FROM THE EDITOR

DAVID TOLL

Show Me The Distributions

Why the fundraising market hasn't rebounded more quickly stems from a host of causes. But buyout firms have only themselves to blame for one of them—a dearth of distributions sent back to investors.

When the all the right elements are in place, the buyout industry creates a virtuous circle as powerful as any Atlantic hurricane. Buyout firms sell companies, take them public, or extract dividends; they shower their investors with cash and stock; investors recycle the money back into fresh commitments to funds; the buyout firms then buy companies, make them more valuable, and tee them up for exits and more distributions.

But buyout firms haven't been making distributions fast enough to keep the virtuous circle churning at its pre-recession pace.

"It's been a relatively difficult period for liquidity," said **Richard Lichter**, managing partner of **Newbury Partners**, a Stamford, Conn.-based secondary buyer. "Funds that during normal periods may have been able to sell companies haven't been able to. So there's more left in these older vintage years."

Evidence for this comes from the latest edition of Investment Benchmarks Report 2010, published this summer by Thomson Reuters. Looking at vintage years 1990 to 2003, U.S. buyout firms generally achieved total value-to-paid-in ratios of 1.4 to 2.0 or so. In other words, they multiplied the money of investors by 1.4 to 2.0 times—a respectable track record. Over time, of course, actual distributions make up a greater portion of the total value, as the portion made up of residual value shrinks.

What's surprising, however, is how far back in time you have to go to find the distributions-to-paid-in multiple consistently running at one or better. (A one indicates that investors have gotten their money back in the form of actual distributions.) The 2001 vintage year is the youngest to cross the threshold, at 1.04; the 2000 vintage comes in at 0.94; the 1999 vintage at 0.94; the 1998 vintage at 0.83; the 1997 vintage at 1.01; the 1996 vintage at 0.93. Earlier vintage years boast ratios well above one, as you'd expect.

The samples used by Thomson Reuters may not be entirely representative of the broader universe of funds. I also took a look at fund return data for both international and U.S. buyout funds from the **California Public Employees' Retirement System** as of March 31. The picture here certainly looks far more favorable to buyout shops. Take the 16 international and U.S. buyout funds that I identified from vintage years 1996 to 1999. The median distributions-to-paid-in ratio is 2.0, while the average is 1.9. That's an outstanding performance, although it's not hard to find outliers.

Case in point: the 1998-vintage Aurora Equity Partners II LP fund, which has generated a 1.4-times total investment multiple for CalPERS as of March 31. The pension fund's data shows that about nearly half of that value remained unrealized. The distributions-to-paid-in multiple clocked in at just 0.7 as of that time. (**Gerald L. Parsky**, chairman at **Aurora Capital Group**, said that as of June 30, the fund is up to a 1.6-times total investment multiple, with almost 90 percent of investor capital returned. He expects the remaining four companies, one of which is publicly traded, to be fully exited over the next 12 to 18 months, and for the lightly leveraged portfolio to exceed a 2x multiple.) The CalPERS sample is small, and the real truth may well lie somewhere between the pension fund's sample and that of Thomson Reuters.

Regardless, the primary fundraising market simply won't return to 2006-2007 levels until buyout firms can turn up the volume on distributions. Meantime, secondary buyers can look forward to a nice run. When investors aren't getting distributions, they need somewhere to turn for liquidity, especially when the pace of capital calls is picking up, as it is now. "That calling of money will drive the secondary market," said Newbury Partners's Lichter. "It's a virtuous circle."

Sincerely,

David Toll