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Mega-deal Slowdown Could Tip Money To VCs

As buyout firms cut back the pace of mega-deals, limited partners are looking more closely at other sectors of the private equity market. That shift in focus could provide a boost to venture capital firms.

In recent years, as buyout firms posted strong results and venture capital suffered from a prolonged downturn, limited partners carved out increasingly larger portions of their alternative investment allocations to LBO funds, often at the expense of commitments to VC funds. Now some LPs are beginning to rethink their investment calculus, if only a bit.

Paul Yett, managing director at private equity asset manager [Hamilton Lane](#), told VCs at a recent conference their turn might come soon because some LPs are reconsidering their love affair with buyout firms, particularly mega-firms that have been forced into hibernation because of the credit freeze. “Now [LPs are] saying, ‘I have way too much exposure on the mega-end of buyouts,’” he said. “You’re coming into a fortunate market right now.”

So far, a rise in LP interest in venture funds has yet to show up in fundraising numbers: venture fund-raising dipped in the third quarter, according to Thomson Financial (publisher of *Buyouts*) and the National Venture Capital Association. In all, 59 venture capital firms raised \$6 billion in the summer months, a drop from Q2, during which 83 funds raised \$9 billion. In the first three quarters of 2007, venture firms raised nearly \$21 billion, or about 79 percent of the volume raised in the same period of 2006.

The fundraising climate for managers of emerging VC funds is “as tough as it’s ever been,” said **Robert Hofeditz**, a partner at San Francisco-based fund placement firm Probitas Partners.

A few years ago, the average length of time it took to raise a new venture fund without a existing LP base was nine to 18 months, Hofeditz said. Over the past year, that has stretched to between 18 and 24 months.

Established funds are raising the lion’s share of money, with the ratio of follow-on to new offerings estimated to exceed six to one. Only eight new venture funds were raised in the most recent quarter, compared to 51 follow-on entities. This represents the smallest number of new funds raised since the second quarter of 2003. However, the total amount of money raised by new funds hit \$554 million, exceeding the comparable dollar volume in five of the last 12 quarters.

Fund-raising may pick up for first-time venture groups. Investors who have plenty of cash to invest are expanding their emerging manager programs, said **Thomas Beaudoin**, a partner at Wilmer Hale, who specializes in fund formation. “They’re basically saying: ‘I can’t get into Sequoia Capital. Where else can I look?’” he said.

Beaudoin said that if commitments to buyout firms drop, then billions of dollars will be freed up to invest in other asset classes. He said that some of that could trickle down to venture capital. Still, LPs remain concerned about venture valuations, fund fees and prospective ROI, said **Julia Feldman**, vice president of the private equity group at Goldman Sachs. Feldman said she has reviewed more than 100 venture funds in the past year and is concerned that “things are getting a little frothy.”