

# WILL CERBERUS' MIXED PERFORMANCE HURT ITS FUNDRAISING AMBITIONS?



## OVERVIEW

Cerberus Capital Management is a New York-based private equity firm with approximately \$42 billion in assets under management.<sup>1</sup>

The firm pursues three general platforms in alternative asset management: 1. Private equity, 2. Real estate, including real assets and non-performing loans (NPLs), and 3. Global Credit, including corporate credit, direct lending, and mortgage securities.<sup>2</sup>

Over the last decade, Cerberus funds have experienced mixed performance. Cerberus Institutional Partners VI (CIP VI), for example, which closed in 2017, is among the worst performers of its peers according to data provider Pitchbook.<sup>3</sup> CIP VI generated 4% annual return (IRR) and 1.04x multiple as of March 31, 2019 according to fund of funds manager GCM Grosvenor.<sup>4</sup>

While the S&P 500 index has earned an average annual return of 13.4% over the past decade, most of Cerberus' recent funds have struggled to break 8%.<sup>5</sup>

Cerberus has continued to charge 1-2% management fees, 15-20% carried interest,<sup>6</sup> and advisory fees to portfolio companies such as Albertsons<sup>7</sup> and Deutsche Bank.<sup>8</sup>

## KEY POINTS

- Private equity firm Cerberus Capital Management has had mixed performance over the last decade. Cerberus Institutional Partners VI (CIP VI), Cerberus' most recent flagship private equity/distressed debt platform, has had notably poor performance generating a 4.5% IRR as of March 2019.
- Cerberus investors seem to have taken note. The Pennsylvania Public School Employees Retirement System, Cerberus' second largest known investor, reported that it had chosen to not invest in Cerberus' newest fund.
- Cerberus is currently fundraising for a dedicated private equity fund, a direct lending fund, and a real estate debt fund.
- Cerberus Institutional Partners VI's investments in the German banking sector may have contributed to poor performance. Specifically, Cerberus' investments in Deutsche Bank and Commerzbank have lost around half their value since Cerberus became a major shareholder in both banks in 2017.
- In December 2019, the US Department of Justice intervened in a federal False Claims Act whistleblower complaint against Cerberus portfolio company Navistar Defense alleging the company overcharged the US Marine Corps for armored vehicle parts.

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### CERBERUS COMMINGLED FUNDS SINCE 2010

FUND NAME	FUND TYPE	VINTAGE	SIZE	DRY POWDER	IRR
Cerberus Global NPL Fund	Debt - General	2019	\$5.10B	\$3.55B	N/A
Cerberus Institutional Partners VI	Distressed Debt/Private Equity	2017	\$4.00B	\$170M	4.51%
Cerberus Levered Loan Opportunities Fund III	Direct Lending	2017	\$2.05B	\$165M	N/A
Cerberus Institutional Real Estate Partners IV	Real Estate Distressed	2017	\$1.80B	\$570M	7.51%
Cerberus Institutional Real Estate Partners III	Real Estate Distressed	2012	\$1.43B	\$347M	12.00%
Cerberus Levered Loan Opportunities Fund II	Direct Lending	2013	\$449M	\$82M	7.30%
Cerberus Institutional Partners V	Distressed Debt/Private Equity	2012	\$2.61B	\$0.00	13.20%
Cerberus Levered Loan Opportunities Fund I	Direct Lending	2011	\$513M	\$341M	4.19%

Source: Pitchbook, accessed January 2, 2020.

### HOW WILL CERBERUS' PERFORMANCE AFFECT FUNDRAISING?

Cerberus investors seem to have taken note. Pennsylvania Public School Employees Retirement System, Cerberus' second largest known investor, with at least \$1.5 billion invested across several funds,<sup>9</sup> reported that it had chosen to not invest in Cerberus' newest fund.<sup>10</sup>

Cerberus' dedicated private equity fund, which registered with the SEC in January 2019 as Cerberus Global Private Equity Partners L.P.,<sup>11</sup> was reportedly seeking to raise \$3 billion.<sup>12</sup> As of January 2020, it is not clear whether the comingled fund has received any commitments.<sup>13</sup>

Cerberus is raising other funds as well. In early 2019 it began fundraising for Cerberus Levered Loan Opportunities Fund IV, part of its direct lending series, with a target of \$2.5 billion.<sup>14</sup> In September 2019 Cerberus began fundraising for a Real Estate Debt Fund.<sup>15</sup>

As Cerberus continues fundraising in 2020, investors may raise questions about Cerberus' track record.

### CERBERUS INSTITUTIONAL PARTNERS VI

The varied performance of Cerberus' recent flagship Institutional Partners funds is worth exploring. With an IRR of 4.5% that places the fund in the bottom quartile of its peers, CIP VI represents a decline in performance from its predecessor.<sup>16</sup>

Like the other funds in the series, CIP VI aims to make investments in distressed securities and assets as well as in control-oriented private equity turnarounds made primarily in the United States, Western Europe, and Asia. The fund is meant to focus on two broad categories: 1. Distressed private equity and 2. Distressed securities and assets including NPLs, residential and commercial mortgage securities and

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assets, corporate debt, and structured loans.<sup>17</sup>

The specific reasons for CIP VI's struggling performance are not clear, though multiple investments raise concern.

### GERMAN BANKING INVESTMENTS

Cerberus, in part through CIP VI, has invested over €4 billion in the German banking and financial industry. The strategy appears to be a gamble, even for Cerberus. While private equity investors typically target a 15-20% return on equity, the sector returned 2% in 2017, when Cerberus started making moves in Germany.<sup>18</sup>

In November 2019, Moody's downgraded its outlook for Germany's banking system from "stable" to "negative," noting that "already weak profitability of German banks will decline further over the next 12 to 18 months as net interest income falls."<sup>19</sup>

So far, some of Cerberus' investments in the sector have floundered.

### DEUTSCHE BANK AND COMMERZBANK

Cerberus bought minority stakes in Commerzbank and Deutsche Bank in 2017.<sup>20</sup> It is among the largest shareholders in Deutsche Bank with 3% ownership and the second largest in Commerzbank with 5% ownership.<sup>21</sup> CIP VI is among multiple Cerberus funds that invested in the banks.<sup>22</sup>

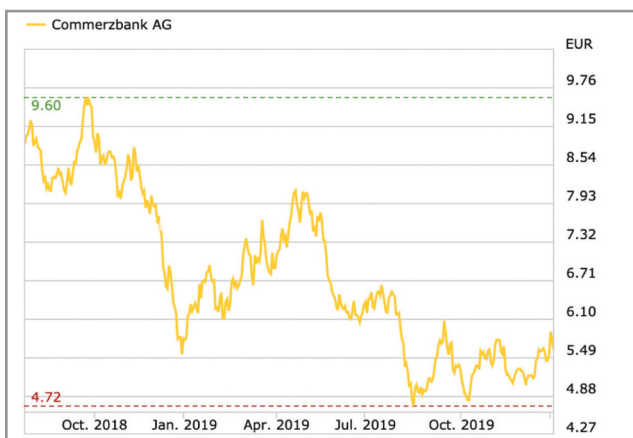
The value of Cerberus' investment in each bank has plummeted; by December 2019, the firm's €960 million investment in Deutsche Bank lost half its value,<sup>23</sup> and its €678 million investment in Commerzbank had lost nearly half its value.<sup>24</sup> Deutsche Bank is currently at the bottom of performance tables for European investment banking and over the last year plunged in rankings for M&A advisory services.<sup>25</sup> The two banks engaged in months of talks to attempt a merger before the deal collapsed. Analysts have speculated that Cerberus took stakes in both banks to attempt to orchestrate a merger.<sup>26</sup>

Amid the banks' financial turmoil, in 2018 Deutsche Bank hired Cerberus as an adviser for restructuring operations. The decision garnered widespread criticism from shareholders who saw the decision as a potential conflict of interest.<sup>27</sup>

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Despite the significant decline in value of Cerberus' and CIP VI's Deutsche Bank stake, Cerberus Operations and Advisory Company, controlled by Cerberus co-founder Stephen Feinberg<sup>28</sup>, collected fees from the German bank.<sup>29</sup>

The advisory agreement was set to end at the end of 2019.<sup>30</sup>

### HSB NORDBANK/HAMBURG COMMERCIAL BANK

In early 2018, an investor consortium led by Cerberus and JC Flowers bought and privatized commercial shipping lender HSB Nordbank for €1 billion cash.<sup>31</sup> It was the first privatized state-owned bank (Landesbank) in Germany.<sup>32</sup> The new owners later changed the bank's name to Hamburg Commercial Bank (HCOB).<sup>33</sup> As part of restructuring, the bank is reportedly cutting hundreds of jobs.<sup>34</sup>

The privatization deal has garnered significant critical attention from pre-buyout creditors.

In December 2018, a group of bond investors filed a lawsuit against HSB Nordbank/HCOB for €1.4 billion in damages for allegedly "improperly" lowering the book value of securities to ease the sale transaction and make itself more attractive to buyers.<sup>35</sup>

The lawsuit concerns securities issued in the early 2000's with nominal value of close to €2 billion. Before the sale, the bank announced that it was writing down the value of the securities to 15% of their nominal value by 2020, which would cut down bondholders' ability to receive coupon payments. According to the bondholders, the maneuver would "create a €1.6 billion windfall profit" that would flow to HSB's new owners.<sup>36</sup>

After almost a year of litigation, HSB Nordbank/HCOB settled with creditors in November 2019. The bank agreed to pay 36.24% of the nominal value of its securities plus extra settlement fees and litigation costs.<sup>37</sup>

In May 2019, a group of 35 institutional investors had announced that they refused to participate in the bank's senior bond financing. Though many of the creditors' concerns pre-dated the bank's privatization, according to their statement "recent actions of the Bank under its new private equity owners, who include Cerberus Capital Management, L.P., J. C. Flowers & Co., and GoldenTree Asset Management LP (together the "New Owners"), have only further increased the Creditors' concerns."<sup>38</sup> It is unclear whether the investor group will continue its refusal to participate in future financing now that the lawsuit is settled.



### NAVISTAR DEFENSE

Navistar Defense is a tactical wheeled vehicle manufacturer serving military, law enforcement, and government agencies around the world. In December 2018, Cerberus acquired a 70% equity interest in Navistar Defense from its publicly traded parent company, Navistar International Corporation (NIC), for approximately \$140 million. NIC retained the remaining 30% equity.<sup>39</sup>

In connection with the closing of the transaction, NIC entered into an exclusive long-term agreement to supply military and commercial parts and chassis to Navistar Defense. It also entered into an intellectual property agreement and a transition services agreement concurrent with the sale.<sup>40</sup>

In November 2019 a whistleblower filed a False Claims Act complaint against Navistar Defense alleging the company defrauded the US Marine Corps of \$1.3 billion.<sup>41</sup> The US Department of Justice intervened and took over the lawsuit the following month.<sup>42</sup> The lawsuit, which is ongoing, alleges that the contractor "wildly" overbilled the Pentagon for armored vehicle parts used in military efforts in Iraq and Afghanistan in 2009.<sup>43</sup>



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## Endnotes

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- <sup>3</sup> Based on 4th quartile ranking. Pitchbook, accessed January 2, 2020.
- <sup>4</sup> GCM Grosvenor report to San Diego City Employees Retirement System, Sept 2019.
- <sup>5</sup> Morningstar S&P 500 Index, accessed Jan 7, 2019.
- <sup>6</sup> Cerberus Capital Management form ADV brochure, March 29, 2019, pg. 8.
- <sup>7</sup> "Private Equity's Biggest Retail Gamble: Albertsons-Safeway", Private Equity Stakeholder Project and UFCW Local 400, November 6, 2019.
- <sup>8</sup> Jenny Strausberg, "Deutsche Bank-Cerberus Advisory Agreement Set to End," *Wall Street Journal*, December 23, 2019.
- <sup>9</sup> Pennsylvania Public School Employees Retirement System board resolution, Private Debt Fund Commitment, Cerberus Institutional Partners VI, L.P., June 11, 2015.
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- <sup>11</sup> Cerberus Global Private Equity Partners SEC Form D, Jan 29, 2019.
- <sup>12</sup> Gillian Tan, "Cerberus Seeks \$3 Billion for First Solo Private Equity Fund," *Bloomberg*, May 22, 2019.
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- <sup>15</sup> Cerberus Capital Management SEC Form D, September 26, 2019.
- <sup>16</sup> Pitchbook, accessed January 2, 2020.
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- <sup>21</sup> "Cerberus builds stake controlling 5 percent of Commerzbank voting rights," *Reuters*, July 26, 2017; Commerzbank Aktiengesellschaft Notification of Major Holdings, July 26, 2017.; Deutsche Bank shareholder structure as of Aug 26, 2019.
- <sup>22</sup> Deutsche Bank: see <https://m.marketscreener.com/DEUTSCHE-BANK-56358396/news/Correction-of-a-release-from-15-11-2017-13-37-CET-CEST-Deutsche-Bank-AG-Release-according-to-Art-25513596/> Commerzbank: see [http://irmobile.commerzbank.com/cgi-bin/show.ssp?companyName=ir-center\\_mobile&language=English&id=2010&newsID=1638295&companyDirectoryName=commerzbank](http://irmobile.commerzbank.com/cgi-bin/show.ssp?companyName=ir-center_mobile&language=English&id=2010&newsID=1638295&companyDirectoryName=commerzbank)
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- <sup>25</sup> Stephen Morris and Olaf Storbeck, "Deutsche Bank knuckles down to close its credibility gap," *Financial Times*, December 27, 2019.
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- <sup>40</sup> Ibid.
- <sup>41</sup> United States District Court for the District of Columbia, Case no. 13-cv-1463 (TSC) first amended complaint.
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