PRIVCAP DIGEST/

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Special Report:

The Incredible Shrinking GP / 12

In This Issue:

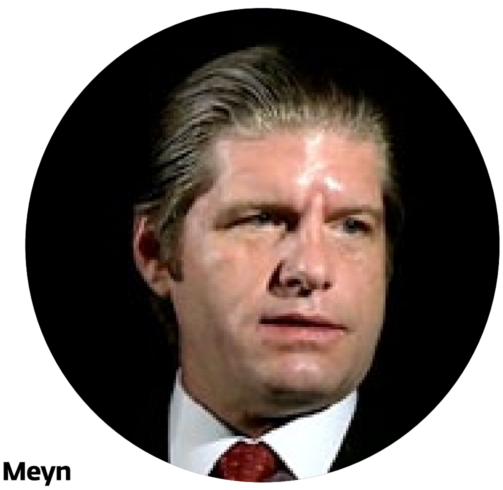
The Big Question/

Taking the pulse of private capital—one answer at a time

This Month's Question:

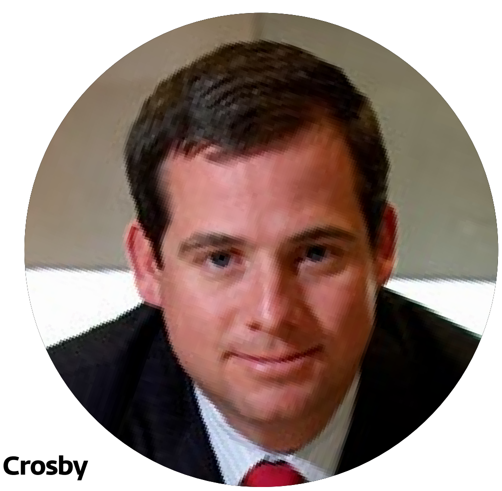
As you assess the environment for your specific investment strategy, what indicators or statistics are you most focused on today? Why? And what are your expectations for those metrics for 2013?

Wachter



Meyn

Patterson



Crosby

The Experts

David Wachter
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Wachter **1**

In Direct Secondaries, DPI Matters

We closely track distributions to paid-in capital (DPI), the hold period for PE investments, and the number of funds reaching maturity. Industry-wide, the median DPI for seven-year-old funds has fallen from 1.07x five years ago to 0.30x today—meaning that in 2007, the median PE fund had returned capital in excess of LP contributions by year seven; today it's less then a third of called capital. Current PE investments have, on average, been held more than five years. Lastly, the number of funds that are reaching end of life is growing, with over 3,000 funds approaching year 12 in the next three years. While LPs have been supporting their managers' objective of maximizing exits, at some point funds will need to reach the finish line. My expectation heading into 2013 is that DPI will steady itself at current levels as GPs focus on ways to at least offset capital calls with exits. However, GPs won't be able to lock in net IRR and clear hurdle rates without material cash distributions. Eventually, DPI must rise to raise subsequent funds.

"GPs won't be able to lock in net IRR and clear hurdle rates without material cash distributions"

David Wachter

Patterson **2**

U.S. Housing Emerges from Distress

Given current low European, Asian, and U.S. default rates during this booming financing market, which accepts all comers like a homeless shelter, we're much more focused on maximizing the value of large investments made around 2009—housing among them. In that industry, the most import metrics are family formation, employment growth, the health of the mortgage market, and interest rates. All the metrics are moving in the right direction, so we're optimistic. What I find most compelling is that the single-family U.S. new-home build tally is still at a fraction of the 1.5 million units reached during the last peak before 2007.

We have about 20% ($1B) invested in the homebuilder and real estate "rebound" sectors, including multi-family apartments. So we also look at our land "runway"—not the land available to invest at today's prices, but the amount we acquired over the last three years, when most sane observers felt acquiring more land was an indication of dementia.

"We see an increase in credit growth driven by healthier banks and expanded public credit, as well as leading indicators that show moderate reductions in delinquencies"

Christopher Meyn

Meyn **3**

Brazil Regains Confidence

At Gavea, we closely follow data that helps us better understand Brazil's macroeconomy, including GDP growth, consumer activity, the IPO pipeline, and the local private equity exit pipeline. On the macro side, we see accelerating GDP growth, showing that confidence is slowly recovering and producing increases in investment. We see an increase in credit growth driven by healthier banks and expanded public credit, as well as leading indicators that show moderate reductions in delinquencies. We also follow same-store retail sales, given the slowdown at major retailers from 2010 to 2011. The statistics point to a slow recovery.

The improved macro conditions may fuel a strong IPO market in 2013, which shows the potential to double or triple the activity of 2012. All eyes are on the potential listing of BB Seguridade, which would be the biggest Brazilian IPO since Banco Santander Brasil in 2009.

Crosby **4**

Keeping an Eye on Commodities

As we assess the environment for energy infrastructure, the most important statistics/indicators are the prices and production levels of major energy commodities (crude, natural gas, electricity, etc.). While heavily intertwined with the energy markets, these commodity benchmarks serve as important indicators of future infrastructure investment. In the past few years, U.S. crude oil production and investment in supporting infrastructure has increased rapidly. Looking forward to 2013, we expect commodity levels that will support strong growth in the U.S. production of both crude oil and natural gas. Likewise, we expect significant growth in the demand for capital aimed at building critical supporting infrastructure such as pipelines, storage terminals, and processing facilities. ■