Alternative Universe

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This Week's Features

Beyond BrokerCheck 5

A background check on Marvin Friedman, a former broker and hedge fund manager, on the NASD's web-based BrokerCheck system will not reveal the millions of dollars in misappropriations and fines he was ordered to pay for a litany of misconduct from 1988 to 1996 when he was the principal of San Diego-based Aimco Securities. Nor will it reveal that he was barred from association with any member of the NASD. That's because any broker who is not registered for two years has his record taken off the BrokerCheck system.

Trouble Around The Corner? 14

If you ask the same question to three different people, chances are you will receive three different answers. Such is the case when it comes to determining what the most pressing topics are for venture capitalists as we head into the new year. Some experts say the most urgent issue is the saturation of fund raising. Other people say research and development will take the greatest hit in the next year. Then there is always the controversial the issue of disclosure.

Also in This Issue

9 FrontPoint Adds Credit Relative Value Team
10 Man Group CEO on Comeback Trail
10 Hedge Fund Consultant Opens Shop
17 KRG Recaps Medical Device Co, Reaps 110% Profit
18 CHAMP Exits Australian Pharma Co For $123M
20 Piper Jaffray Spins Out PE Business

Hedge Funds Pages 3-11

Top News
3 SEC to Vote on Manager Registration Oct. 26
The Shadow Sows
4 "The Choke's On Us", Too: Hedgies and Private Equity Won't Find Greener Grass on The Other Side
Dataview
6 Hedge Fund Performance, Last 12 Months
Funds
7 Manager Launches First FoF For Islamic Investors
8 GAM Turns Four Funds Into One
8 Julius Baer Reopening Fixed Income Hedge Fund
People
8 BOA President to Launch Hedge Fund
9 Barclays Cap Veteran Plots Hedge Fund
10 Feud Prompts Catequil Liquidation
Guest Opinion
11 A Strategy For Active Cash Management

Private Equity Pages 12-20

Top News
12 Welsh Carson, Thoma Cressey in $2.3B Hospital Deal
12 3i Sells Nursing Homes Co For £525M, Nets 80% IRR
Central Intelligence
13 As Legends Leave, A New Industry Emerges: The Retirement of Dealmakers Leaves a Lack of Personalities
Dataview
15 Financial-Sponsor Acquisitions, Last 12 Months
Deals
16 Lehman Sells Aircraft Parts Co to Aurora For $1.06B
16 Carlyle Exits Riello Group Investment in €600M Deal
16 MMC Capital Drawing Scrutiny After Parent Company's Civil Suit
Funds
19 Genstar Closes Fourth Fund on $475M
20 Kohlberg Closes Fifth Fund on $800M
People
20 Hicks To Retire at Year End, Not Next March

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Index » Companies In This Issue

3i 12
ABN AMRO Capital 18
Ace 17
AFFC Holdings 19
AIG 17
Aimco Securities 5
Alchemy Partners 12
Allianz Capital Partners 12
American Capital 17
Amoco Fabrics and Fibers 19
Arc Group 17
Aurora Capital 16
Australian Pharmaceutical Industries 18
Axis Capital 17
Backtrack Reports 5
Banc of America Sec 8, 12
Barchester Healthcare 12
Barclays Capital 9
Berg Electronics 20
BP 19
BrokerCheck 5, 6
California First Amendment Coalition 14
CalPERS 15
Carlyle Group 4, 16
Castle Harlan Australian Mezzanine Partners 18
Catequil Asset Management 10
CCS Medical 18
CheckFundManager.com 6
Citigroup 16
Civco Medical Instruments 17
Clear Channel 20
Cliffwater 10
Clinton Group 9
Coller Capital 17
Cresent Capital Management 7
CSFB 19
Deutsche Bank 9
Dockers 18
DLJ19
Dresdner Bank 17
EIFGroup 19
Essent Healthcare 12
Event Capital Markets 5
Forstmann Little & Co. 20
Four Seasons Health Care 12
FrontPoint Partners 9
GAM 8
Genstar Capital 19
Ghiradelli Chocolate 20
GMT Communications Partners 18
Goldman Sachs 9, 16, 19
Goldman Sachs Private Equity Partners 19
Greenwich Roundtable 3
Halcyon Management Co. 9
Hamilton Lane 20
Harvard Business School 14
Hicks, Muse, Tate & Furst 20
Horizon Cash Mgmt 11
HSBC 8
ICG Communications 20
ING 8
International Home Foods 20
Investec 18
ITU Ventures 20
J.P Morgan Chase 16
J.P. Morgan 9
Jazz Pharmaceuticals 12
Julius Baer Group 8
K&F Industries 16
KKR 13
Kohlberg & Co 20
KRG Capital 17
Lazard 20
Lehman Brothers Merchant Banking 16
Levi Strauss 18
LF Global Investments 5
Lone Star 17
Loral Space & Communications 16
Madison Capital 17
Man Group 10
Managed Funds Association 3, 6
Marsh & McLennan 16, 17
Masspower 19
Matria Healthcare 18
Merrill Lynch & Co. 9
Meyer Capital 7, 8
MMC Capital 16, 17
NASD 5, 6
National Venture Capital Association 14
New Price Retail 18, 19
Pacific Corporate Group 10
Pathway Capital Management 10
Permal Investment Management 7
Piper Jaffray 1, 20
President's Working Group 3
Rhythms NetConnections 20
Riello Group 16
Ropes & Gray 12
Salomon Brothers 9
Securities and Exchange Commission 3, 5
Select Medical Corp. 12
Sharia Funds 7
Sightline Partners 20
Spine Wave 12
Steleus Group 18
Swiss Re Private Equity Partners 19
Teacher Retirement System 15
Tekelec 18
Teligent 20
Texas Growth Fund 15
Texas Pacific 4, 13
The Harlan Co, 19
Thoma Cressey Equity Partners 12
Triton Energy 20
U.S. Chamber of Commerce 3
UBS 8
US Oncology 12
Vestar Capital Partners 18
Viatel 20
Weil Gotshal 19
Welsh, Carson, Anderson & Stowe 12
Wentworth Private Equity 18
Westminster Health Care 12
Wilshire Associates 10
Yell 20
Zenith Capital 5

Visit Our Websites »

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SEC to Vote on Manager Registration Oct. 26

BY JEREMY SMERD | The Securities and Exchange Commission will meet Oct. 26 to vote on whether to adopt a rule forcing hedge fund managers to register as investment advisors, according to the SEC's Web site.

The commission voted July 15 to propose the rule by a narrow 3-2 decision, a rarity for the usually unified group. In all likelihood, a similar scenario will prevail Oct. 26, as commissioners Cynthia Glassman and Paul Atkins have consistently voiced their opposition to chairman William Donaldson's efforts to rally support for a rule he believes will bring increased transparency to the industry.

"The proposals would seek to ensure more timely investment information to investors without mandating delays in the offering process and would further integrate disclosure processes under the Securities Act and the Securities Exchange Act of 1934. The proposals would address communications related to registered securities offerings, delivery of information to investors, and procedural restrictions in the offering and capital formation process," the SEC wrote on its Web site.

Opponents to the rule say it will increase the cost of compliance with no tangible benefit to investors.

The rule, if passed, would require all hedge fund managers with 15 or more investors and $25 million or more in assets to register with the SEC as investment advisors.

The proposal seeks to close a loophole in the Investment Advisers Act of 1940 that has allowed hedge fund managers to avoid registering with the SEC because the fund – not the individual investors that compose it – is considered a single investor. Currently, managers with fewer than 15 investors, which translates into fewer than 15 hedge funds – do not have to register. This rule, originally intended to help small managers with few assets avoid the costs of compliance, seeks to change that.

The SEC says registration would better serve the investor because the entire universe of hedge fund managers would be known and therefore trackable. Opponents say this goal could easily be achieved by tracking hedge funds through prime brokers, auditors, attorneys and other third-party professionals that are also regulated.

The comment period which began after the commission voted to propose the rule July 15, has generated a small response. Of the approximate 6,000 hedge funds managing more than $800 billion, only 124 letters commenting on the proposal have been received by the SEC. Of those comment letters, 91 or 73% were against the proposal and 33 or 27% were in favor.

> Of the 124 letters commenting on the proposal received by the SEC, 91, or 73%, were against the proposal and 33, or 27%, were in favor.

Some of those opposing the registration are powerful voices in the financial services industry as a whole. They include the Managed Funds Association, the U.S. Chamber of Commerce and the President's Working Group. Other notable figures against the proposal include Alan Greenspan.

The SEC will meet on Oct. 26 at 10 a.m.

But one group the SEC is trying most to protect – investors – has announced its support of the intention of the SEC though, like others, it questions its methods. In their comment letter to the SEC, dated Sept. 15, the Greenwich Roundtable, a Connecticut-based group "considered to be the most influential and respected investors in hedge funds," said a majority of its board members supported "endorses the government's role to protect investors and supports the Commission's desire to formalize a culture of compliance among hedge fund managers, which largely exists informally today."

But the group criticized the rule proposal as having potential unintended consequences. By defining a hedge fund as a private fund having a lockup of less than two years, man-

CONTINUED ON NEXT PAGE

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agers may simply extend the lockup in order to avoid registration. Managers exploiting this loophole may hurt investors, the group argued.

Like others opposed to the means of the SEC, the group warned that legitimizing the hedge fund industry via government registration may translate as a stamp of approval for accredited yet unsophisticated investors to invest in hedge funds.

The MFA has offered alternatives to hedge funds registration. They include increased information sharing among regulators and increasing the amount of money individuals must earn in order to be deemed an accredited investor. The group also suggests using independent firms to audit hedge funds and make audited and unaudited financial statements available to investors.

The group also suggests "Suspicious Activity Reports" which are required by the Financial Crimes Enforcement Network of the Treasury Department and prepared by broker-dealers, banks and other financial institutions "be amended to include reporting of illegal activity by hedge funds and their advisers."

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The Shadow Sows
Commentary From Our Man On the Inside

'The Choke's on Us', Too

Hedgies and private equity won't find greener grass on the other side

To quote the *New York Daily News* after the Yankees got flushed down the toilet bowl of history Wednesday night: The Chokes on Us.

And the choke- or rather the joke - just may be on everyone if hedge funds and private equity funds start sleeping in each other's beds.

I'm talking about strong rumor No. 1, indicative of a general trend: Private equity powerhouse The Carlyle Group is raising money for a hedge fund. After selling Carlyle Asset Management years ago in order to concentrate on doing what they do best, industry insiders all agree: Carlyle is back in the (liquid) money again.

This is unconfirmed, mind you ,and certainly Carlyle is not going to admit it. "We wouldn't want to piss off the SEC by confirming rumors would we? That would look like marketing. Tsk tsk tsk."

But the grist for the rumor mill is gristly, dripping with fat and everybody seems to be chewing on this notion: what does it mean? What does it mean!!

Well, here are some thoughts in the form of a riddle: When is a hedge fund not a hedge fund? When it's a private equity fund, of course. And when is a private equity fund not a private equity fund? Okay, you get the idea.

Let's call this the cross-over scenario that so many managers are treading on. The press has been jabbering away on it for several months now – with each writer thinking they've – Eureka! – got a scoop. This is no trend or flash in the pan and here's the simple reason why: As more money from conservative institutions (pensions! yikes!) flood both hedge funds and private equity markets, managers go looking for returns elsewhere.

The problem is the puddle of returns is drying up.

Theodore Forstmann told the *New York Times* returns in private equity have been declining for years. Now firms that used to compete for fund deals are teaming up just to get a slice of an ever diminishing pie.

And hedgies are scraping by on basis points. Managers not looking deep into the credit market for new ways to make lemonade are turning to private equity. Everyone is stepping on each others toes and the Shadow wonders: Will anything but diluted returns come of this?

When two animals start sniffing each other, that's natural enough. But please! Don't let them mate! Stick to what you know.

Here's another reason the hedgies are going after private equity: There are some advantages in this soon-to-be regulated hedge fund world with longer, five year lock-ups. Such a time frame would keep the SEC of a managers back, though it baffles the Shadow why anyone looking to invest in hedge funds to offset the risk associated with illiquid (ie. private equity) investments would subject themselves to a lengthy lock-up.

It's no wonder private equity managers are getting pissed. But private equity funds are just as guilty. Appealing to institutions, private equity firms offer a hedge fund where institutions can park cash while the slow, illiquid private equity fund gets fully invested and returned. I guess that's why Texas Pacific Group hired a former Goldman trader to start a hedge fund.

Both private equity and hedge fund industries are becoming victims of their own success. Institutional investors are redefining the business. They are the 'too much money' in a hedge fund industry that some say was never meant to grow to $1 trillion but is expected to grow to $10 trillion. They are the lowest common denominator that everyone must dumb their strategies down to, giving mediocre managers a couple of million to benchmark. Ironically, the choke may be on the institution.

The views expressed in this column do not necessarily reflect the views of Channel Capital Group Inc.

Beyond BrokerCheck

Forget SEC regulation, hedge fund managers with rap sheets hide behind NASD loophole

BY JEREMY SMERD | A background check on former broker and hedge fund manager Marvin Friedman on the NASD's web-based BrokerCheck system will not reveal the millions of dollars in misappropriations and fines he was ordered to pay for a litany of misconduct from 1988 to 1996 when he was the principal of San Diego-based Aimco Securities.

Nor will it reveal that he was barred from association with any member of the NASD.

That's because any broker who is not registered for two years has his record taken off the BrokerCheck system, in accordance with NASD rules.

When Marvin Friedman reinvented himself as a La Jolla, Calif.-based hedge fund manager, founding LF Global Investments, LLC, investors like John Bugbee were none the wiser. At least not until his $100,000 investment turned into $20,000 and the Securities and Exchange Commission seized the assets of the fund- what little was left – in March , according to the SEC's fraud complaint. Bugbee, who is not an accredited investor, invested in the hedge fund through Zenith Capital, a money management firm.

As regulators meet Oct. 26 to vote on whether to force hedge fund managers to register as investment advisers, those who conduct background checks on would-be hedge fund managers say major cracks in the system still exist that registration does not address.

"Think about the irony," says Randy Shain, a principal of Backtrack Reports, a firm that conducts background checks on managers, of the SEC push to regulate hedge funds. "The SEC is saying: 'What we really want is more regulation but by the way some of these records that already exist, we are going to throw them away.' How can that possibly be?"

Of course, not all the records are thrown away. While states differ on the which records they seal and for how long, most records are there for those – like due diligence professionals – to hunt and find. They exist piecemeal in state and federal courts, through state banking commissions and other regulatory bodies like the SEC. The NASD BrokerCheck system takes many of those records – from minor complaints to adjudicated issues – and collates them for the public.

At question is a rule set by the SEC to limit the two-year time a broker's record can follow him after he leaves the business. According to the NASD rules posted on the SEC Web site, the two-year period coincides with the period in which a broker can return without having to reqaulify by examination. Disclosing a broker's record indefinitely would be "inappropriate."

"NASD Regulation believes it should strike a balance between an investor's interest in being easily able to obtain information about a former associated person and that person's desire for privacy once he has left the securities industry," according to NASD rules posted on the SEC Web site.

But, of course, many who leave the securities industry, some because they were kicked out, turn around and set up a hedge fund, background check experts say.

Though these experts differ on their attitude toward registration, they say having a record follow you – and making it easily accessible through BrokerCheck – is a clear deterrent against fraud.

"I thought that was the point," says Chris Manthey, another principal at Backtrack Reports. "Deterrence only occurs if [your] record follows you around. They modify their behavior unless they think they can get away with it."

Robert Krause of Watchung, N.J.-based Event Capital Markets has his share of "due diligence war stories," as he calls them. These are managers who lie about their past because they think no one will look into it.

"We've found arsonists, child molesters, DUI violators, embezzlement, forgery, market manipulation. We've pulled up hundred of different things," he says. One hedge fund manager, who was charged with racketeering, has been managing an offshore fund since 2000. Though he does not know its performance, it "hasn't blown up."

Krause cautions against using the NASD BrokerCheck as a one-stop shop for due diligence. His services include background checks as well as due diligence on the fund's pricing, accounting and risk control. But, he says, the absence of information is misleading.

Because the NASD is authorized by Congress it is a quasi-regulatory body, therefore, "if you do a search you assume you've got good information," Krause says.

Background check experts say the fix is quite simple. Guy Simonian, another background check expert, advocates extending the window from two years to seven years. The SEC has cited fraud as one reason to register hedge funds.

"Our stance is that here is a simple step that can be taken to tighten up the current regulatory requirement without turning to changing regula-

CONTINUED ON NEXT PAGE

Hedge Fund Performance, by Strategy

Last 12 Months Through September 2004, by Percent Return

This chart displays the last 12 months of the aggregate performance of hedge funds through September 2004, according to HedgeFund.net-PerTrac Universes, a feature of PerTrac Online. The data below presents select strategies. HedgeFund.net-PerTrac Universes charts the aggregate performance of a total of 35 different hedge fund strategies.

	Oct 2003	Nov 2003	Dec 2003	Jan 2004	Feb 2004	Mar 2004	Apr 2004	May 2004	Jun 2004	Jul 2004	Aug 2004	Sep 2004
All Funds	**2.03%**	**0.88%**	**1.78%**	**1.68%**	**1.33%**	**0.40%**	**-1.35%**	**-0.51%**	**0.23%**	**-0.74%**	**0.03%**	**1.34%**
Convert. Arbitrage	2.11%	0.72%	0.76%	1.24%	0.16%	1.00%	0.35%	-1.33%	-0.92%	0.15%	0.44%	-0.50%
CTAs	1.88%	-0.21%	3.08%	0.43%	3.81%	-0.55%	-4.23%	-1.06%	-2.42%	-0.76%	-0.73%	1.50%
Distressed	2.89%	1.89%	1.90%	3.57%	0.71%	0.07%	0.64%	-0.40%	2.55%	-0.11%	1.05%	1.22%
Emerging Markets	2.40%	1.41%	4.71%	3.12%	3.12%	2.33%	-3.07%	-1.85%	0.22%	-0.54%	1.65%	3.28%
Event Driven	1.74%	1.24%	2.19%	2.34%	1.14%	0.12%	0.03%	-0.14%	1.08%	-0.81%	0.28%	0.97%
Fixed Income	0.69%	0.56%	1.93%	1.14%	0.71%	0.52%	-0.42%	-0.32%	0.72%	0.92%	0.68%	0.57%
Fixed Income Arb.	0.69%	0.86%	1.17%	1.09%	0.77%	0.18%	0.33%	0.34%	0.61%	0.56%	0.61%	0.51%
Fund of Funds	1.51%	0.67%	1.69%	1.57%	1.12%	0.41%	-0.86%	-1.01%	0.29%	-0.44%	0.00%	0.92%
Long/Short Hedged	3.16%	1.31%	1.60%	2.10%	1.19%	0.30%	-2.08%	-0.26%	0.78%	-1.59%	0.00%	2.35%
Macro	1.73%	0.40%	3.15%	0.80%	1.34%	0.77%	-2.26%	-0.58%	-0.35%	-0.41%	-0.94%	0.03%
Mark. Neutral Equity	0.68%	0.56%	0.21%	0.94%	0.62%	0.38%	-1.08%	0.27%	0.52%	-0.23%	-0.44%	0.54%
Risk Arbitrage	0.51%	0.36%	0.90%	0.88%	0.44%	0.13%	-0.27%	-0.09%	0.15%	-1.15%	-0.18%	0.42%
Short Bias	-3.97%	-0.17%	-2.62%	-1.37%	-0.31%	-0.64%	1.77%	-0.56%	-1.00%	3.67%	0.06%	-0.90%
Technology Sector	4.95%	1.28%	0.99%	5.71%	-0.26%	-1.57%	-4.66%	1.04%	0.74%	-6.74%	-1.56%	0.30%
Value	3.78%	2.65%	2.36%	1.65%	1.61%	0.83%	-1.27%	0.40%	1.73%	-1.36%	-0.40%	2.28%

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tions," says Simonian, president of CheckFundManager.com.

Simonian has similar stories of brokers with criminal records leaving the industry and setting up a hedge fund. While some have egregious marks on their records, others simply have a past most investors cannot investigate on their own because the records are no longer easily accessible.

Simonian has tried to close that loophole. He has sent letters to Senators on the banking committee, Chairman Donaldson, Attorney General Eliot Spitzer as well as the NASD and securities organizations asking for them to extend the two-year period to seven years. He has not received any response. Other managers, like those from Backtrack, have tried for the past four years to get regulators at the NASD to look into the issue.

The NASD says they are simply abiding by the SEC's ruling. While the purpose of BrokerCheck is to allow investors to check the backgrounds of brokers and firms they are thinking of investing with, the service is not meant to follow managers throughout their careers.

"Any person or firm that sells securities to the public – even one – must be registered with the NASD," says Herb Perone, an SEC spokesman.

The key word here is "public." Since hedge funds are private placements, its investors are not included in what Perone refers to as "the public." This refrain has long been echoed by the hedge fund industry, which says its investors do not need protecting by regulators.

"We do not regulate hedge funds," Perone says. "We only have jurisdiction over any individual or firm that sells securities to the public."

Now, of course, the SEC is trying to change that, though it is unclear whether registration would make a broker-turned-manager's records public. In their quest against the SEC's proposal, hedge fund lobby group the Managed Funds Association has advocated what they call alternatives to registration. While extending the two-year limit on BrokerCheck has not been specified, the group does advocate "increased information sharing among regulators."

Until then, hedge fund managers with nefarious backgrounds will continue to operate and investors will have no easy recourse to their records. Those who find nothing in BrokerCheck cannot assume that there are no records to be found.

Manager Launches First FoF For Islamic Investors, Finally

BY JEREMY SMERD | After nearly an 18-month delay, Conn.-based Sharia Funds has opened the first fund-of-funds compliant with Islamic or "sharia" law, to investors.

Meyer Capital, of which Sharia Funds is a subsidiary, will manage the Sharia Equity Opportunity Fund, a long-short fund-of-funds with 10 underlying managers. The fund will target high-net-worth individuals and institutional investors in the Muslim world, focusing on the Gulf States.

While it is the first fund-of-funds, it is not the first hedge fund based on sharia law, which prohibits investments in certain industries, including pornography and entertainment, commodities such as pork, as well as companies that make profits from interest payments, such as banks and insurance groups.

Oil-rich investors flush with cash but who follow Islamic precepts have long been hemmed in by traditional investment tools that go against the dictates of their faith.

Edicts against interest-baring investments, stocks that are related to pork and other no-no consumables, prohibitions against investing in something you do not own – for instance shorting a stock, which is borrowed – have, until recently, left investors out of the loop.

But savvy managers with the help of Islamic scholars such as Sheik Yusuf DeLorenzo, who also has a background in finance, have figured out ways to make these two worlds meet. And the potential is grand - around $300 billion, DeLorenzo figures.

The roadblocks are not merely moral, however. The multi-trillion dollar financial services industry is a behemoth that can't easily be manipulated to cater to a few investors. So managers like Eric Meyer, president of Meyer Capital, have developed proprietary techniques to make their investments – for instance, shorting a stock without really shorting it – look like any other trade in the eyes of the broker.

Other managers have also launched sharia-compliant hedge funds.

Chicago-based Cresent Capital Management launched the sharia-compliant Appleton Crescent Currency fund last year as did funds-of-funds group, Permal Investment Management, which launched the Alfanar U.S. Equity Hedge Fund in October of 2003.

The Alfanar U.S. Equity Hedge fund, which focuses on mid-to-large growth U.S. equities, launched with $20 million in assets. Permal had been running the fund with the Saudi Economic & Development Company.

But the road to launching the

CONTINUED ON NEXT PAGE

Derivatives & Hedge Funds:
Evolving Complexities of Equity & Fixed Income Derivatives

KEYNOTE SPEAKER: David Krell – Pres. CEO, and a Founder of the International Securities Exchange

SPEAKERS: Jonathan Bloom, Banc of America Securities
Susan C. Ervin, Dechert LLP
Diane Cossin & Steve Kenton, SS&C Fund Services

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fund-of-funds has been long.

In January 2003, Meyer Capital told HedgeFund.net the fund would launch at the end of the first quarter. The reason for the delay, said DeLorenzo, who is an advisor to the fund, is that UBS – the firm's global placement agency – took its time to conduct due diligence on the fund.

"From sharia perspective and U.S. regulatory perspective, they were ready to go a year ago," said DeLorenzo. "Whenever you do something with a huge financial organization like UBS, there is a bureaucracy. This is the first time UBS is launching an Islamic product globally. They want to make sure everyone is legitimate and the product is legitimate."

> "From sharia perspective and U.S. regulatory perspective, they were ready to go a year ago," said DeLorenzo. "This is the first time UBS is launching an Islamic product globally. They want to make sure...the product is legitimate."

The fund is open to investors but it has not invested in the stock market yet, DeLorenzo said.

GAM Turns Four Funds Into One

BY JEREMY SMERD | The world's second largest hedge fund manager, GAM, has consolidated four of its single strategy funds into one multi-strategy fund in order to diversify its portfolio in an ever-changing hedge fund market, the company said.

GAM Trading II, GAM Trading Euro, GAM Trading US$ and GAM Cross-Market have been allocated into a single fund. The funds have "identical mandates, high correlations and commonality of managers and similar levels of returns," according to a company press release.

The funds are currently capped and the changes have yet to be approved by shareholders. GAM said the changes are not due to poor performance.

"A larger investment pool will allow investments in talented trading advisers on a scale that is most attractive to them, thereby enabling greater access to funds," the firm said in the press release.

The minimum investment is $25,000.

GAM, founded in 1983 and now owned by UBS, manages $34.4 billion in assets, with approximately $21 billion of that total in hedge fund assets.

Julius Baer Reopening Fixed Income Hedge Fund

BY CHRISTOPHER GLYNN | Julius Baer Group will reopen a diversified fixed income hedge fund closed since last July, said Tim Haywood, head of hedge fund single strategy for the Zurich, Switzerland-based financial-service firm.

The two-year-old fund has a $300 million target and will require a minimum $500,000 investment.

Julius Baer Group has added staff in order to increase the capacity of the $1.2 billion Julius Baer Diversified Fixed Income Hedge Fund, said Haywood.

The firm last month hired Darren Reece—who headed value swap trading at ING for nine years—as a credit strategist.

Mark Dragten, a FOREX specialist from the Zurich branch of Julius Baer Group and James McAlevy, a fixed income portfolio manager now with HSBC will also join the firm at the beginning of 2005.

Both Dragten and McAlevy will serve as assistant portfolio managers.

The fund has returned 40.2% since its inception while posting an annualized volatility of 7.1%.

The fund will accept new and existing investors from November 2004 through December 2004 while a second "soft close" period from January 2005 to July 2005 will close the fund to new investors. The fund will, for the most part, remain closed after July 20005.

BOA President to Launch Hedge Fund

BY JEREMY SMERD | Banc of America Securities president Jon Sandelman is leaving the firm to launch his own hedge fund.

A spokesman confirmed that Sandelman, who was named head of

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debt and equities in February and has been with the firm since 1997, was leaving to pursue a long-time desire to launch a hedge fund.

Bank of America announced it hired Mark Werner as head of Global Markets. Werner spent 22 years with J.P. Morgan, according to a press release.

Sandelman joined the bank from Salomon Brothers, where he oversaw equity derivatives and convertibles.

Sandelman joins the burgeoning number of high-ranking executives leaving investment banks to launch a hedge fund.

Most recently, Goldman Sachs has experienced executive attrition to hedge funds. Last week, Steven Mandis left the firm to join New York-based Halcyon Management Co. as chief investment officer for its special credit and select opportunity funds.

Barclays Cap Veteran Plots Hedge Fund

BY CHRISTOPHER GLYNN | Alan Burnell, head of fixed income derivative and government bond trading for Barclays Capital, will leave the investment bank at year-end to start his own hedge fund, the company said.

Domenico Crapanzaro, managing director of European rate trading, Justin Excell, head of European bond trading and David Knott, head of derivative trading, will join Burnell in launching the new hedge fund. Crapanzaro, Excell and Knott have each served alongside Burnell on his fixed income derivative and bond trading team, confirmed Kerry Kennedy, communication director for Barclays Capital in London.

Eric Bommensath, head of global fixed income derivative and bond trading for Barclays Capital, will assume Burnell's responsibilities, Kennedy said.

Burnell joined Barclays Capital in April 2002 after serving with Deutsche Bank Group, where he oversaw European government bond trading since 1995. He started his career with Merrill Lynch & Co. Burnell did not return calls seeking comment.

FrontPoint Adds Credit Relative Value Team

BY CHRISTOPHER GLYNN | FrontPoint Partners added a credit relative value fund following the acquisition of a veteran credit team.

> "The market has become broader in the amount of credit as well as deeper in the liquidity," Duff said.

Robert Smalley and Robert Wenzel lead the team that has joined the $4 billion hedge fund manager and will direct FrontPoint in its foray into credit relative value.

Credit relative value has evolved from a hedge risk via credit default toward a growing, more investment-oriented market, making the addition of a credit relative value fund crucial, said Phil Duff, FrontPoint CEO.

"The market has become broader in the amount of credit as well as deeper in the liquidity," Duff said.

Greenwich, Conn.-based FrontPoint has long sought the addition of a credit-relative-value product, searching for credit-relative-value personnel since 2002 before reaching a final agreement with Smalley and Wenzel.

Smalley, a 14-year research analyst, as well as Wenzel, a 12-year veteran portfolio manager, both join FrontPoint from New York investment adviser Clinton Group. Seven to eight staff members will join Smalley and Wenzel on the team, Duff said.

Strategy for the fund will include long-short positioning but focus on a cash-versus-derivative basis, Duff noted. He refused to disclose the roll-out date for the strategy or cite the minimum investment required.

The addition of a credit relative value team also underscored the FrontPoint philosophy of building specialized hedge fund capacity, Duff said. The hedge fund outfit over the last two-month period has added both a Japan and Pan-Asian long-short fund.

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Man Group CEO on Comeback Trail

BY CHRISTOPHER GLYNN | Man Group chief executive officer Stanley Fink is making a gradual recovery from an operation to remove a benign brain cyst, said David Browne, head of group funding at the hedge fund manager.

Fink will return to full-time work in mid-November, at which point he will resume his role on a day-to-day basis, Browne said. These days, Fink is coming to work at the Man Group's London office two to three days per week, Browne said.

A medical examination revealed the brain cyst in August while Fink vacationed with his family in Botswana.

Meanwhile, Man Group has partitioned his workload among other executive staff, including Harvey McGrath, the non-executive chairman and former chief executive officer at the hedge fund manager, Browne said.

Fink, who joined the $38 billion hedge fund manager in 1987 and orchestrated the purchase of RMF in 2002, has served as chief executive officer since 2000.

Feud Prompts Catequil Liquidation

BY CHRISTOPHER GLYNN | A bitter feud has led Catequil Asset Management to self-destruct when one co-founder of the New York hedge fund accused his partner of looting $1 million in client money, according to Reuters.

The battle between Robert Ellis and Paul Touradji—in which Ellis filed a lawsuit in a Delaware court accusing his longtime partner Touradji of misappropriating $1 million in client money—has resulted in a decision to liquidate the $1.5 billion hedge fund because the acrimony between the two men has prevented them from working together.

The liquidation should conclude in January 2005, according to Gary Traynor, a lawyer representing Touradji.

Ellis claims Touradji put his girlfriend and family on the company payroll, lent company money to a relative, demanded the company pay an $11,000 hotel bill for a private vacation to Bora Bora and Tahiti and committed fraud with his company credit card.

Touradji is also accused of abusing and intimidating the personnel at the hedge fund, telling staff to ignore Ellis and telling investors Ellis did not run the fund.

Catequil Asset Management is registered in Delaware.

Hedge Fund Consultant Opens Shop

BY CHRISTOPHER GLYNN | New consultant Cliffwater has begun inviting solicitation from potential hedge fund managers.

Santa Monica, Calif.-based Cliffwater will provide asset allocation, investment structure, manager selection and risk management to the institutional investor market, including the endowment and plan-sponsor segment. Cliffwater will also offer consulting in private equity and real-asset investing in addition to its hedge fund service.

Institutional plan sponsors, including state-employee defined-benefit plans, often hire consultants in order to hire and fire money managers as well as balance and reallocate pension portfolios.

Like other consultants, Cliffwater has focused on alternative assets as more institutional money enters the hedge fund market. In the private equity world, Pathway Capital Management and Pacific Corporate Group are also alternative-asset consultants.

Cliffwater has not revealed its client list.

Four veteran staff from consultant Wilshire Associates formed Cliffwater in July. Cliffwater chief executive officer Stephen Nesbitt along with Katherine Barchick, Barbara Smith and Denis Sugino each average a 10-year-long career in the consulting industry.

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A Strategy For Active Cash Management

BY CARY MUSSER | The low interest rate environment of recent years has brought into focus the difference between active and passive management of cash reserves. For hedge funds that either always have a cash portion or those which strategically allocate to cash, actively managing cash cannot be ignored. As the U.S. Federal Reserve embarks on a tightening cycle, a move toward active cash management must be embraced.

The most common investments used for cash are passive investment strategies – rolling purchases of T-Bills and sweep investments into money market funds. The paltry returns on these investments since 2002 have done little to help hedge funds' bottom line net-asset-value.

The critical first step in the active investment of cash is to make the decision to do it. This seems easy enough but it is probably the hardest decision for hedge fund managers to make. There are many elements involved but perhaps the one that stands out is fear of illiquidity. In other words, what happens if cash is needed and it is not available? There is a pervasive misconception that active management equals enhanced risk and illiquidity. The following paragraphs will explain an active strategy that has historically delivered returns in excess of T-Bills and institutional money-market funds during several upward and downward shifts in the yield curve -- while providing ample overnight liquidity to meet hedge fund clients' needs even during exceptional risk events (i.e. 1998 crisis and 9/11).

Below is a look at the framework that can be utilized when executing an active cash management strategy:

The framework:

1. Buy and hold strategy is usually employed with client-driven caveats.
2. Barbell with underlying laddering of securities.
3. Weighting of barbell is determined by yield curve, interest rate expectations and liquidity needs.
4. Target more than 75% of portfolio to own U.S. Treasury, U.S. Agency securities, or repurchase agreements that use these security-types as collateral

Strategy Execution:

1. Extend portfolio duration beyond 90 days. Money market funds that want to maintain their AAA credit-rating from nationally recognized statistical rating organizations (NRSRO) are required to keep their weighted average maturities less than 90-days. In addition, an eligible security for a rated fund can only have a remaining maturity of 397 calendar days or less.

Increasing the duration of a portfolio beyond 90-days or purchasing a security with a maturity greater than 397 days during the appropriate interest rate environment can improve the performance without incrementally increasing portfolio risk.

2. Purchase securities with incrementally less liquidity and hold to maturity. Money market funds are allowed to hold up to 10% of their portfolio in so-called "illiquid securities." However, most money market funds will not purchase odd-lot securities, loan participation notes, commercial paper issued through one dealer or other securities perceived as less liquid due to their internal mandates, internal trading policies or simply the "hassle factor."

Purchasing well-researched securities with relative wider bid-ask spreads and holding these to maturity can improve the performance without incrementally increasing portfolio risk. There are times when intense research offsets the price of perfect liquidity and the addition of a less-liquid security becomes prudent.

3. Purchase lower-rated securities with short maturity dates. Money market funds that want to maintain their AAA-rated status from Nationally Recognized Statistical Rating Organizations" or "NRSROs" are not allowed to purchase second tier securities.

Purchasing second tier commercial paper, corporate notes and loan participations with investment grade ratings that have been scrutinized by our research efforts in combination with standard NRSRO research can improve the performance without incrementally increasing portfolio risk. There are times when adding industry-diversified, lower-rated, investment grade corporate paper to a portfolio becomes prudent.

4. Efficiently manage the credit approval process in a timely manner. Most money market fund complexes and other large financial institutions manage their credit process in a slow, methodical and bureaucratic manner. The opportunity cost of this "efficiency" (in most cases), is to lose the ability to turnaround time-sensitive credit information quickly.

Having a credit process that is efficient and time-sensitive allows portfolio managers the ability to capitalize on market opportunities in a real-time environment. A typical money market fund credit approval process may take a substantial amount of time allowing some market opportunities to dissipate. Efficient and time sensitive credit research allows timely prudent investment.

Investors pay a price for constant NAV and 100% daily liquidity - it is often too high. Prudent exploitation of the inefficiencies of the short-term money markets in the separate account model can provide returns in excess of traditional benchmarks.

Cary Musser is senior vice president and senior portfolio manager for Horizon Cash Management.

Private Equity

Alternative Universe

Welsh Carson, Thoma Cressey in $2.3B Hospital Deal

BY ALEX J. STOCKHAM | Welsh, Carson, Anderson & Stowe is leading the privatization of specialty hospital company Select Medical Corp. for a total of $2.3 billion.

Thoma Cressey Equity Partners, a current stakeholder in Select, is participating in the privatization, according to Bryan Cressey, a partner at Thoma Cressey Equity Partners.

The acquisition group, which includes Select's management, will acquire the company for $18 per share, valuing the company at $2.3 billion. The price represents a 36% premium for the company's average closing price for the past 30 days. The consortium will also assume Select's debt.

> "[The Ortenzio's] are outstanding operators," Cressey said. "We love investing with them."

Select operates 83 long-term acute care hospitals in 25 states. The company also operates outpatient rehab clinics and has contracts with nursing homes, schools, worksites and assisted living centers to provide rehab services. The company had $1.4 billion in revenues in 2003, according to its Web site.

Select's board of directors unanimously approved the transaction, which is expected to close later this year. Select can solicit other bidders until Nov. 5 and unsolicited bids can come in after that. If a better offer comes, Select must pay a $40 million breakup fee and expenses up to $750,000. Banc of America Securities served as Select's financial adviser for the deal. Ropes & Gray was the legal adviser to the group of buyers.

Thoma Cressey has invested with Select's management team, led by chairman Rocco Ortenzio and chief executive officer and president Robert Ortenzio, since 1982, according to Cressey. The firm once held 11 million shares of Select, most of which have been distributed. The firm's sixth fund still owns 2.1 million shares that are being rolled over into the new company. The firm is also investing $50 million from its seventh fund.

"[The Ortenzio's] are outstanding operators," Cressey said. "They're smart entreprenuers and very competitive and consistently successful. We love investing with them."

This is Welsh Carson's second healthcare privatization of this year. In March, the firm acquired cancer-care services company US Oncology in a deal valued at $1.7 billion.

Thoma Cressey opened an office in Boston, led by partner David Mayer, in June to focus on the healthcare industry, including health services, medical devices, pharmaceuticals and life-science instrumentation. The firm has investments in healthcare companies including Jazz Pharmaceuticals, Essent Healthcare and Spine Wave.

3i Sells Nursing Homes Co For £525M, Netting 80% IRR

BY ALEX J. STOCKHAM | U.K. private equity giant 3i has sold nursing home company Westminster Health Care to strategic buyer Barchester Healthcare for £525 million ($950 million).

3i had an IRR of 80% on the deal and returned four times its invested capital, according to a press release. The firm's proceeds from the deal are £225 million.

Westminster operates 88 nursing care homes in the United Kingdom. The company's services including care for patients with dementia and those needing respite care. 3i led the £267 million management buyout of the company in 2002, backing chief executive officer Tony Heywood.

Barchester operates 75 retirement homes, primarily in England. The combined companies expect £265 million in total revenue this year.

Nursing homes have been an attractive investment for private equity firms, particularly in the U.K. Earlier this year, Alchemy Partners sold Four Seasons Health Care to Allianz Capital Partners in a deal valued at £775 million that netted Alchemy a reported profit of £200 million.

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MARKET COMMENTARY BY ALEX J. STOCKHAM

As Legends Leave, A New Industry Emerges

The retirement of high-profile dealmakers leaves a dearth of personalities

A handful of incredibly bright people started the private equity industry as a way to change the way corporate America worked.

As the old guard exits to work on other projects - mostly of a more personal nature - one wonders in what shape they are leaving the industry they created. As evidenced by the ever-greater number of firms and assets under management, there's no doubt the industry is much larger now than when it started 30-plus years ago, but bigger isn't necessarily better. While returns are still existent, they've no doubt shrunk, as has the personality that made the industry so appealing to begin with.

When the private equity industry first got off the ground in the late 1970s and early 1980s, it was founded by mavericks with an idea of how to transform companies both public and private. When the industry hit its heyday in the late 1980s, and first captured the general publics' attention, the men who ran firms were iconic business figures with personalities and reputations to match. Henry Kravis, Theodore Forstmann, Tom Hicks, Thomas Lee, David Bonderman - these were men everyone had heard of. They were captains of industry. There were newspaper stories, magazine features and books written about them. Movies were made about them. Private equity was cool.

When the industry hit its heyday in the late 1980s, and first captured the general publics' attention, the men who ran firms were iconic business figures with personalities and reputations to match.

In those days, firms were much more likely to be rivals than friends. Much has been written about the supposed feud between Forstmann and Kravis. Forstmann detested the use of junk bonds to help finance deals, one of Kravis' specialties. His missives to the press and the way he railed against high yield debt in speeches were taken as a shot against Kravis. While Forstmann has said their enmity was overblown in the press, it no doubt helped fuel interest and awareness in private equity overall. It made for a good story. In those days, Kravis and Forstmann were as likely to appear in gossip columns as they were on business pages.

But the industry these men began has since changed. Some would argue it has changed for the better. In the early days, the firms these men were considered middle market. Their success led to the mega buyout firm as we know it. And that success and growth may be what's hurting the industry today.

As the size of assets in the private equity industry grew - and the stock market of the late 1990s made everyone lose perspective - firms lost their way. Both Hicks and Forstmann have been candid about how their firms veered from proven investment focuses to commit capital to telecommunications companies - an industry they admit they new relatively little about. It was hubris that got them into trouble. Then again, it was their confidence that made them so successful in the first place.

To say the private equity industry is in trouble would be wrong, though. There are a number of highly talented people stepping into leadership roles at their firms - and in the industry. Even though Tom Hicks is stepping down, the management team of John Muse, Jack Furst and Lyndon Lea is highly competent and very successful in their own right. Other names, like Damon Buffini, Guy Hands, Tim Collins and Josh Harris are creating their own reputations. Executives like David Rubenstein and Stephen Schwarzman aren't going anywhere. Firms like KKR and Texas Pacific will always be able to attract sufficient talent to keep their organizations rolling.

The main question is whether these skilled people will ever attract attention to the industry the way Kravis, Forstmann, Bonderman and Hicks did. There is less incentive now to ruffle the feathers of the competition because the competition may end up doing a deal with you. There is so much competition in the industry that being on the best of terms with other firms must be more prized than beating them to a deal because of the club deal phenomenon.

That increased competition has led to a decline in returns. There still may be attractive multiples and some gaudy IRRs, but they are fewer and farther between. To get back to where the industry once was, it will require new thinking - and perhaps new blood can provide it.

In the end, most general partners in the private equity industry probably don't care about being in the newspapers - except when they buy or sell a company. That's fine. Blandness isn't a bad thing. Most would rather concentrate on finding good deals, executing them to perfection and selling them for a profit for their investors. That's what they're paid to do. That's the reason the "cowboys" who started the industry attracted the attention they got. They were successful. No doubt the industry is hoping the new guard can garner that type of attention as well.

Trouble Around The Corner?

Private equity and venture capital pros discuss the biggest concerns in the coming year

BY MARC RAYBIN | If you ask the same question to three different people, chances are you will receive three different answers.

Such is the case when it comes to determining what the most pressing topics are for venture capitalists as we head into the new year. Some experts say the most urgent issue is the saturation of fund raising. Other people say research and development will take the greatest hit in the next year. Then there is always the controversial issue of disclosure.

Paul Gompers, a professor of business administration from Harvard Business School is convinced the most important problem facing venture capitalists in the coming year is there is far too much money in the market right now. The private equity and venture capital markets are much smaller, in terms of capitalization, than other asset classes, however, the amount of money coming into the market is far out pacing the rate of expansion of the market itself.

With so much funding banging on the doors of general partners, firms will need to exercise more restraint than ever, says Gompers. The larger outfits are to be commended for not accepting too much capital. However, Gompers says investors' money will eventually make its way to funds that will accept the capital. The problem is these funds are not nearly as savvy as the funds run by the top tier firms. The marginal funds should never have gotten capital in the first place, says Gompers. The result is the saturation of the market where everyone's returns dissipate, prices go up and nobody will make money.

Gompers says it is possible to have too much of a good thing.

"It is too much capital that wants to fit into the industry," says Gompers. "If you want to avoid a train wreck you have got to find a way to keep that money out of the industry."

"It is too much capital that wants to fit into the industry," says Gompers. "If you want to avoid a train wreck you have got to find a way to keep that money out of the industry."

One can only hope market sanity will prevail when it comes to raising money, but the odds are pretty unlikely. Next year looks to be a heady time for fund raising, as more and more large institutions continue to allocate larger chunks of their capital to private equity.

Gompers estimates the limit for a healthy venture market, as far as fund raising, is $15 billion a year in capital, but the issue for next year will be how much more the bubble will expand with many more firm are expected to return to the market. At the height of the tech boom, venture fund raising rose to a mindblowing $80 billion to $100 billion.

Gompers says another issue has to do with life sciences. A great deal of funding for stem cell research and development will presumably come from the coffers of venture capital, and how far the R&D can go will depend upon the results of the November presidential elections.

Venture firms specializing in the life sciences investment may be pulling for Democratic candidate Senator John Kerry to beat President George W. Bush. Kerry has embraced the expansion of stem cell lines, while Bush has said he wants to work with current stem cell supplies. Having said that, ultimately, this may not be the case.

Mark Heesen, president of the National Venture Capital Association, disagrees that only a Kerry presidency will be good for life sciences-focused venture funds. Heesen says it really does not matter which candidate is in the Oval Office come January 2005 because the issue will most likely come down to individual states' allocation of money to life sciences research and development, and the pressure this will put on government at the federal level. Even if Bush were to win the election, says Heesen, the President may be forced to put more money toward stem cell research if more states call for it.

Heesen cited Republican Governor Arnold Schwarzenegger's recent endorsement of a $3 billion bond measure, and bucking of current White House policy, to fund human embryonic stem cell research in California as evidence of the pressure states can bring to bear on federal policymaking.

Peter Scheer, the executive director of the California First Amendment Coalition, thinks one of the most important issues facing pension funds and private equity firms in the next year is disclosure. The CFAC was founded by the California Newspaper Publishers Association and the Society of Professional Journalists, and recently brought suit against the California Public

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Financial Sponsor Backed Acquisitions

Last 12 Months Through September 2004

This chart displays the number and value of global financial sponsor backed acquisitions for the last 12 months through September 2004, according to Capital IQ. The data is presented as buyout-only, venture capital-only and total deals. Values are in $mil. Learn more about Capital IQ at www.capitaliq.com. The data is up to date as of October 22, 2004.

	No. of Buyout Deals	Value of Buyout Deals	No. of Venture Deals	Value of Venture Deals	Total No. of Deals	Total Value of Deals
Sep 2004	154	$23,192.17	442	$4,448.05	596	$27,640.22
Aug 2004	100	$24,083.92	419	$4,144.71	519	$28,228.63
Jul 2004	149	$33,887.80	451	$8,395.09	600	$42,282.89
Jun 2004	129	$17,751.24	509	$6,128.25	638	$23,879.49
May 2004	131	$24,712.01	456	$6,267.49	587	$30,979.50
Apr 2004	116	$11,902.02	496	$5,943.30	612	$17,845.32
Mar 2004	145	$21,989.79	576	$10,648.48	721	$32,638.27
Feb 2004	105	$11,337.99	510	$6,863.76	615	$18,201.75
Jan 2004	105	$10,325.01	547	$5,900.51	652	$16,225.52
Dec 2003	136	$12,195.98	630	$8,007.45	766	$20,203.43
Nov 2003	125	$22,269.95	550	$25,332.07	675	$47,602.02
Oct 2003	127	$17,817.94	538	$6,972.52	665	$24,790.46
12-Month Total	**1,522**	**$231,465.82**	**6,124**	**$99,051.68**	**7,646**	**$330,517.50**

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Employees' Retirement System to reveal the amount of fees the pension pays to each of its managers in its alternative investments program, including private equity firms and venture capital firms.

Scheer's beef with CalPERS is that while the pension fund discloses how much it pays in fees to private investment managers - roughly $500 million - there is no breakdown of how much each firm earns. Scheer's opinion is if this information were available, private equity firms would be pressured to lower fees in order to compete with each other.

"Certainly, fees need to be disclosed," Scheer says. "Information in a very general nature about investments that private equity funds make ought to be disclosed in some central way."

Many managers of private equity firms and venture funds say some amount of disclosure is a good thing, but for Heesen there is a much more nefarious issue at hand.

"Where the issue does rear its ugly head," says Heesen, "is where some people will use it as a political issue for higher office."

Earlier this month, Greg Abbott, the attorney general for Texas, gave a speech at a luncheon sponsored by the Freedom of Information Foundation of Texas, where he called for increased disclosure by private investment firms. In light of recent corporate scandals, when it comes to public pension funds' investment in private equity firms, Abbott said the public had a right to know how its dollars are spent.

Abbott's office said the Teacher Retirement System of Texas and the Texas Growth Fund, a private equity firm that manages money for Texan public pensions, must make certain information public, including portfolio company performance information.

Although Heesen did not question Abbott's altruism out rightly, the president of the NVCA says he would not be surprised if Abbott was simply using the issue as a springboard toward more political power.

"The attorney general may be using [this issue] as he aims for the governor or senator level," says Heesen.

Scheer thinks the pressure for more disclosure will increase in the next year; it will emanate from a variety of directions as people start to key in on unregulated hedge funds, venture capital funds and private equity firms. How much disclosure will be required and along what lines should become much clearer, he says.

It is difficult to predict where, exactly, the industry will be one year from now, but one thing is certain: if the Boston Red Sox can beat the New York Yankees for Major League Baseball's American League championship in four straight games after being on the brink of elimination, anything is possible.

Ivestors and general partners alike should expect a wild 2005.

Lehman Sells Aircraft Parts Co to Aurora For $1.06B

BY ALEX J. STOCKHAM | Lehman Brothers Merchant Banking has agreed to sell aircraft parts manufacturer K&F Industries to Los Angeles-based private equity firm Aurora Capital for $1.06 billion.

Lehman and K&F chairman and chief executive officer Bernard Schwartz each own 50% of the company, according to an article in *The Deal*.

Lehman, which has already reaped more than $200 million on the investment after a few recapitalizations, will end up making almost $500 million total on the deal. The firm invested a total of $83.8 million into the company.

K&F, through its Aircraft Braking Systems Corp. subsidiary, is a leader in the manufacture of wheels, brakes and brake control systems for aircraft. K&F's other subsidiary, Engineered Fabrics Corp., is a producer of aircraft fuel tanks, de-icing equipment and specialty coated fabrics used for storage, shipping, environmental and rescue applications.

Schwartz is also chairman and CEO of Loral Space & Communications, which recently filed for Chapter 11 bankruptcy protection. Lehman Brothers Merchant Banking and Schwartz bought Loral's 22.7% stake in K&F in 1997.

Aurora Capital will invest between $300 million and $350 million of equity into the deal and raise financing from a plethora of sources, including Goldman Sachs, Citigroup, Lehman Brothers and J.P Morgan Chase.

Carlyle Exits Riello Group Investment in €600M Transaction

BY MARC RAYBIN | Private equity giant The Carlyle Group agreed to sell its 50% stake in the Riello Group to the Riello family in a deal valued at €600 million ($750 million).

Italian merchant bank Palladio Finanziaria was a co-investor in the Carlyle stake, acquiring 8% of Riello Group. The bank had no votes in Riello Group's board of directors.

> "The company was performing well - we had an opportunity and we took it," said Lanzavecchia.

Riello Group is headquartered in Legnago, Italy. The company focuses in the domestic heating sector, including burner production and wall-mounted boilers.

"The company was performing well - we had an opportunity and we took it," said Edoardo Lanzavecchia, a managing director with Carlyle.

Carlyle invested an undisclosed sum in Riello in July 2000, from the €1 billion Carlyle Europe Partners I, to help one branch of the Riello family buyout another branch of Riello family from the business.

"The two families had diverging ideas about the direction of the company and we helped one [set] buy back the company," said Lanzavecchia. "The company is well-managed and ready for the future."

MMC Capital Drawing Scrutiny After Parent Company's Civil Suit

BY ALEX J. STOCKHAM | MMC Capital, the private equity division of insurance giant Marsh & McLennan, is under fire for potential conflicts of interest.

An article in *The New York Times* says MMC's Trident II fund, which was closed in 1999 on $1.4 billion, received capital from Marsh & McLennan's independent directors and may have profited by buying or investing in companies that Marsh once owned or worked with. Marsh & McLennan itself committed $300 million to the fund. The conflict arises when Marsh executives may have profited through their investment in Trident at the expense of the public company's shareholders by throwing sweetheart deals toward MMC Capital.

However, the article went on to say there is no evidence at this time that Marsh's public shareholders were hurt by any deals done by Trident.

This summer, MMC Capital closed Trident III on $1.1 billion. Independent directors of Marsh & McLennan were prevented from investing in the fund, though the company did invest. In an interview earlier this month

CONTINUED ON NEXT PAGE

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with *PrivateEquityCentral.net*, Charles Davis, chairman and chief executive officer of MMC Capital, said the bulk of Trident III's capital came from third party investors.

The scrutiny focused on MMC Capital comes as New York State Attorney General Eliot Sptizer filed a civil suit against Marsh & McLennan, charging the firm with fixing prices with other insurers such as AIG and Ace. Investigators are aware of the potential Trident conflicts of interest, but are focusing on the price fixing scandal, according to the article.

Potential conflicts arose in 2002, when MMC acquired a 43% stake in a small insurance broker, Arc Group, from Marsh & McLennan for $23.6 million, resulting in a $9 million profit for Marsh. Davis and Marsh's chairman Jeffrey Greenberg were entitled to receive incentive payments for the deal, but deferred the payments. Another MMC investment – the creation of reinsurance company Axis Capital in late 2001– drew suspicion because Axis places some of its policies through Marsh.

MMC Capital, however, has strict procedures in place to prevent conflicts of interest with its parent company. It is unclear if any of those tenets were broken.

MMC Capital didn't return a request for comment.

Lone Star Acquires German Loans From Dresdner

BY ALEX J. STOCKHAM | Texan private equity firm Lone Star Funds has acquired a portfolio of German loans from Dresdner Bank with a value of €1.2 billion ($1.5 billion).

Lone Star beat out two other interested parties. The majority of the loans Lone Star acquired are non-performing while the rest are sub-performing, according to a press release.

The portfolio consists of 1,300 loans made to more than 300 borrowers. Approximately 40% of them are in the commercial real estate sector.

Dresdner has reduced its German loan portfolio from €9.2 billion to less than $4 billion after this transaction.

Last month, Dresdner sold a portfolio or private equity investments made in North America to Coller Capital for $90 million. The portfolio consisted of 22 companies in a variety of sectors.

KRG Recaps Medical Device Co, Reaps 110% Profit

BY ALEX J. STOCKHAM | KRG Capital has returned 110% of its invested capital after recapping medical device company Civco Medical Instruments.

KRG originally invested $21 million into Civco in July 2003. Madison Capital, American Capital and management invested another $5.6 million at that time, according to David Kessenich, a principal with KRG Capital. KRG retains an 80% ownership stake in the company after the $60 million refinancing, which went to refinance some debt and pay back some of Civco's investors, including management.

> "There's a huge trend toward minimally invasive procedures, which can be done in a surgical center environment," Kessenich said.

Civco makes metal and plastic brackets, guides and covers used in minimally invasive surgical procedures. Kessenich said the guides direct biopsy needles to cancerous spots on targeted body parts.

"There's a huge trend toward minimally invasive procedures, which can be done in a surgical center environment," Kessenich said. "Civco's products are critical to accomplishing those procedures."

Civco is currently undertaking initiatives which could grow the company dramatically, Kessenich said.

"This is a great management team and a great company and we want to continue building it over the next three to five years," Kessenich said.

In June, KRG acquired the phar-

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macy and lab supplies division of Matria Healthcare through its CCS Medical portfolio company in a deal valued at $130 million.

GMT Exits Steleus Investment For $55M

BY MARC RAYBIN | European private equity firm GMT Communications Partners announced portfolio company Steleus Group was acquired by Tekelec for approximately $55 million in cash, according to a statement released by the firm.

Steleus is a performance management company that supplies network-related intelligence to telecom operators. The company has more than 100 telecom operators in more than 35 countries throughout Europe, North America and Asia-Pacific.

Tekelec supplies products for next-generation switching and signaling for telecommunications solutions and network performance management technology. The company is headquartered in Calabasas, Calif.

Steleus will form the cornerstone of Tekelec's new communications software solutions business unit, which will include existing Tekelec technology.

The current deal was a modification of a transaction agreed to by Steleus and Tekelec on August 20th. Original terms of the deal called for Tekelec to purchase Steleus for $29 million in cash and $27 million of Tekelec stock.

A representative from GMT did not immediately return a phone call seeking comment.

Vestar Loses $800M Bid For Dockers

BY MARC RAYBIN | Contrary to previous reports, Levi Strauss & Co. will not do the full monty. The company has decided to keep its pants on by not selling its popular men's casual clothing brand Dockers to private equity firm Vestar Capital Partners and Eric Rothfield, a clothing industry veteran, in a deal reportedly valued at $800 million.

Levi Strauss determined their Dockers brand was more valuable to hold onto rather than to sell. Dockers generates $1.4 billion in worldwide revenue.

"We said we were exploring the possibility of selling the brand, but that we retained the right to hold onto it, and that's what we did," said Jeff Beckman, a spokesman for Levi Strauss.

A definitive agreement with Vestar was never in place, said Beckman. Furthermore, Beckman would not confirm Vestar's reported bid nor that Vestar was even one of the "multiple" bidders.

The announcement comes on the heels of Levi's release of its fiscal third quarter results. For the nine months ended Aug. 29, the company had a net income gain of $49.8 million, compared with a $104.2 million loss the year prior. Levi had a $46.6 million net income gain for the third quarter, compared with a $4.3 million loss for the same time period the previous 12 months.

Perhaps this is good news, as Levi Strauss' annual net income has steadily decreased every year to a loss of $349.3 million in 2003, from a gain of $223.4 million in 2000.

Calls to Vestar seeking comment were not returned.

Castle Harlan Exits Australian Pharmaceutical Investment For $123M

BY MARC RAYBIN | A consortium of investors that included Castle Harlan Australian Mezzanine Partners, the Australian arm of private equity firm Castle Harlan, ABN AMRO Capital and Investec Wentworth Private Equity sold New Price Retail to Australian Pharmaceutical Industries in a deal valued at approximately AUS$167 million ($123.2 million), according to a statement.

New Price Retail is a pharmaceutical, health and beauty-aid retailer. The portfolio company has more than 300 stores in Australia. Nearly

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140 of these stores are company owned. New Price Retail had revenues of AUS$372 million in the last 12 months, more than a 17% increase from the year prior.

The group of private equity firms acquired New Price Retail for AUS$107 million in February 2003. The sale of New Price Retail resulted in CHAMP's offshore group of investors realizing a return of $13.5 million on its $8.3 million investment.

John Castle, former president and chief executive officer of investment banking firm Donaldson, Lufkin & Jenrette, and Leonard Harlan, founder and former chairman of The Harlan Co, founded Castle Harlan in 1987. The firm has completed acquisitions worth more than $7 billion. CHAMP manages or advises approximately AUS$850 million invested in the Australasian region. Its CHAMP I fund is currently 60% invested.

EIF Group Acquires Additional Interest in Masspower

BY NAOMI COHEN | Power investment specialist Energy Investors Funds Group announced it increased its investment in Masspower by 12.5% by investing approximatley $13 million.

The firm used capital from its US Power Fund, which closed on $250 million in December 2003, according to a company statement.

Masspower is a 270-megawatt gas-fired cogeneration plant located in Springfield, Mass. In 1997, Energy Investors Funds' Project Finance Fund III acquired a 17.5% interest in the plant.

"[Masspower] is extremely well run by management and the operators on site," Rick Carlson, a vice president at EIF, said. "It has a package of contracts it received in the late 1980s and early 1990s that lock in long-term value. There could also be upside in restructuring those contracts to extract near-term cash. These [attributes] sit in the middle of the fairway for US Power Fund."

"[Masspower] is extremely well run by management and the operators on site," said Carlson.

The firm acquired two power generation plants in June, also using capital from the US Power Fund.

Energy Investment Funds Group was founded in 1987. The firm currently manages more than $1 billion in five funds and has offices in Boston and New York. The firm has made more than 65 investments.

Genstar Closes Fourth Fund on $475M

BY NAOMI COHEN | San Francisco-based private equity firm Genstar Capital, announced the final closing of its fourth and largest fund - Genstar IV - on $475 million.

The firm will focus on investing in the life sciences, business services, and industrial technology sectors, according to a Jean-Pirre Conte, chairman and managing director of Genstar.

Genstar's latest fund had more than $1 billion in interest from limited partners, Conte said. The firm decided to cap the fund at less than $500 million in order stay focused on the middle market. The fund began formal fund raising in July. CSFB acted as placement agent and Weil Gotshal provided legal counsel.

Goldman Sachs Private Equity Partners Funds and Swiss Re Private Equity Partners invested in the fund, according to the statement.

Genstar IV already has two deals under exclusivity, Conte said. The firm expects them both to close by the end of the year.

The firm's third fund, Genstar III, closed on $221 million in July 2001.

Earlier this month, Genstar's portfolio company, AFFC Holdings acquired Amoco Fabrics and Fibers from oil giant BP.

Hicks To Retire at Year End, Not Next March

BY ALEX J. STOCKHAM | Tom Hicks, one of the co-founders of Dallas-based private equity powerhouse Hicks, Muse, Tate & Furst, announced his plans to step down as chairman at the end of this year, three months earlier than anticipated.

Hicks made the announcement at the firm's annual partners' meeting.

In his statement to the meeting, Hicks said the transition process has already been completed, so there was no real need for him to stay on past Dec. 31. John Muse will assume Hicks' chairman title on Jan. 1, 2005. The firm's management committee, which Hicks has led the past three years, will be comprised of Muse, Jack Furst and Lyndon Lea. Muse is responsible for the firm's global investment activities, Furst focuses on North America and Lea is in charge of day-to-day operations in Europe.

"I don't mind telling you that I will miss my active role at HMTF," Hicks said in his speech to investors. "It's a role I've been honored to play, and have deeply enjoyed, for a very long time."

> "I don't mind telling you that I will miss my active role at HMTF," Hicks said in his speech to investors. "It's a role I've been honored to play, and have deeply enjoyed, for a very long time."

Hicks will focus on running his family's interest in the Texas Rangers baseball team and the Dallas Stars hockey franchise, as well as real estate interests.

The bulk of Hicks' remarks focused on his firm's past. He singled out investments he's been proud of, including the firm's $35 million investment in Berg Electronics in 1993 which the firm sold for $479 million in proceeds. Other deals Hicks pointed out were its International Home Foods, Triton Energy, Ghiradelli Chocolate, Yell and Clear Channel.

Hicks did say his firm veered from its traditional formula in 1999 and 2000, which saw the firm dive into telecommunications companies, with disastrous results. Investments in Rhythms NetConnections, Teligent, Viatel and ICG Communications all turned out poorly. Hicks said he's as proud in the firm's turnaround after those ill-fated investments as anything he's done.

Hicks' retirement highlights the upcoming departure of some of the private equity industry's innovators. Last week, Forstmann Little & Co. co-founder Theodore Forstmann announced he'll shutter his firm after its current fund expires.

Kohlberg Closes Fifth Fund on $800M

BY MARC RAYBIN | Kohlberg & Co., a Mt. Kisco, N.Y.-based private equity firm, announced the final closing of Kohlberg Investors V on $800 million.

The fund took six months to raise and was $150 million oversubscribed, according to a source familiar with the fund's closing.

Approximately 40 investors from the United States and Europe participated as limited partners in the fund. Lazard acted as placement agent for the fund.

Private equity firm Hamilton Lane was one of the investors in the fund, according to a source familiar with the firm.

ITU Raising $175M Third Fund

BY ALEX J. STOCKHAM | Los Angeles-based venture capital firm ITU Ventures is raising its third fund with a target of $175 million.

The firm hopes to complete the fund raising process in the first half of next year, according to Chad Brownstein, a managing partner at ITU Ventures.

This is the firm's third fund. Its first fund closed on $20 million in 2000. Its second fund closed in $44 million last year, Brownstein said.

Brownstein said raising a fund almost three times as large as the previous fund shouldn't be a stretch for the firm.

"We've put out more than $60 million over four years and our portfolio companies have raised $150 million in third party capital," Brownstein said. "We consider, and our investors consider, a $175 million fund a natural progression."

The new fund will continue ITU's focus on investing in seed-stage companies coming out of research facilities, such as universities, federal laboratories and corporate research and development offices.

ITU doesn't have a placement agent at this time, though they are considering getting one, Brownstein said.

"Our success in what's been a tough market puts us in a nice position," Brownstein said.

ITU Ventures has relationships with professors and students at universities to help source technology coming from leading institutions that could develop into companies. The firm's other managing partner is Jonah Schnel. In August 2003, ITU sold computer chip company Coatue to industry giant Advanced Micro Devices for an undisclosed sum.

Piper Jaffray Spins Out PE Business

BY MARC RAYBIN | Piper Jaffray Cos. announced plans to spin off its venture capital business into an independent firm in the fourth quarter.

Sixteen-year private equity veteran Buzz Benson, according to a Piper Jaffray statement, leads the new firm, Sightline Partners. Sightline will have offices in Minneapolis and San Francisco.

Sightline will manage each of Piper's four healthcare funds, comprising $225 million in capital. The funds will be renamed Sightline Healthcare Funds. Future healthcare-related funds will be raised by Sightline independently of Piper Jaffray.