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Buyouts

Morgenthaler Closes Fund VIII With New Investment Period

Ari Nathanson
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Private equity shop Morgenthaler closed its eighth hybrid investment vehicle to the tune of $450 million. The new fund, which will invest in both buyout and venture capital deals, is almost half the size of its $850 million predecessor fund-a factor that is partly due to growing limited partner demand for quicker returns, said Morgenthaler General Partner John Lutsi.

Raising Morgenthaler Partners VIII "was a bit more challenging because we had to incorporate a change in strategy," Lutsi said. "Typically, we used to do three and a half- to four-year investment periods, but our LPs convinced us to change it to two and a half to three years for this fund...Most of our LPs' interests are geared toward liquidity and fast returns."

Another reason for the lower capitalization, Lutsi said, is because "the world is moving away from hybrids." Limited partners want to make allocation choices themselves, and accordingly, fewer and fewer tend to seek solace in investment platforms labeled as "venture/buyout" funds. As such, Fund VIII will be Cleveland-based Morgenthaler's last hybrid fund, Lutsi said, noting that the firm's ninth fundraising drive will likely be split into two separate vehicles-one for buyouts, another for VC.

But despite the challenges, Morgenthaler's fundraising initiative for Fund VIII was relatively swift. The firm began marketing the fund in April, held a first close in September, and a final close about one month later, albeit below its $600 million target.

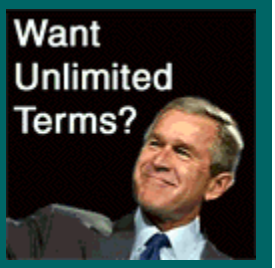
Limited partners in Fund VIII include The University of Texas, Fairview Capital Partners Inc. and JP Morgan, Lutsi said. Investors in previous Morgenthaler funds, according to Buyouts, include Stanford, MIT and the Ohio State Teachers' Retirement System. Spencer Timm, head of investor relations at Morgenthaler, spearheaded the fundraising run for Fund VIII. The firm opted not to employ the services of a placement agent.

Although no specific parameters have been set for capital allocation, Fund VIII's investment activity will likely end up split three ways-one third devoted to buyouts, one third to VC investments in information technology companies, and one third geared toward VC investments in the life sciences arena.

"If buyouts are hot, then we'll focus more heavily on buyouts," Lutsi said, adding that the same holds true for IT and/or life sciences. "That's one of the benefits of a hybrid fund; it gives us more options with regards to where we place our capital. But the LPs don't like it for that same reason; they'd rather make that choice themselves."

The firm's buyout team, called Morgenthaler Partners, will continue to focus on industrial companies with transaction values between $75 million and $250 million and EBITDA in excess of $10 million. The firm typically places between $30 million and $70 million of equity in each company.

Thus far, capital from Fund VIII has been used to facilitate one venture capital deal in the IT sector, which closed in early October, Lutsi said. He declining to name the company or the amount invested. Fund VII, meanwhile, is more than 75% deployed, and will invest in one more platform company before year-end, at



which point its remaining capital will be used for add-on acquisitions and other growth initiatives, Lutsi said.

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