

ACG Chicago

Winners Emerge

A First Hand View at the Future of Private Equity

Philip A. Canfield, Principal, *GTCR*

May 17th, 2011

GTCR

ACG Chicago Conference

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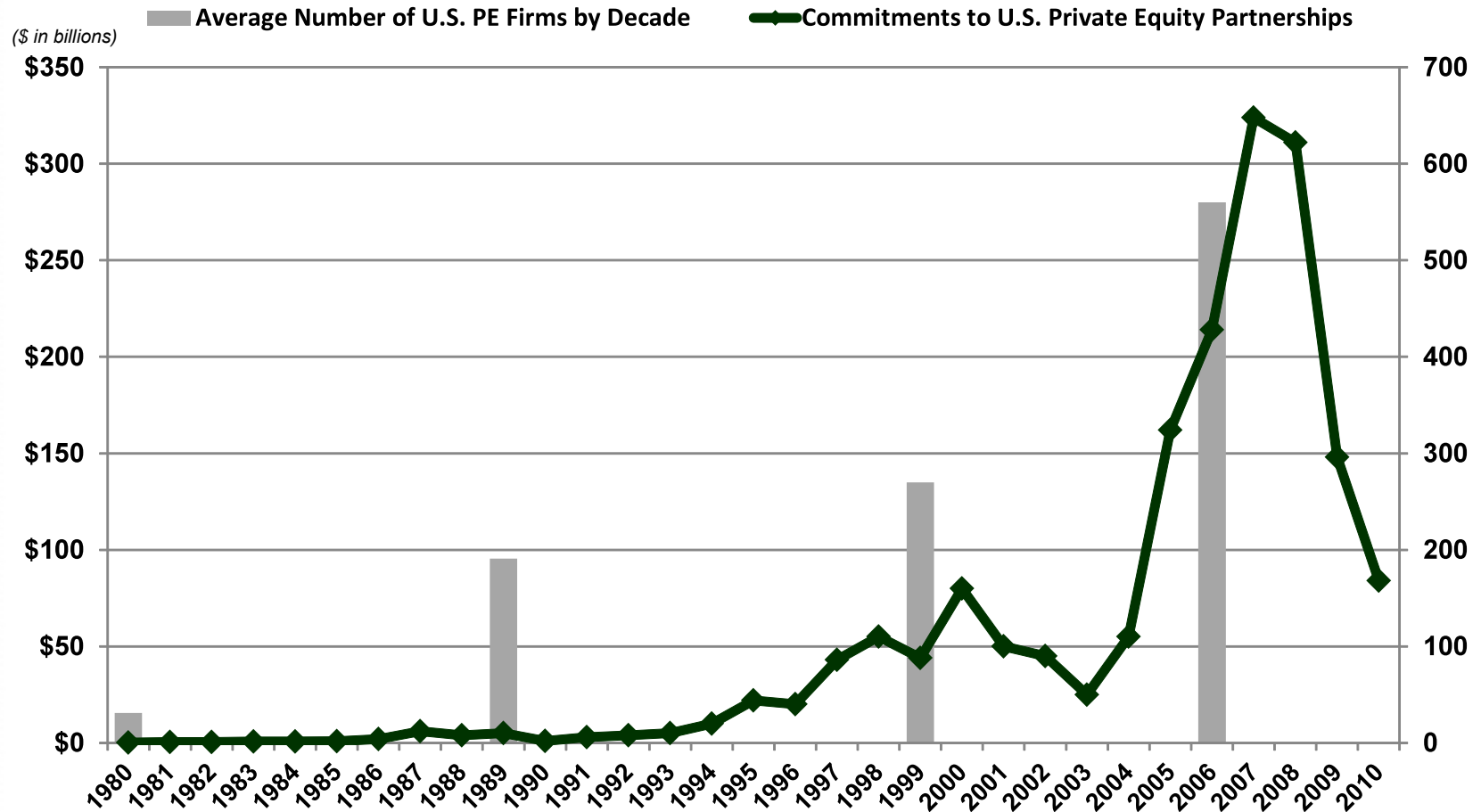


- “Fundraising Troubles Mean Danger for PE Funds”
- *Institutional Investor*
- “One of the Least Amenable Fundraising Environments Ever”
- *Buyouts*
- “The Grimmiest Capital-Raising Environment in Years”
- *Private Equity Beat*
- “Fund Managers Still Struggling to Emerge from Fundraising Trough”
- *Private Equity International*

A Look at the Next Five Years

- Historical Snapshot
- Current Environment
- Realistic Scenarios for the Future
- What Investors are Looking for
- GTCR's Blueprint for Success

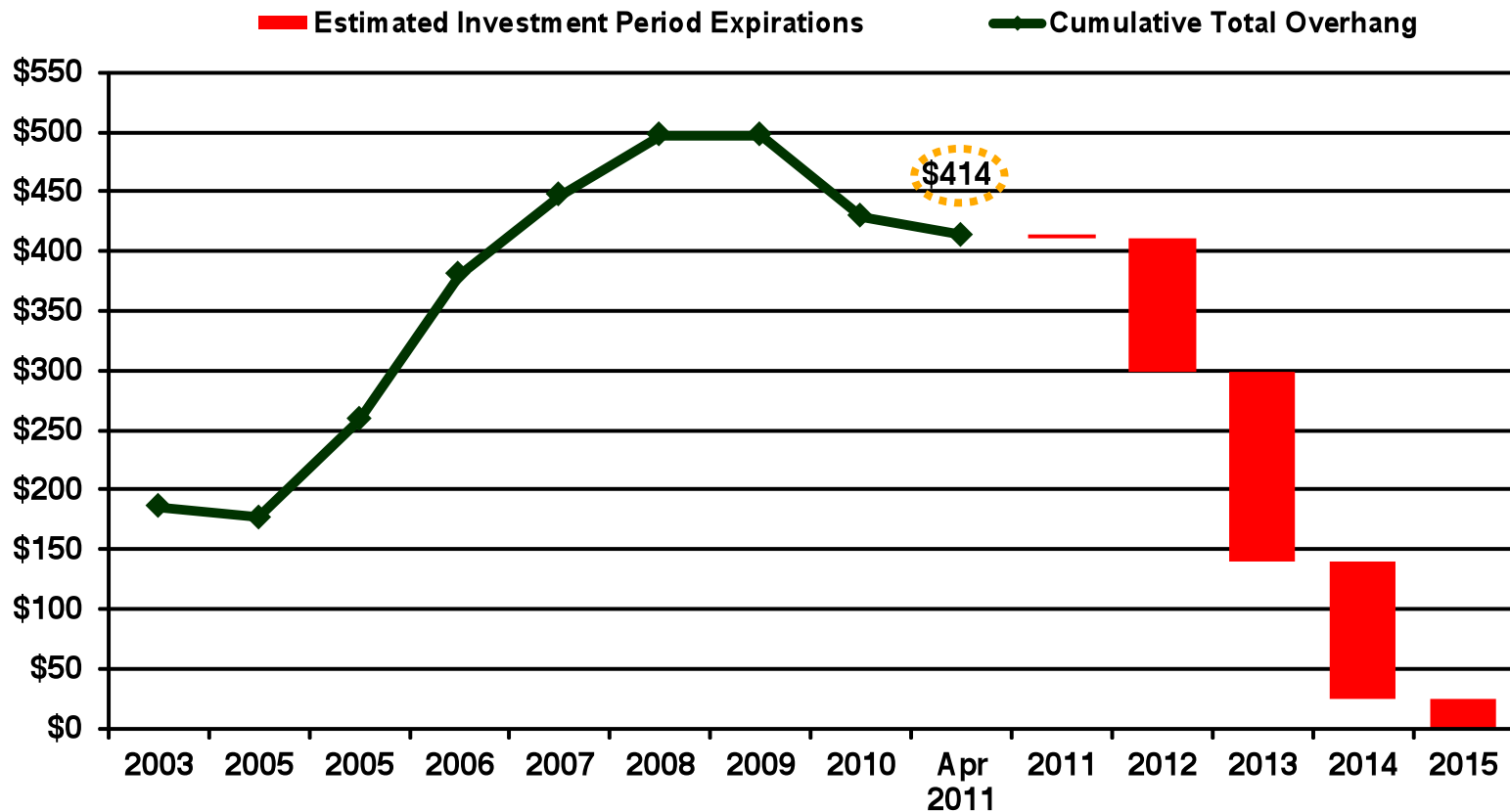
A Snapshot of the Last Thirty Years



Source: Steven N. Kaplan (Chicago Booth), Pitchbook Data, Inc., GTCR.

What is Happening Today

PE Callable Capital Reserves / Dry Powder vs. Investment Period Expirations



Source: Prequin, Pitchbook Data, Inc., GTCR.

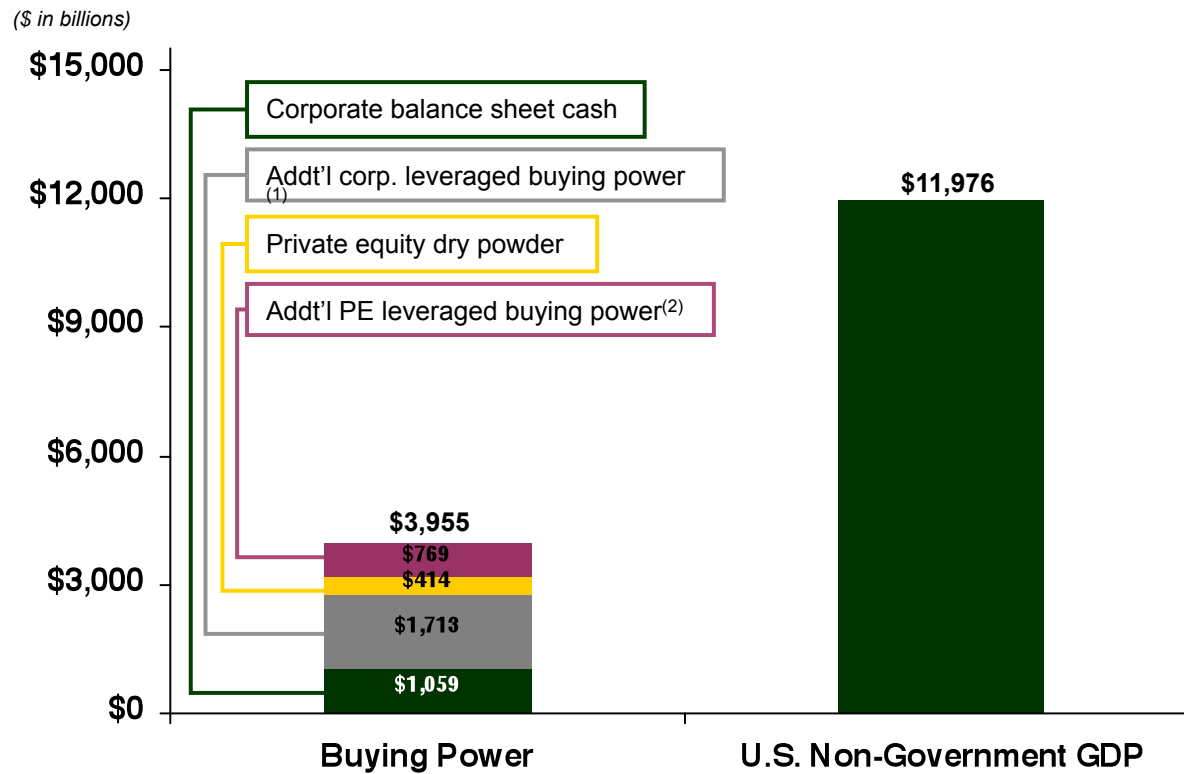
Note: Investment period expirations assume a 5-year commitment period for new investments.

Lots of Money Looking for Returns

- Private equity dry powder (U.S.) = \$414 billion
- Cash of non-financial S&P 500 over \$1 trillion
- Both can and will be levered
- Financing is available and CHEAP



Acquisition Capital vs. GDP Very High!



Total buying power of ~\$4 trillion represents ~33% of Non-Government GDP!

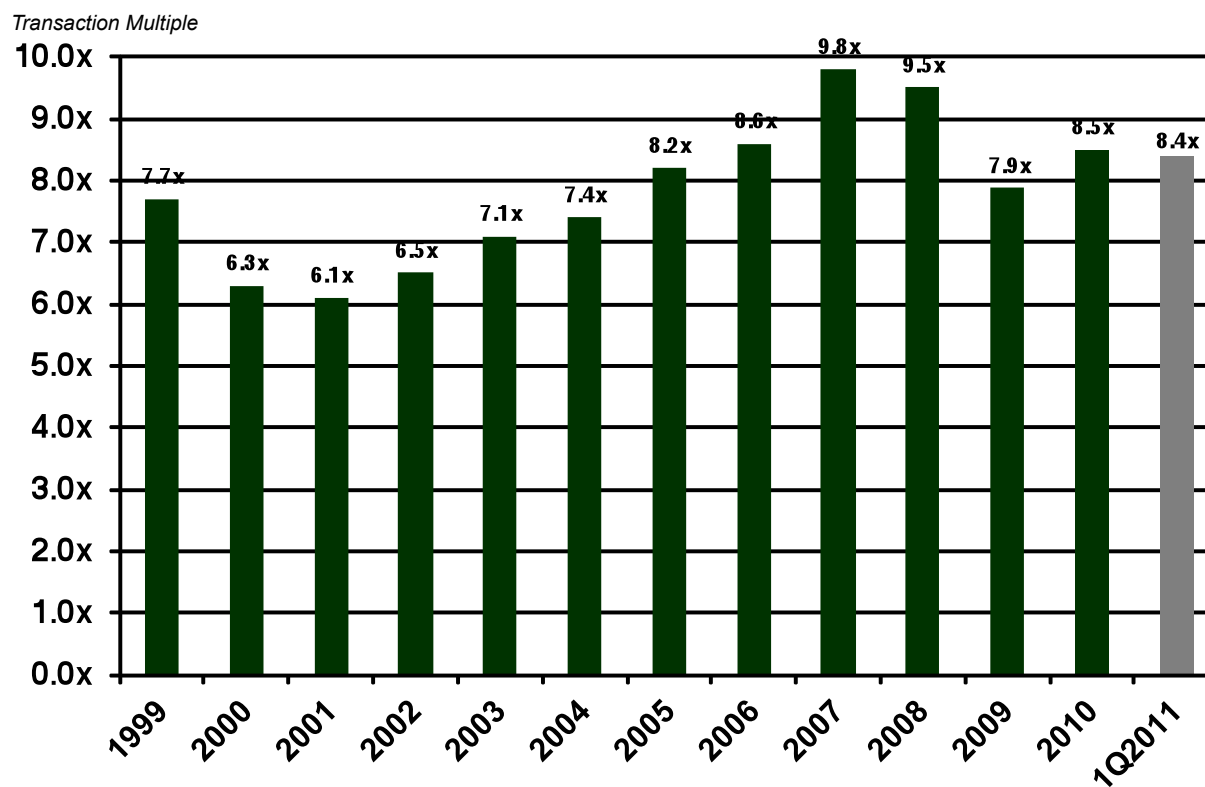
Source: GTCR, Bureau of Economic Analysis. U.S. GDP data as of 4/28/11.

1. The S&P 500 had a Total Debt / EBITDA ratio of ~1.8x as of 12/31/10. Assuming 3.0x total leverage, the S&P 500 has an additional \$1.7bn in buying power.

2. PE leveraged buying power assumes 35% equity minimum investments.

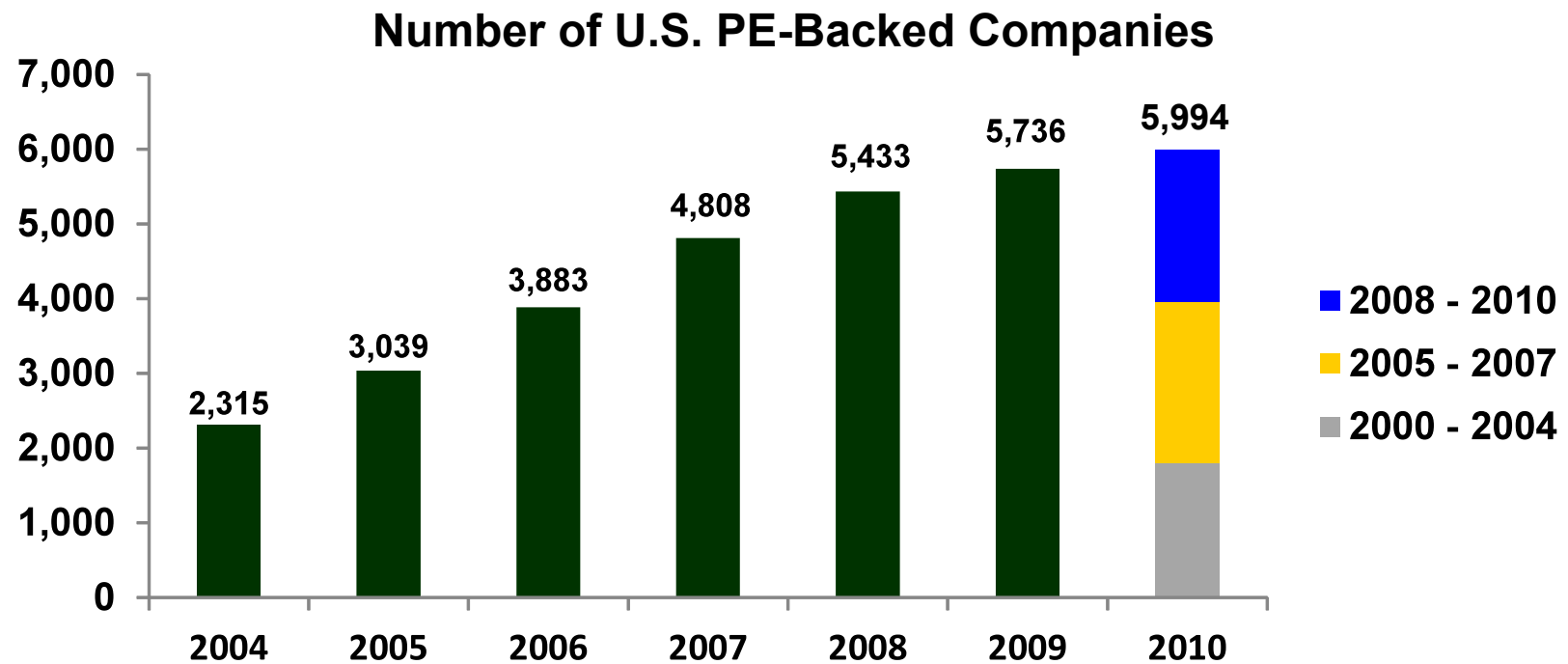
Prices Will Continue to Go Up

Average LBO Transaction Multiple



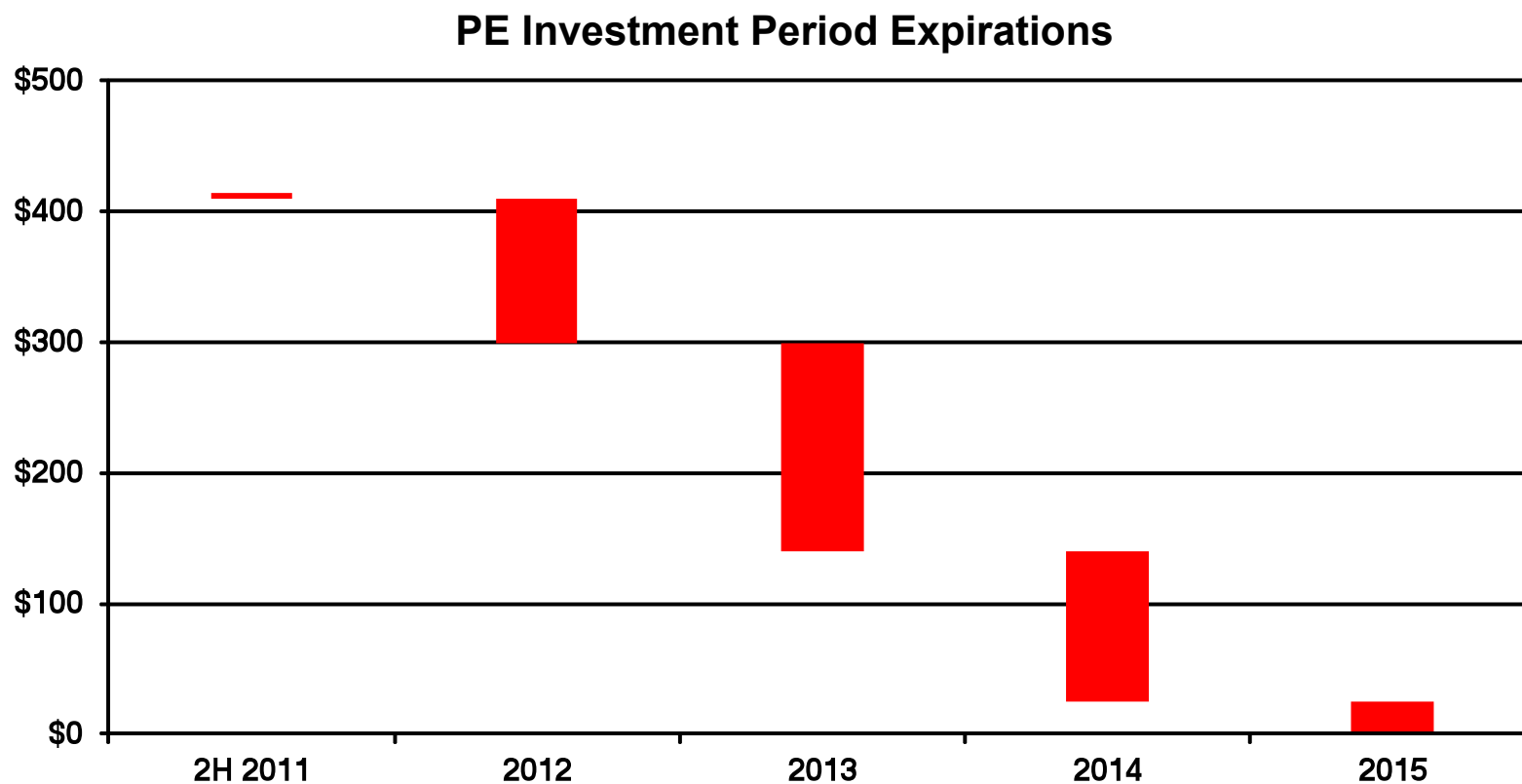
Source: S&P Leveraged Lending Review, "Large Corporate LBO Loans".

Expect a Lot of Private Equity Exits in the Near Term



Source: Pitchbook Data, Inc.

Remember the Stairs?



Source: Prequin, Pitchbook Data, Inc., GTCR.

Note: Investment period expirations assume a 5-year commitment period for new investments.

How is It Going to Play Out?

“Re-ups are being closely scrutinized, and managers will need to think carefully about their terms and conditions in addition to their proposed strategies in order to achieve success.”

– Tim Friedman, Prequin, January 12, 2011

“Funds haven’t performed as well as advertised, and the jury is still out on mega buyouts... In 2006, managers were showing 25 percent returns in marketing materials. Now they have to pitch for commitments with much less impressive numbers.”

– Lawrence Schloss, CIO for NYC Pension Fund, January 24, 2011

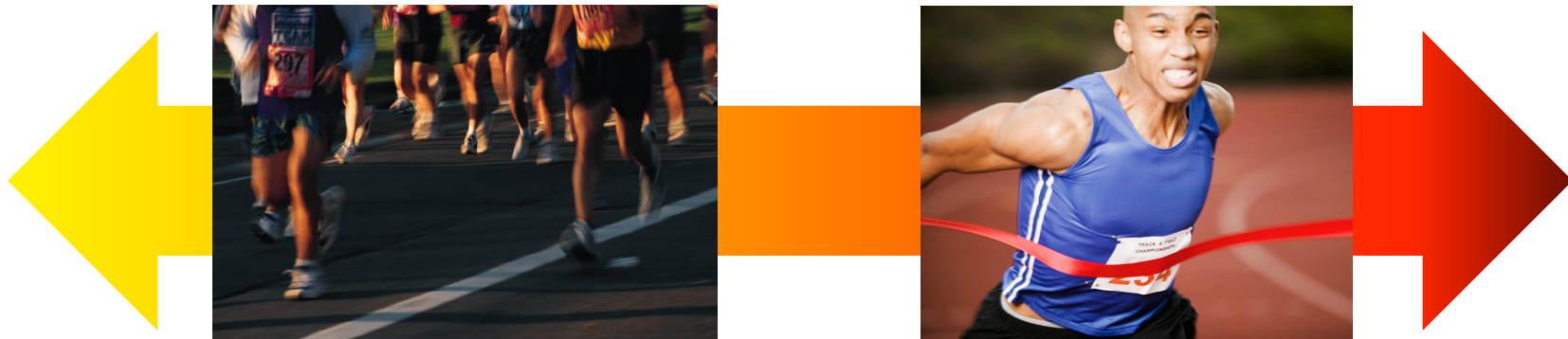
“...Fundraising has remained incredibly tough, with many firms opting to put off new offerings until absolutely necessary. For the second year in a row, the total capital raised by the PEI 300’s top 50 firms has shrunk.”

– Philip Borel, Private Equity International, May 4, 2011

“Increased competition will lead to a significant number of firms failing in the fundraising market and quietly ceasing to exist once their current vehicles are liquidated in the next few years.”

– Tim Friedman, Prequin, January 12, 2011

PE Industry Gets Reshaped in the Next 2 – 3 Years



Muddle Along

- Everyone survives
- Fund sizes go down
- Pressure on GP organizations
- Hard to differentiate
- Returns rebound modestly from poor levels of 2005 – 2008

Winners Emerge

- Firms culled
- Winning firms grow capital and people
- Firms can differentiate
- Returns rebound to levels seen in vintages between 1995 – 2005

The Case for Muddling Along

- Recovery of S&P 500
- Recent fundraising success
- New sources of capital
- Big firms targeting less capital

The Case for “Winners Emerge”

- 45% of firms that launched fundraising since the beginning of 2008 have not hit target
- LPs doing more diligence than ever:
 - Returns and return drivers
 - Strategy
 - Organization
- Per *The Deal* Magazine, the following funds are considered imperiled:

(\$ in billions)

Imperiled: Sponsors Least Likely to Survive						
Sponsor	Year Fund Closed	Size	% Invested	Value / Cost	IRR ⁽¹⁾	
J.C. Flowers & Co. LLC	2006	\$7.0	100%	0.36	(39.7%)	
Candover Partners Ltd.	2005	\$4.1	82%	0.50	(26.4%)	
Terra Firma Capital Partners	2007	\$7.3	64%	0.27	(47.7%)	
Elevation Partners	2004	\$1.9	80%	0.82	(9.9%)	

Source: *The Deal* Magazine.

1. Estimate as of 3/31/10.

What are Investors Looking for?

- Great returns
- Differentiated strategy
- Well-run organization

Great Returns

- Either you have them or you don't
- Surprisingly low realizations
- Return drivers matter
- Are the drivers replicable?

Differentiated Strategy

- Sourcing deals
- Having an edge
 - Differentiated knowledge
 - Differentiated performance
- Pretty hard

Well-Run Organization

- Investment teams
- Investment process
- Portfolio management
- Back-office

GTCR's Blueprint for Success:

- Great Returns 
 - *Ratable pace*
 - *Bias toward contrarian*
- Differentiated Strategy 
 - *Leaders Strategy*
- Well-Run Organization 
 - *Human capital development*
 - *Building investment teams*
 - *Teams interaction with IC & functional areas*
 - *Partnership model*

A Fund Above the Rest



Winners Emerge

- Emerge as winner
- Dominate a strategy
- Attract best from others

Summary

- PE industry is under pressure
- Industry will get re-shaped
- Shake-out?
- Winners will emerge

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