

Greenpark Capital Roundtable Discussion

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The lack of completed deals last year surprised a lot of people. How has the market developed so far in 2010?

MA: There have been periods where nothing seemed to be happening, and then there has been a lot of deal flow in a short space of time. Overall, there has been more deal flow, but punctuated by gaps caused by macroeconomic shocks, such as the Greek crisis.

RS: Transaction volumes in the first six months of 2010 were higher than for the same period last year. The big financial institutions are having to divest their private equity exposures, either because it's expensive to hold these assets or because they need to remove them from their balance sheets. For decent portfolios of assets pricing remains stiff with vendors looking for prices nearer to NAV than last year. The result is that pricing has reached discounts of 10-20% of NAV and there are cases of transactions completing at NAV.

The lack of completed deals in 2009 was partially caused by a considerable disconnect on pricing. Are spreads now reduced in the mid-market?

NO: Discounts have narrowed. It is now relatively easy to price at small discounts, and some top-performing funds are actually being sold at a premium. Discounts narrowed to an average of 28% below NAV at the end of last year, and have narrowed still further.

MA: Some GPs value more aggressively than others, so you need to consider pricing by individual GP rather than size of transaction. Using even a slightly different EBITDA multiple and a discount for liquidity can change the price significantly.

RS: There has been a flight to quality for GPs across the market. Longevity is a sign of quality, so firms raising their eighth or ninth fund are in a strong position. Pricing has become keener for these high-quality assets, because they are more likely to outperform than underperform as the market improves.

How does this affect your ability to put money to work?

NO: We primarily look to acquire substantially funded positions. There are many more of these opportunities, which were scarce last year, in the market now. It is now possible to buy good, mature portfolios, whereas last year there were a lot of young vintage funds in the market. Last year, because of pricing, those who didn't need to sell good-quality assets hung on to them. It is now a much more transactable, benign atmosphere by comparison.

And where do you see deal flow coming from over the next 12 to 18 months?

RS: It is expected that between \$15bn to \$20bn of assets will come on to the secondaries market in 2010, from banks offloading primary assets. This compares with approximately US\$10bn in 2009. Banks are under a lot of financial and regulatory pressure, and this is potentially a big source of deal flow. The other driver is in the fact there are a lot of funds with cash that they were not able to deploy last year, who are keen to transact this year, with the result that pricing is being driven up where transactions are competitive.

PM: GPs are becoming more active in influencing the sale process to find the right buyer. We expect more deal flow to come from GPs directly. The balance of LP / GP power has shifted in favour of LPs, and now GPs are keen to get sticky investor bases. They are being more proactive in order to achieve this.

To what extent are portfolio management and asset allocation driving sellers' motivations, as opposed to a need for liquidity?

MA: We have tracked sellers' motivations, and "need for cash" transactions rose from 5% of the market in 2007, to 20% in 2008, to 50% last year, and that tells you a lot of what you need to know. The data for the first half of this year will have gone back to a much lower figure.

NO: We can see from deal processes that "need for cash" transactions are lower this year than last year, and the market has moved back to more pure portfolio management. This is much better for us because we are seeing more older vintage funds than young funds with large unfunded exposures. Investors are under more pressure to re-up, so we are seeing much more housekeeping. Managing GP relationships is going to be more of a feature in sellers' motivations.

Has there been much competition from new entrants to the secondaries market since the downturn?

MA: A lot of the activity last year was from opportunistic buyers, many for the first time, but this has now settled down. In 2009 we saw first-time secondaries buyers investing in unfunded positions, often GP-intermediated. Now it's different: those assets aren't being sold because of pricing or regulatory issues, and this phenomenon has largely disappeared.

NO: Opportunistic buyers tended to buy single LP positions in a fund where they were already invested, which reduced their overall cost of capital. They were unfunded positions, but since they already knew the GP and were invested in the fund, they could do it.

How significant a phenomenon were these opportunistic buyers last year?

NO: According to research from Cogent Partners, 50% of secondaries deals closed in the first half of 2009 went to primary investors – pension funds and other investors who usually invest in the primary market. Of those, half went to first-time secondaries buyers. That is to be expected in a market where most of the assets on sale were unfunded, and that figure would be a lot lower now.

RS: An interesting point is that some of the buyers of unfunded positions last year will have done well because they were buying at big discounts. One mega-fund, for example, went from a valuation of 25% of NAV to 80% of NAV in six months. The problem in 2009 was, how much could you believe in NAVs?

MA: Yes, when you price secondaries you have to look at pricing the unfunded portion as well as the assets themselves. The unfunded part can be valued as an asset or a liability. In 2009 it was priced as a liability because the entire market had private equity indigestion.

What does competition look like, and how do you go about competing with the larger players that have dipped down into the mid-market in recent times?

MA: If you are a true mid-market operator with a clear focus, as we are, you don't need to rely on big deals. The larger firms – many of which raised big vehicles last year – are under pressure to deploy capital. The €15 million to €20 million transactions that are our staple just aren't feasible for larger players over the long term, which gives us a huge competitive advantage.

PM: We like detailed due diligence. Last year the larger guys started doing smaller deals, but this will change as soon as they find larger deals to do – we at Greenpark don't need an HBOS to put money to work.

MA: There is certainly a big difference between the funds of funds and Greenpark. Our preference is for fully funded deals and our approach involves thinking tactically about buying. Funds of funds and LPs often rely on judgments about track record and GP quality, but because we focus on late secondaries, we focus as much on asset pricing and quality, and transaction structures and tactics.

NO: Take our Inflexion transaction, for instance. This was a complex transaction, involving underwriting a stapled transaction, facilitating the spin-out of the general partner and running a syndication process. Such a transaction is not going to be possible for a first-time buyer in this market. We paid an optically full price but it has been a great deal.

RS: In the primary market, sub-£1 billion deals have seen the most activity because private equity firms there are happy to transact with each other and are less reliant on the IPO market. 2010 has not been good for IPOs but it has been good for the mid-market because leverage still exists for a £500m deal, where five or six banks will club together to form a syndicate. You get quicker exits from a mature secondaries mid-market portfolio because there are constant liquidity events.

How has Greenpark fared in terms of distributions during the financial crisis?

GS: Even in an extremely difficult market like the one we've experienced over the past 18 months, we've received constant distributions. This, together with increases in valuation for unrealised investments, has helped us achieve a good performance for our investors even in such a difficult environment. Diversification across a significant number of general partners and underlying companies, and our focus on the mid-market have proved to be very important factors in this respect.

What do you think will be the secret of success for GPs who manage to ride out the current downturn?

MA: One of the key differentiators for GPs is how they manage companies. Over the past 10 years we have seen bankers and accountants, with transactional expertise but no experience of stewardship, setting up private equity firms. Several firms went into this downturn having overpaid and overleveraged their businesses, but the follow through in some cases on operational improvement has been extraordinary. It is not all focused on cost cutting, because there is a point in cost cutting where a firm begins eating its own flesh. It's more focused on working harder and smarter. But that is where you see the difference between "buy & hope" GPs founded only on M&A skills and "buy & fix" GPs founded both on M&A skills and on the stewardship of companies.

Looking forward to the rest of this year, how do you see the market developing?

RS: In the final quarter we could see a flurry of banks and financial institutions selling their private equity assets, to tidy up their balance sheets before the end of the year – this will create huge opportunities for the tactically astute and fleet of foot in the market.

NO: Because the exit environment has been slow, a lot of funds have been extending beyond 10 years. In this situation, if there is any opaqueness on fees, there will be a bun fight, and this could also create secondaries volume.

MA: We expect deal flow to continue increasing this year, and the quality of assets on the market will also show continued improvement. This plays increasingly into the hands of firms like ourselves, who have deep industry knowledge and experience, and are valued by GPs as a long-term, committed investor in the asset class with the ability to handle complex situations efficiently.

NO: 2008 was a strong year for Greenpark, and while the quality of deal flow in 2009 was much lower than the year before, volumes were only around 5% lower. Given that 2010 has to date seen an increase both in volume and quality of deal flow, it could turn out to be as good a year as 2008, if not better.

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