Secondaries market sees activity rise

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The private equity secondaries market is expected to be a rare beneficiary of the credit crunch as institutional investors quietly sell their interests in big buy-out funds that face a drop in performance.

Sales of limited partner interests in private equity funds are expected to rise by one-fifth to a record $18bn this year, according to NYPPEX, a securities trading and investment banking firm. The market – dominated by specialist secondary investors such as Coller Capital in the UK and Lexington Partners in the US – has traditionally served as an exit of last resort for private equity investors, who were otherwise locked in for many years. However, it has more than doubled in a decade, boosted by the overall growth of private equity and the trend for investors to be more active in shaping their portfolios.

Historically, the secondaries market has grown fastest during downturns, when short-term private equity performance suffers and times are tough for investors, forcing them to rethink their strategies.

Often, investors use the secondaries market to exit private equity funds they think may underperform. The value of secondary sales shot up after the tech bubble burst in 2000 and venture capital investors rushed for the exit.

But there may also be distressed sellers, such as banks needing cash after a liquidity crisis or unable to meet their unfunded commitments to a private equity fund.

“Expectations are starting to come down a little right now for private equity returns, so people are thinking about selling while they can,” said Dexter Blake, managing director of NYPPEX. “Some of the current growth is attributable to liquidity issues and some is down to increasing portfolio management and rebalancing of portfolios by investors,” he said.

The secondaries market is also being used by private equity groups themselves to dispose of companies left over from older funds. NYPPEX said this market for “direct secondaries” was expected to grow from $3bn last year to $5.7bn this year.

The overall secondaries market remains shrouded in mystery as sales are often agreed behind the scenes with no public announcement. In one deal, Calpers, the US pension fund, this year sold $189m of interests in a variety of private equity funds and about $25m of unfunded commitments to a consortium of secondary funds.

At a closed-door presentation to investors in London on Friday, NYPPEX predicted the secondary market would accelerate as private equity groups were forced to write down the value of big buy-outs completed during the credit boom. It identified private equity groups that had used the highest levels of debt-to-earnings in their buy-out deals.

Those that Nyppex described as “vulnerable to significant asset writedowns” were: Madison Dearborn, Providence Equity Partners, Blackstone, Thomas H Lee, Carlyle, Goldman Sachs, Apollo, TPG, Bain Capital and KKR.