

# MINNEAPOLIS ST. PAUL BUSINESS JOURNAL

MAY 19, 2006

## Hedge funds competing for private-equity firms' territory

BY MARK REILLY AND NICOLE GARRISON-SPRENGER  
STAFF WRITERS

Private-equity firms, already facing a cash-flush sellers' market, now have a new source of competition for buyouts and investment deals: hedge funds.

Hedge funds, which once focused on making high-stakes, short-term investments in the public markets, are expanding their attention into the private-capital markets as returns from their traditional targets decline.

This is good news for entrepreneurs and firms looking for capital, because hedge funds have plenty of money and a desire to invest it. That can mean higher valuations and better terms.

"It's one more player with money at the table, which drives prices up further," said Michael Smiggen, principal at Tonka Bay Equity Partners, a Wayzata private-equity firm that recently opened a \$125 million fund.

Why the interest? Hedge funds traditionally focused on complex investments in stocks, bonds and other securities. They got big returns using strategies such as short-selling and arbitrage, in which buyers can profit from price differences on the same investments in different markets.

But their success drew more investors, which eventually crowded out most of the good deals.

"So much money was being made that more money went in, and then no one made money," said James Rovner, senior vice president with Minneapolis-based

Marquette Asset Management. Rovner, a former investment officer with the hedge-fund management firm Labyrinth Group, said it's only natural that fund managers would look for other opportunities. "Hedge funds are going to go where the returns are."

Right now, that's in private equity, said Michael Sweeney, managing director of Goldner Hawn Johnson & Morrison, an equity firm in Minneapolis. A private-equity fund can deliver compounded returns of 20 percent to investors, while a 12 percent return is considered decent for many hedge funds.

Goldner Hawn has encountered competition from hedge funds in its investments. Last year the firm agreed to pay roughly \$1 billion in cash and debt to acquire Green Bay, Wis.-based retailer ShopKo Stores Inc., only to see rival bids surface from hedge funds.

Even though the hedge fund bidders didn't win — another private-equity firm outbid everybody in the end — Sweeney said their "agitation" of the market raised the profile of the deal and may have helped drive up the price for ShopKo.

But he doesn't think hedge funds are pushing up valuations by themselves; money was rushing into the private-equity market anyway.

Sweeney said that it's actually more common for hedge funds to engage private-equity firms cooperatively rather than competitively on a deal. Both types of funds can take positions in the same company, with private-equity firms taking

### WHAT'S A HEDGE FUND?

**The term applies to** lightly regulated private investment fund that employs unconventional strategies. The term refers to the practice of "hedging" investments, in which some stocks were bought in the hopes they would rise, while others were "bought short," using borrowed money in the hopes that their value would decline. That way, the investor can make money whether the market rises or falls.

stock and hedge funds taking a preferred stock or high-level debt.

The Twin Cities has its share of active hedge funds: Cargill Inc.'s investment arm employs hedge funds, and Deephaven Capital Management, a \$3 billion fund owned by Knight Capital Group, also is active in the space. Officials could not be reached for comment.

Several equity managers noted that while private-equity investors often hold positions for seven to 10 years at a time, hedge-fund managers are traders by nature, changing their investments often.

"What's going to happen when the economy goes through its cycle?" he asked, and hedge funds start seeing losses: Will they sit tight, or seek to cash out their holdings at a loss? If it's the latter, he said, private-equity firms might reap the rewards of a renewed buyer's market.

mreilly@bizjournals.com | (612) 288-2110  
and ngarrison@bizjournals.com | (612) 288-2112

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