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Placement Agents Have Record Year as Private Equity Firms Fundraise

Danielle Fugazy, Buyouts Newsletter
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Considering that last year's $42.2 billion buyouts and mezzanine fundraising total was up about $15 billion from the previous year, 2004 was a pretty good year for funds and their placement agents. But as 2005 comes to a close, with LBO firms having raised more than $150 billion at press time-that's a 200% increase over 2004-last year looks downright paltry. Equally shocking is the number of funds in the market-more than 350 have been in the market this year, compared with 130 firms that raised capital in 2004.

Indeed, it's a great time to be a placement agent. Perhaps Jeffery Stern, a managing director with Forum Capital Partners, describes the market best in just two words: "Simply terrific." However, it's not only the sheer number of firms, or the dollar amounts that are making placement agents giddy. Perhaps more significant is the fact the private equity firms have been spending so much time on deals that they have little time to worry about fundraising.

"The fundraising process can be lengthy and painful, and we didn't want to be distracted," said Doug Newhouse, a managing director with Sterling Investment Partners, which closed Sterling Investment Partners II this year with $545 million of new capital commitments, easily surpassing the firm's $400 million target. Sterling started pre-marketing the fund in February and held a final close in September, using Credit Suisse First Boston as placement agent. "If you use a placement agent it allows you to focus on your core competency-deal making. You only raise funds every four, five, six years, [so] you can't do it as well as a professional," said Newhouse.

CSFB, for example, has been involved in more than 25 fund raises this year alone. On the flip side, the firm has turned down more than 500 private equity firms that were willing to pay for its assistance. The point is clear: The competition to raise new funds is fierce, and is certainly no place for a beginner.

"There were a lot of funds in the market this year, but not everyone can get funded," said Paul Denning, the chief executive officer of Denning & Co. "A majority of LPs spent their money on re-ups and reconsiderings. To become a new name in an LPs' portfolio is extremely difficult right now."

In fact, many believe new funds have no chance at all, especially when high-profile firms like Advent, Castle Harlan and Code Hennessy & Simmons, which have solid track records, are fundraising. Stern echoed this point: "Institutional investors are becoming more selective and increasingly thoughtful about manager selections and they are carefully evaluating their roster of relationships. First-time managers will continue to have a hard time getting raised. It's worse than ever."

However, while many LPs want to invest in what is safe, they are also aware that some of the best returns in the future will come from new firms that have an experienced manager. "No one is going to invest in a no name, but a fund manager that's spun out of a bank and adds something unique to the mix will get funded," said Stern.

Most major firms can trace their ancestry back to one of the large investment banks. Lehman Brothers, Bear Stearns, BancBoston, Morgan Stanley and Drexel Burnham Lambert serve as progenitors to many of the bigger names in the business, whether one generation removed or even four or five generations separating the link.

"Emerging managers are in demand. And you do have teams break away from larger funds. All these guys are interesting if they have a track record, they could be the next great franchises," said Stern.

There have been plenty of spinouts this year. Elevation Partners, for example, sprouted from Silver Lake Partners, which descended from the Blackstone Group, which is one of the many buyout shops that emerged out of Lehman Brothers. This year, Michael Madden left Questor to found Centurion Capital Partners. He followed similar moves from Flexpoint Partners' Donald Edwards, who left GTCR Golder Rauner; Diamond Castle Holdings head Lawrence Schloss, who left DLJ; and Monomoy Capital's Michael Presser, who cut ties with KPS Special Situations.

"These are people who have already proven they can get returns, so they are new to the marketplace, just adding a different flavor," said one advisor. "These are the kinds of firms that make LPs perk up. New firms, yet experienced players. It's our job to scout these firms for the LPs."

From The GP's View

The placement agent relationship has become a coveted one, especially for firms that have grown in size and needed to add new names to their roster. Both Sterling, which raised $545 million, and Sentinel Partners, which raised a $319 million fund, figured the best way to beef up their investor roll call was with the help of a placement agent.

"When one wants new investors, or to raise a larger fund, one is left with the task of speaking to strangers, and a placement agent can be helpful with that," said David Lobel, a managing director with Sentinel. "Most people want new investors in every fund to mix in with the existing ones."

With the help of CSFB, Sentinel added Abbott Capital, AllState, AlpInvest Partners, Bessemer, Bank of New York, Invesco, Lehman Brothers Crossroads, Oak Hill Capital and RCP Advisors as LPs to its latest fund with closed in the second quarter. "We doubled the capital and felt we wanted a placement agent with relationships," said Newhouse. Sterling Investment Partners I raised $234 million and was closed in October 2001. This year the firm added Pantheon Ventures, Auda, Partners Group and Alliance Capital to its line-up.

However, despite how good a placement agent is, no firm is going to be able to attract LPs if they haven't proven themselves. "At the end of the day it's your record that is raising the fund, and the placement agent is there to introduce you to the right contacts for you to sell yourself too," said one private equity pro.

One thing is for sure: there was no lack of funding for GPs with a track record. Buyouts expects fundraising numbers to hit an all-time high of around $200 billion before the end of the year.