FINANCIAL NEWS ONLINE
Securities and Investment banking www.efinancialnews.com

Funds face shortfall despite cash glut

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3 Jan 2005

Private equity firms are set to struggle in 2005 to raise funds from investors amid a glut of fundraising and fierce competition for capital.

Analysts estimate the amount being targeted by funds in Europe this year at more than €60bn ($80bn). Appetite for the asset class has bounced back after a couple of relatively dour years for fundraising.

The renewed enthusiasm is buoyed by pay-outs from funds preparing to return to the market. However, backers are expected to be more selective.

One investor said: “It is going to be a bumper year. Investors have been impressed by the money that has come back in 2004 and we are, generally, eager to reinvest. But it is going to be pretty congested in some areas of private equity and we won’t be able to back everyone.”

Part of the problem for investor relations executives is the programme-driven priorities of the more sophisticated investors.

Mounir Guen, founder and chief executive of placement agent MVision, said: “How much money can investors allocate in a given year? For many of them it is finite.”

It is not only the amount that is restricted, they also have pre-defined fund sizes and regions that they adhere to in any given year.

Another placement agent said a glut of UK middle-market funds pitching to investors this year meant that some funds would find it difficult to reach their targets, even though there might not be any intrinsic weakness in their strategies.

Guen said: “Up to 80% will be increasing commitments to existing relationships. But this year there is going to be double the number of funds looking for money. It will be hard to increase the amount, let alone keep anything over to experiment.”

Large buy-out groups will also have problems, especially if they are increasing their fund size. The average commitment by investors across all fund types, according to placement agents, is about €50m. They said that if a middle-market fund increases its size it may only need an additional couple of investors. If any of the mega-funds move up in scale by just 25%, they need to find as many as a dozen additional investors.

One agent said: “It will be interesting to see how easily Apax raises the rest of its fund. Its new fund target is only 12.5% bigger than the existing one, but that is still €500m and that is where it may become a slow slog.”

Apax might find it even tougher as Warburg Pincus and Blackstone Group are expected to enter the fray with mega-funds, representing more than just marginal increases in scale. Investors are anticipating an $8bn fund from Warburg and Blackstone has said it intends to top that.