7 million and USD 14.1 million, respectively.
- Noticeable government involvement, from practically zero before 2010 to \$20 million in grant funding during 2010-2011, distributed among 61 startups in total.
- A rapid increase in transactions and investment volumes for hi-growth companies. Available figures for 2011 show 215 transactions amounting to USD540 million invested in young internet companies, as compared to 59 deals totaling USD225 million in 2010.

Actual figures (including undisclosed deals) are thought to have reached the USD1 billion mark in 2011, versus USD500 million in 2010. The analysis of the largest transactions is said to confirm an investor preference for proven business models and major players in their segment. At least half of the top 10 investments, including VKontakte, Darberry, Avito and Kupivip, are seen as direct analogs of Western business models. Significantly, there are two transactions considered true "success stories" in the group analyzed: Groupon's acquisition of Darberry and Skype's purchase of Qik.

BIG BUYOUTS BIDDING WARS

This week's largest deal looks to be a second PE bid for frozen foods maker Iglo Group. According to [Reuters](#), Blackstone and BC Partners are working on a higher offer after Permira rejected their recent EUR 2.5 billion bid. In the meantime, the price for Quest has gone up to USD 2.32 billion. We reported it as last week's [deal of the week](#) as a USD 2.17 billion bid from Insight Venture Partners and Vector Capital. The higher bid is rumored to come from strategic buyer Dell.

M&A GLOBAL ACTIVITY DROPS: NO FAST RECOVERY

Mergers and acquisitions activity fell 25 percent worldwide in the first half of 2012 as global economic uncertainty slowed down expansion plan. Bankers don't expect much improvement over the rest of the year, reports [IVC Post](#). Deals announced totaled slightly more than USD 1 trillion to June 19, down from USD 1.33 trillion over the same period last year, according to preliminary Thomson Reuters data. The report predicts three more slow months, in the absence of an "obvious catalyst" and this is despite rich company balance sheets and lowering valuations.

Other findings

- U.S.-targeted M&A fell sharply in the first half by 44 percent compared to last year.
- European M&A volumes were only down 7 percent at USD 354 billion over the same period, due to several large-sized deals during the first half.
- Deal volumes in Asia Pacific (excluding Japan) fell 23 percent to USD 175 billion over the period ended June 19.
- Energy and power deals accounted for 19 percent of the first half M&A volume. But deal activity was down 28 percent from the same period in 2011.
- PE-backed acquisitions fell 19 percent or about one-tenth of overall deal volume.

UNQUOTE PROBES STRENGTH OF SECONDARIES BOOM

How long will the secondaries market thrive? Unquote [published its answer](#), stating that the secondary PE market thrives on “every macroeconomic hit that slows the primary market down”. To the degree the European primary market has been slowing down lately, the secondary market has picked up the slack, and then some, say unquote. It recorded eight secondary buyouts in June alone, most notably EQT's EUR 1.82 billion acquisition of BSN Medical from Montagu Private Equity Partners.

The secondary market feeds off the debt crisis, explains unquote, the poor lending outlook of banks and macroeconomic stress factors. The increase in available portfolios is further bolstered by large-scale sell-offs by insurers and banks in anticipation of Solvency II and Basel III. But ultimately the profitability of secondary transactions is subject to the same factors that drive the primary market. The risks, according to the article, include valuation. The deepening European crisis and its complex effects make forward valuations extremely difficult to estimate and the capital structure of many companies may be unsustainable. The risk of misleading and inflated valuations is compounded by the incipient decrease in the number of distressed sellers and a continuing growth in demand for mature portfolios that offer attractive returns.

LP TRENDS IN PE 2012 : GLOBAL PRIVATE EQUITY BAROMETER

The latest [Collier Capital Global Private Equity Barometer](#) and survey is summarized with the key findings below:

- Almost half of LPs think private equity is seen by those outside the industry as a ‘bad thing’.
- About two thirds of investors think the industry’s reputation is worse than it deserves.
- About 60% of LPs believe that further improvements in terms of transparency and risk management are needed across the industry (though only about 10% of investors think that most GPs are deficient in this area).
- Three quarters of LPs surveyed opined that venture capital in Europe will not reverse its decline without significant government support and an improved regulatory and tax environment,
- The Barometer shows that typical investment (median) in European venture funds has made an overall return of 0 to 5% from European VC – over a third of European venture’s LP backers have lost money overall.
- a majority (59%) of European LPs think more government support would improve regulatory issues and make a crucial difference.
- Three fifths of investors expect distressed debt to deliver annual net returns of 11 to 15% over the next five years. Almost all LPs (89%) expect returns of greater than 11% from distressed debt.

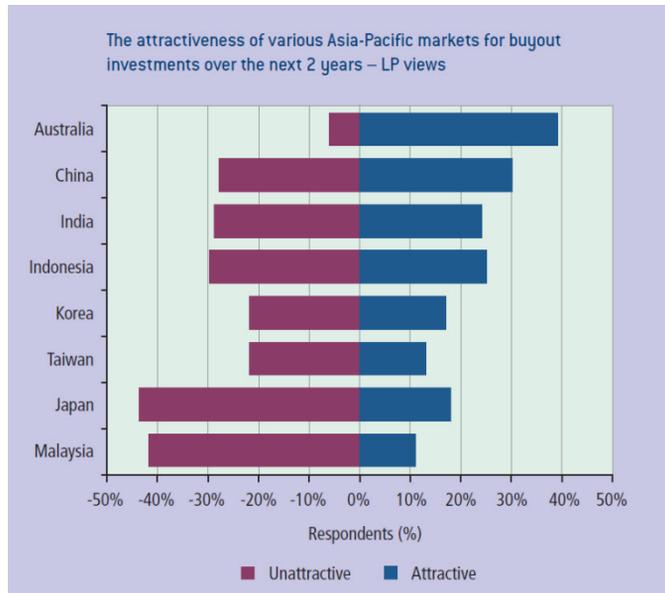


Image source: Collier Capital Global Private Equity Barometer Summer 2012

- Direct investing and co-investing is increasing. In the Summer 2006 Barometer only about one third of fund investors also invested directly. It has now grown to two thirds.
- A large majority of investors expect economic recovery in North America in the next 12 to 18 months. Only one-quarter of LPs expect the same for Europe.
- 39% of European and North American LPs aim to invest more than a tenth of their private equity commitments on the Asia-Pacific region within three years (compared with just 15% and 21% of investors in those two regions today).
- In terms of individual countries within the APAC region, Australia is the most attractive destination for buyout investments. LPs think China, India and Indonesia are currently the best markets for venture capital/growth investments.

QUOTE OF THE WEEK: VC'S GOLDEN AGE



Image source:
Institutional Venture Partners website

“With the right segment and the right entrepreneurs you can build a billion dollar company in less than five years today, something that was impossible half-a-dozen years ago”.

Who said it: Norm Fogelsong, General Partner at Institutional Venture Partners

In Context: According to Fogelsong, the first real golden age was in the U.S. in the early 1980s, when Ronald Reagan was elected, taxes were cut, and there was an unprecedented burst of entrepreneurship. His GP made eight investments in 1980 and six of them went public within two years. Another golden age, he says, stretched from 1994 to 1999, covering the dawn of the Internet, before dotcom bubble had not yet inflated. He believes today is another such golden time despite “the most challenging global economies we’ve seen”. It is due to the rapid development of the internet in the last five years. This is segment he refers to in the quote. Norm Fogelsong was one of three industry insiders (two LPs and one GP) interviewed in an article, entitled [Venture Capital Roundtable: New golden age for returns?](#)

Where we found it: The Triago Quarterly, March 2012

The Dealmarket Digest empowers members of Dealmarket by providing up-to-date and high-quality content. Each week our in-house editor sifts through scores of industry and academic sources to find the most noteworthy news items, scoping trends and current events in the global private equity sector. The links to the sources are provided, as well as an editorialized abstract that discusses the significance of the articles selected. It is a free service that embodies the values of the Dealmarket platform delivers: Professional, Accessible, Transparent, Simple, Efficient, Effective, and Global.

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