

BUYOUTS BEAT

FIVE QUESTIONS WITH...



DAVID KENNEDY
MANAGING
DIRECTOR,
SERENT CAPITAL

1 Serent Capital, led by yourself and Kevin Frick, former consultants for McKinsey & Co., closed this month on a debut \$250 million fund. It seems as though you raised more money than you expected and did it faster than you expected. How do you account for the response by limited partners to your debut fund?

I think LPs are largely looking for more exposure to smaller-market buyouts. Secondly, our backgrounds, which are nontraditional for private equity given that neither of us is coming from an existing firm, nonetheless resonated a lot, particularly with the strategy we're following, which is a pretty intensive business-building strategy. The fact that I've been an operator who's built a business was compelling to LPs. I think the two issues are building a business after you invest and diligencing to make sure you get into a great business. Kevin had done 60-plus diligences for everything from mega-buyouts to growth investments over the last several years.

2 Your firm focuses on service businesses. What is a "service business," and why is that your focus?

We're talking about businesses that have pretty light balance sheets. There's no manufacturing or even light manufacturing. They tend to be more scalable, and there's also not a huge amount of competition from other buyout firms. Services can be harder to lever, so people tend to shy away. Kevin and I both are contrarian by nature, and we believe in trying to hit 'em where they ain't, if you will. Growth services businesses is a sector where you can both scale businesses rapidly and make great returns for investors and have limited competition in doing that.

3 Are you going to be a control-stake investor, a growth-stake investor, or both?

We'll do control more often than not.

4 Do you have a preference for working with existing management teams or bringing in executives of your own choosing?

We don't have a preference. We're very comfortable bringing in a management team to the extent a founder wants to exit. We're also very comfortable working with an existing management team to the extent that we like them. I think our backgrounds make us intrinsically less nervous about swapping out a management team—more so than guys who have a deal background as opposed to a business-building background.

5 You've raised the fund, which is a big hump to get over. But now you're entering a choppy deal environment. Do you think you'll be able to put your new money to work in the next six months?

I think the environment is good for us, believe it or not. For us, there was never a lot of debt in the first place, partly because we're looking at light balance sheets and there's not a lot to borrow against. The usual sources of debt for us are going to be seller notes, which are still there, and mezzanine funds, and a bunch of those guys are still there. For us, the leverage is still there and valuations are going down. ❖

LEGAL BRIEFS

By Jeremy Harrell

One of the occupational oddities of writing about the buyout business involves covering firms in the midst of fundraising.

Rule 502 of Regulation D of the Securities Act of 1933 prohibits firms from making "any form of general solicitation or general advertising" of their funds. Many attorneys have interpreted that phrase to mean that firms can't even acknowledge publicly that they're in fundrais-

ing mode for fear that any mention could be construed as a solicitation. The result can be an awkward two-step between reporter and source, with some sources issuing a barely audible "no comment" when asked if their firm is in fundraising mode.

That said, *Buyouts* and rival publications regularly cover news of private equity fund-raising. Many buyout professionals believe that it's OK to talk to the trade press about their funds, on the argument that that hardly constitutes a broad-based solicitation for money. In other cases, fundraising news springs out of the mouths of "people familiar with the fundraising effort," such as limited partners and placement agents.

Viewed from a particular angle, the rule makes sense. The Securities and Exchange Commission is concerned that an LBO shop would engage in a certain amount of public puffery to

drum up potential investors. After all, private fund managers—the rule applies to hedge funds, as well—put big chunks of backers' money to work in high-risk investments, and those backers shouldn't be flimflammed into committing their cash.

Viewed from **Philip Goldstein's** perch at hedge fund Bulldog Investors, however, the rule makes no sense at all. Only qualified investors are allowed to commit to hedge funds and buyout funds, and those investors are supposed to be rich enough and sophisticated enough not to fall prey to dubious pitches.

Last month, Goldstein, who earlier successfully rebuffed the SEC's attempt to make hedge funds register as investment advisers, announced his intention to sue the SEC in hopes of forcing it to overturn the advertising rule. If the SEC puts up a fight—and right now the two sides are said to be negotiating a

pact that could head off litigation—Goldstein said he's willing to appeal on the grounds that the rule violates the First Amendment's guarantee of free speech. Goldstein wants to put information about his hedge fund up on the Internet; he doesn't consider it advertising, and he said he doesn't plan to use the Web to solicit funds.

"What's the big deal?" Goldstein told *The New York Sun* in March. "It's not like we're putting up plans to make an atom bomb."

In 2003, an SEC staff report concluded that "there seems to be little compelling policy justification" for an advertising ban if the funds are only open to qualified investors. That conclusion didn't lead to a change in policy, however. Is the SEC is a more conciliatory mood this time around? We'll see: A ruling on Goldstein's case could arrive as early as next month. ❖