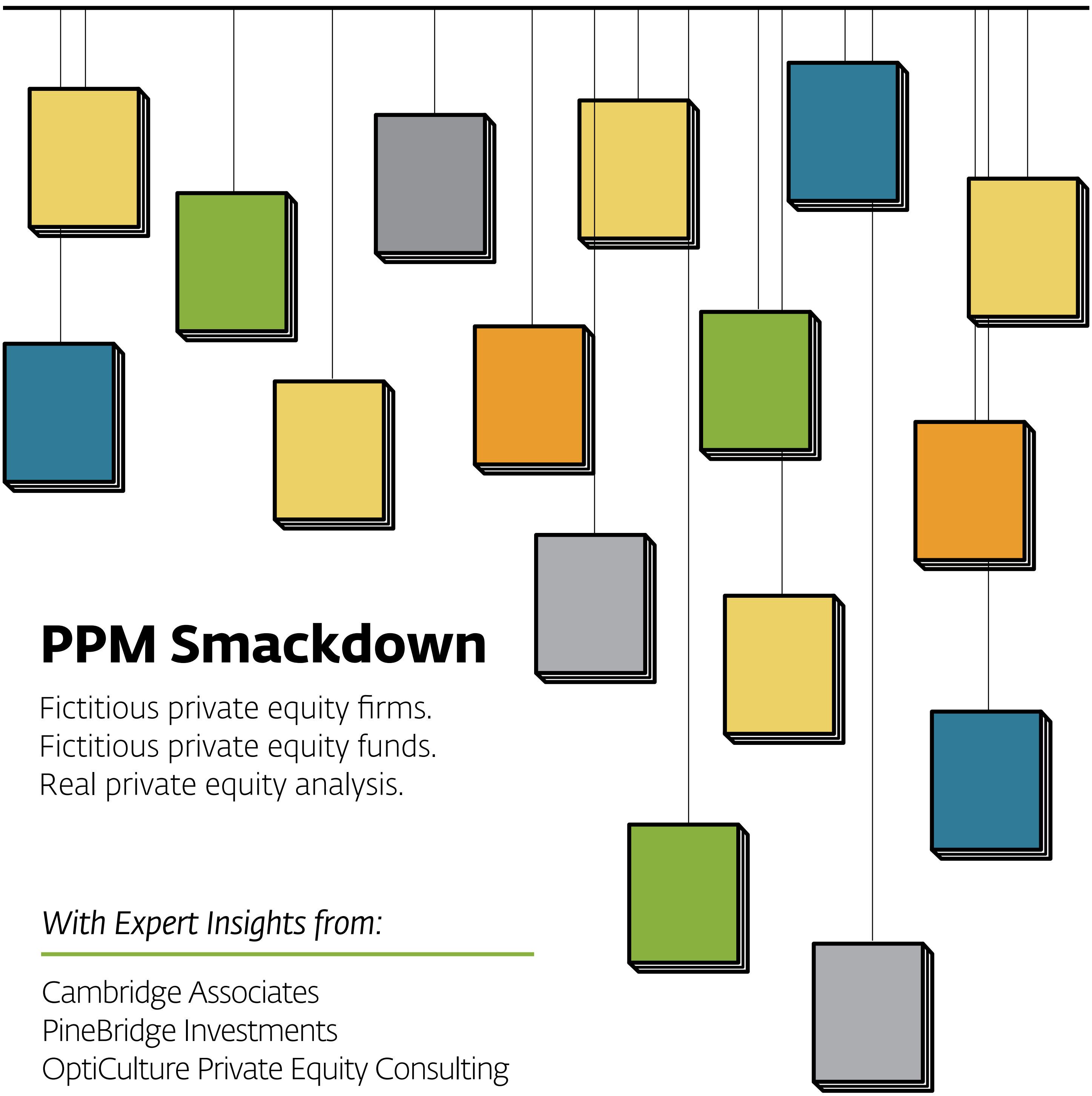
PRIVCAP REPORT/

Inside:



PPM Smackdown

Fictitious private equity firms.
Fictitious private equity funds.
Real private equity analysis.

With Expert Insights from:

Cambridge Associates
PineBridge Investments
OptiCulture Private Equity Consulting

Dropping the Shroud of Secrecy

From a media guy's perspective, a frustrating fact of the private capital industry is that the most important exchanges of ideas take place in private.

Robust debates about whether or not to do deals happen in highly confidential investment committee meetings. Intense discussions about whether or not to commit capital to a GP's next fund take place in private and involve highly confidential marketing materials.

Almost every other human endeavor enjoys media coverage highlighting the different opinions and approaches toward it. The movies have movie reviews. Sports have sports talk shows. Stocks have CNBC. But in private equity, good luck finding a limited partner willing to openly discuss the reasons why she is or isn't committing capital to the next, say, Blackstone fund. It's not done. Information is exchanged off the record, in private phone calls, in hushed hallway conversations and closed-door meetings.

With "PPM Smackdown," we think we've found a way to let an audience listen in to the sophisticated analysis that goes into the GP vetting process without actually airing confidential information. This informative program asks three experts to evaluate fictitious fund offerings that, nevertheless, have some of the exact same thought-provoking characteristics as real funds in the market.

I hope you enjoy this summary and get a chance to watch the full video series we've created. I'm confident you'll learn a lot about how the most sophisticated LPs evaluate fund investment opportunities—no nondisclosure agreement required.

David Snow
CEO & Co-founder
Privcap
@SnowsNotes

In This Report

Click to watch this video at privcap.com

PebbleOak Capital: Big Win, Big Wipeout

In this episode of Privcap's PPM Smackdown, the experts discuss the good and bad of PebbleOak Capital's Fund II, their due diligence findings, and whether they ultimately give it a thumbs-up or thumbs-down

THE EXPERTS

Andrea Auerbach
Managing Director,
Cambridge Associates

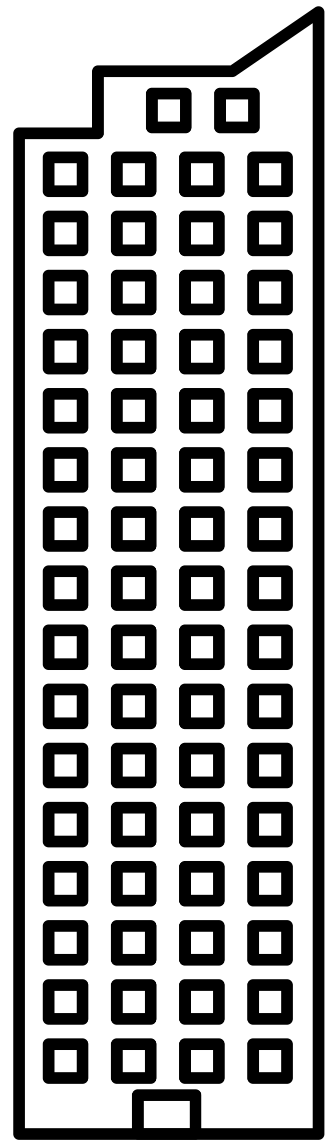
Steven Costabile
Managing Director,
Global Head of Private Funds Group,
PineBridge Investments

Timothy Kelly, Ph.D.
Founder,
OptiCulture Private Equity Consulting
Former Managing Director,
Adams Street Partner

➜ CONTINUES ON NEXT PAGE

PebbleOak Fund II: The (Fictitious) Facts

The (fictitious) fund is seeking to raise $500M, double the $250M raised in Fund I in 2009. Of PebbleOak's five original partners, one left last year, and he is described in the PPM as the partner who led the one deal that went bankrupt, in 2014. PebbleOak Fund I has been fully invested in six portfolio platform companies, and landed in the top quartile of 2009 vintage U.S. PE funds. However, that fund has only had two exits; the first exit generated 4x net return on equity and the second exit generated 1.4x net return.



Privcap: So what are your initial reactions to the size of the fund, the timing of Fund II, and anything else?

Andrea Auerbach, Cambridge Associates: Well, the question in my mind is the intention here by doubling the fund size to achieve an escape velocity from the lower middle market. So we often see a lot of managers raising smaller funds as their maiden voyage of their sophomore turn. But is their real goal to get to where they want to be, which might be in the upper middle market instead?

Tim Kelly, formerly of Adams Street Partners: The $250M to $500M is a red flag off the page, but that doesn't necessarily scare me. The concern, to me, though, is that they've been out of the market for six years. If it's taken them six years since their last fundraise to come back to market, I need a little more understanding of why it's taken so long to invest $250M and now they believe that they can invest $500M.

Of PebbleOak's five original partners, one departed last year. He is described in the PPM as the partner who led their one deal that went bankrupt. The firm has added one partner to replenish the ranks of deal talent. It says that after the successful close of Fund II, it will add one more partner. Is that acceptable?

Auerbach: How a partnership stands up for its underperforming investments says a lot about the partnership. To have it explicitly stated in the PPM ("It was that guy")—to not own that loss—is a little aggressive, given it probably was a partnership decision. One of the questions I had is whether this a Lone Ranger type of setup, where each partner is doing deals away from the rest of the partnership and has that consent with their partners to just do the deals they think are best. There's much more referencing that would need to be done here.

Steven Costabile, Pinebridge Investments: The concept that they spun out from a larger firm is really, for me, more of a due diligence item for Fund I.

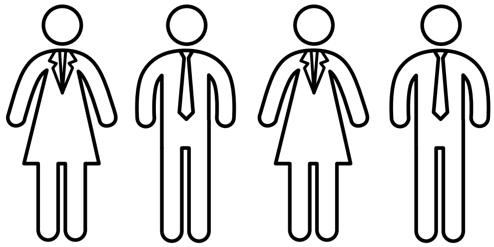
Obviously they've made the transition. There might be some lingering issues to make sure they're institutionalized in all the ways they need to be for raising a fund that's twice the size of the last one, but for the most part I'm comfortable with that.

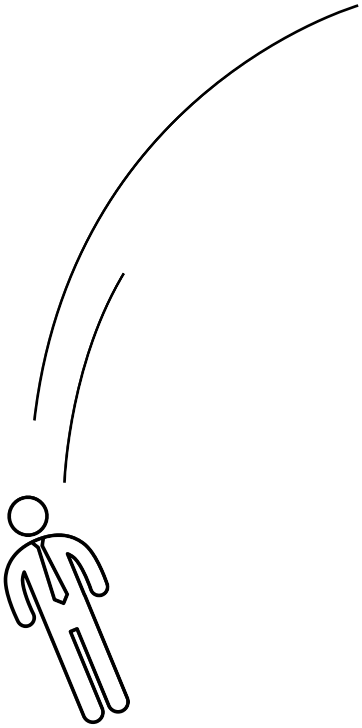
So what is your reaction to the stated track record?

Auerbach: I had a couple of reactions. Six companies—that's concentrated. And I also have to call out PebbleOak's LPs. How could they let these guys blow through their portfolio exposure limit, to have 15 percent in every company? I was like, shame on those LPs. Their net IRR is really generated by the one strong exit.

Kelly: I am intrigued by the concentration element. Not when you overlay, necessarily, the three particulars that they've had on the realized side in terms of the volatility, but I like teams that have conviction about what they do best, if you can get comfortable that they are able to do that and they have a real differentiated strategy on creation of value.

➜ CONTINUES ON NEXT PAGE





THE DUE DILIGENCE

It's time now for invasive due diligence, in which each of you reveals a due diligence finding from this group. Tim, what did you find about PebbleOak during your due diligence?

Kelly: One of the founding partners is in the middle of a highly acrimonious divorce. It starts becoming an issue where the partners view themselves as sharing carry equally, but one or more of them are highly distracted because of personal issues.

Auerbach: I much prefer the conscious uncoupling rather than the acrimonious divorce, but we're investing in high-performing teams, and things happen to people. And so when we learn of personal situations that may impact an individual's ability to execute on their strategy, we often just dive back into the pit and start looking at partner attribution, trying to get a sense of who's been more active in terms of putting deals on the books.

Costabile: It could mean nothing, or it could actually cause one of the partners to have to delink from the firm. And we have seen that in the past, where that partner going through this unfortunate situation was unable to continue with the fund.

Steve, what have you found in your due diligence?

Costabile: We found that all six portfolio company CEOs interviewed, including the CEO from the bankrupt company, attest to the expertise and professionalism of the firm's partners.

So a good due diligence finding.

Costabile: Yes, that's very meaningful across the board. Obviously we don't just call the references that are given. Any due diligence construct has to go off the reference list.

Kelly: How broadly were the comments in terms of off-reference-list? If it's just the six CEOs, then I need to know more. They don't want to ruin their next opportunity to be running another potentially successful portfolio company because of speaking negatively about a GP that's in fundraising.

VERDICTS

Costabile: Assuming that the track record holds up, the references superficially look good. So based on what I'm seeing here and the fact that they focus on operations, I would be positively inclined to look at this.

Auerbach: I'm going to give it a slight thumbs-up. There's enough here to really compel a deeper dive and to keep moving this forward through a process, and if we get comfortable with all of the issues we've been discussing, there could be some real interest to commit later.

Kelly: It's not a thumbs-up in the sense of okay, let's write the check. But there's definitely enough here to get excited about. If there's reason to believe that they can generate more of those 4x returns than they do bankruptcies, there might be justification for doing it ■

Of PebbleOak's five original partners, one departed last year. He is described in the PPM as the partner who led their one deal that went bankrupt.

Click to watch this video at privcap.com

Kramer Health Fund I: The New Spinout

In this episode of PPM Smackdown, our experts pick apart the *(fictitious)* track record of *(fictitious)* **Kramer & Co.**, a Los Angeles–based private equity firm that focuses on the healthcare industry and was recently spun out of another PE firm following an acrimonious split.

THE FACTS

- Kramer & Co. is seeking a $400M fund to focus exclusively on healthcare deals. The firm is a spinout by a faction of partners from Rose & Kramer, whose most recent fund rounded up $500M in 2009, focusing on consumer deals as well as healthcare.

- In 2012, the two founders, Rose and Kramer, had a falling out and the firm split in two, with most of the healthcare team forming Kramer & Co. The new firm has an impressive roster of senior healthcare executives on its board of advisers.

- Rose & Kramer showed strong performance through four funds, except for Fund III. The healthcare deals at Kramer & Co. have a cumulative 2x net return, with no losses. By contrast, the consumer deals at Rose & Kramer have a mixed track record.

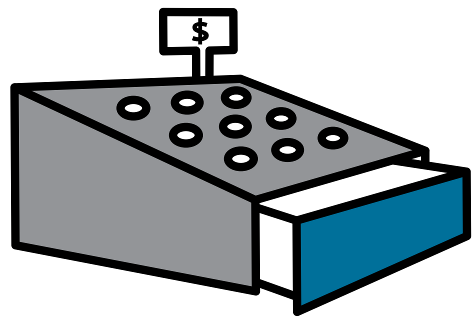
- Kramer & Co. says it has the experience, deal flow, and value-add toolkit to execute on healthcare opportunities in the U.S.

THE DUE DILIGENCE

- Two healthcare deals in the track record were, for a time, marked above where they ultimately exited. These markups happened during a fundraising period.

- All of the healthcare company CEOs for the Kramer & Co. team members confirm that the lead partners on the healthcare deal teams were as indicated by Kramer and were true value-add experts for those particular deals.

- The former CEOs of the two consumer investment disasters say both deals were led by Kramer himself.



VERDICTS

Auerbach: *"I don't want to get married to someone who's interested in an acrimonious split. I'd rather have the happily-ever-after in terms of performance, return, and organization development."*

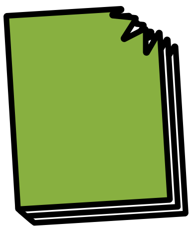
Kelly: *"At this point in time, I'm inclined to go with my gut and say that there might be something here, given the spinout nature of the team."*

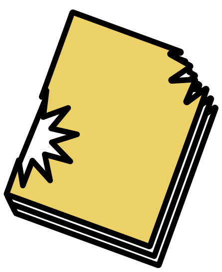
Costabile: *"I'd have to say no, only because I know there's plenty of other opportunity in the space."*

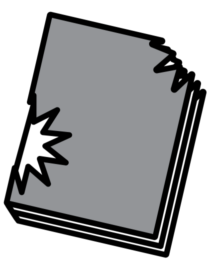
Click to watch this video at privcap.com

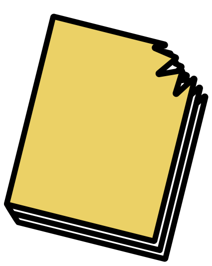
TKTK Fund VI: Mega Firm Seeks Mega Redemption

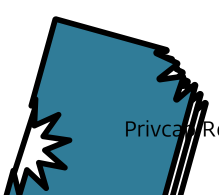
In this episode of PPM Smackdown, our experts pick apart the *(fictitious)* track record of *(fictitious)* London-based mega-firm **TKTK Capital**, which has been damaged by a string of bad deals and departures.











THE FACTS

- The firm is seeking $8B for Fund VI, down from $12B for Fund V in 2008 and $10B raised for Fund IV in 2005. The new fund will continue TKTK's pan-European investment strategy.

- The firm's two co-founders are legends in PE and still at the helm. However, several senior partners have left, and offices in Shanghai and Budapest have been shut down. Fifteen professionals within the firm have been promoted to partner.

- TKTK's fund performance has become mixed, after several successes. Three portfolio companies in Fund IV went into bankruptcy. Fund V has had only two exits, and the firm says it's on track to deliver strong performance.

THE DUE DILIGENCE

- Half of the LPs from Fund IV aren't re-upping for Fund VI.

- One of the two founders of TKTK has recently committed capital to an investment group that purchased a U.K. Premier League soccer team.

- The firm's valuations and reporting through economic and fundraising cycles have been remarkably detailed, timely, and accurate.

VERDICTS

Auerbach

"Maybe if they were to change their fee and carry structure and up that GP commit...it might be worth a little more of a look rather than a browse."

Kelly

"The organizational dynamics suggest no, but I would try to get to know some of those 15 new partners or some of the partners that have left, trying to figure out if there's an element there of who generated the value in the first three funds."

Costabile

"There's just too many negatives for me to want to have exposure to the potential upside, based on all these negatives that are right in front of me."

From the Archives

Compliance & Regulation

Managing the Compliance Burden
Pepper Hamilton's Ed Dartley tells Privcap about the challenges that PE and VC firms face in meeting new compliance regulations.

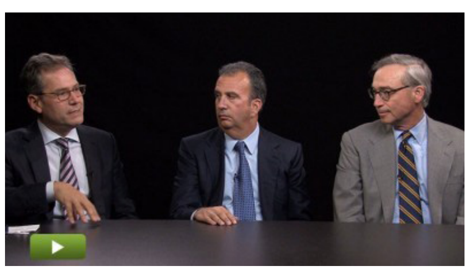
Hunting for Conflicts of Interest
The SEC's increasing focus on hunting down potential conflicts of interest at PE firms should have the attention of all GPs, says Scott Gluck of Venable and Matthew Reynolds of McGladrey.

Real Assets

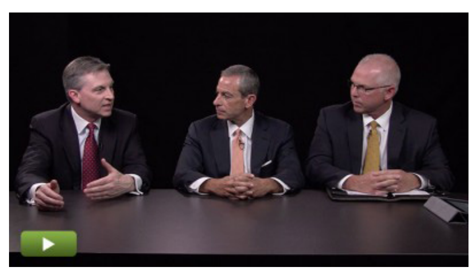
Infrastructure in Emerging Markets
Experts from Pembani Remgro, IFC Global Infrastructure, and NSG on their approach to putting PE capital to work in emerging markets infrastructure.

Energy Reform Fuels Investments in Mexico
KKR discusses how widespread energy reforms in Mexico are opening the market to foreign investors.

Portfolio Operations



Fact: PE Deals Outnumber Exits
Experts from BlackRock, W Capital, and Gen II discuss the impact of the fact that there are three new deals for every exit.



The Key to Operating Value-Add
A discussion about the crucial relationship between portfolio company management and the operations team at the sponsoring PE firm.