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PE's Inexorable March To the Public Market

Private equity moves two steps closer to its public destiny

When **Kohlberg Kravis Roberts** and **Apollo Management** each unveiled publicly traded private-equity vehicles this past summer, the market was aflutter. After years of locking out retail investors, it seemed that private equity was finally reaching out to the hoi polloi. As it turns out, however, KKR's and Apollo's foreign-listed flotations weren't exactly accessible to domestic investors. But that doesn't mean that the march forward came to a halt.

To be sure, the industry's slow transition to the public market has moved in fits and starts. In the late 1990s, it was the venture capital firms that tested the public's appetite for alternative assets, and two years ago, Apollo sparked a trend when it floated a business development company on Nasdaq. The past 18 months, meanwhile, have seen an influx of blank-check companies, LBO-leaning REITs, a diversified trust IPO and now the first domestic ETF.

"Private equity has been an outperforming asset class, and up until now, the average American has largely been precluded from investing in the space," says **Malon Wilkus**, the founder and CEO of American Capital.

While that may be true, there are distinct changes afoot.

PowerShares Capital Management last week launched trading in what is the first US private equity exchange traded fund, the PowerShares Listed Private Equity Portfolio (PSP:Amex), and **American Capital Strategies** has continued to build on its asset management fund platform. Both initiatives mark significant steps in advancing private equity as an option for retail investors.

The private equity ETF launched by PowerShares currently consists of 34 public companies that are either directly involved with or work around the periphery of the buyout market. According to the Web site of **Red Rocks Capital**, which manages the ETF, the fund is split 50/50 between debt and equity providers, with 65% of its capital going to late-stage investment companies and the balance going to mid- and early-stage investors. Select holdings include positions in American Capital, Apollo Investment (Apollo's US-listed BDC), **Silicon Valley Bank** and **CIT Group**.

"The big benefit for investors is the liquidity and transparency of the product," says PowerShares President **Bruce Bond**, citing two factors that differentiate the ETF from a traditional, privately held fund of funds. Bond adds that he sees the ETF market for private equity evolving in a similar fashion to how REITs first emerged out of the real estate landscape.

From REITs to Mutual Funds

Less than three weeks prior to the ETF's launch, American Capital made news when it raised its second asset management fund, corralling $1 billion for the vehicle from private investors. The fund will act like any typical private equity vehicle, although American Capital will be managing the fund and thus be in line to collect management fees.

The firm's current investors reacted enthusiastically to the development because it adds the stability of recurring fees to the firm's business model. But the bigger picture, at least to the private equity market, is that the new vehicle furthers American Capital's grand scheme to create a series of management funds that one day may also trade publicly.

"In the end, our strategy is to create a series of funds," American Capital's Wilkus says, adding that the goal is to create for private equity a model "akin to a mutual fund group, such as T. Rowe Price."

American Capital has already launched two private asset funds focused on the European and US markets. Future vehicles are expected, with possible variations covering special situations, CDOs and energy. Even as investment in these funds is currently confined to private institutional investors, such as **HarbourVest** or **Partners Group**, the anticipated progression is that one day, when the funds are fully invested, these vehicles could be made available to public shareholders, giving retail investors exposure to a wide range of private equity strategies in much the same way they can now pick and choose mutual funds.

Just as other public market initiatives have brought out the detractors, there will also be speculation regarding the prospects of these latest developments. Already, there has been conjecture in the press that private equity's move to the public markets is just another way to profit on the current exuberance exhibited by the asset class.

Not so, says Wilkus. "Ninety-seven percent of the companies in the world aren't public, and there's no way for most people to invest in these businesses," he says. "The private sector is where we see the highest growth rates, the most innovation and the most creativity. It's a critical part of the economy, but right now the average American can't invest there."

American Capital and PowerShares are making a bet that if given the option, the average American will.

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