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Why Private-Equity Firms Are Selling Some of Their Portfolios

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In the world of private equity, few deals mean little action and fewer returns. But behind the scenes, chunks of private equity portfolios are changing hands at record levels.

Laurence Allen, the CEO of NYPPEX, has a front-row seat. His firm advises investors who want to sell their holdings in private equity funds and serves as an exchange where they can trade their stakes.

Deal Journal Primer: Such sales are called "secondaries." Here's how they work *(click and scroll down)*: The private-equity world is comprised of general partners like Blackstone and Madison Dearborn Partners and limited partners that invest in those funds. When LPs want to exit all or part of their holdings, the sales are called secondaries. Allen expects $18 billion of secondary sales in 2008, up from the record $15 billion of 2007.

It is a simple process but, most of the time, it is out of the public eye. That is changing. In a widely publicized deal last week, a Goldman Sachs Group-led consortium bought a big chunk of ABN Amro's private-equity investments from Royal Bank of Scotland and other banks. "Five years ago, 99% of deals were kept quiet. Today, 80% are kept quiet. You're seeing greater transparency in the asset class, which most people like," Allen says.

That isn't the only change. Private-equity firms themselves are starting to sell chunks of their own portfolios–sometimes to speed up the monetization of their profits, sometimes to raise money to pay off investors, and sometimes to get rid of investments that are dragging down their returns.

Deal Journal talked to Allen to find out why secondaries are becoming so popular. Here are some of the highlights of that conversation:

Secondaries are a way for PE firms to offset declining returns from their investments: "Many institutions are evaluating rebalancing their portfolios….Many general partners are interested in making cash distributions to their investors.

Prices are still strong: "The prices in the secondary market are reasonable, down from historical highs in the second quarter of 2007 but have not declined as much as the public markets."

The private-equity downturn will last for several years: Low valuation multiples for companies and the credit crisis have conspired to make the current private-equity downturn "more analogous to the 1970-to-1980 period. It's going to be a longer period than two to three years."

PE firms can wait out the downturn for a long time by relying on secondary sales: "We believe they can sell quite a bit. We believe that the market is a more accepted third alternative for exits."

PE firms can borrow against their portfolios: "A different deal structure we've seen is not outright selling, but instead borrowing against the assets. That has become a big business for us. In other words, the private-equity firms ask us to arrange a credit facility for up to 50% of the fair-value assets. The reason for that is the firm doesn't want to sell the assets, they just want more liquidity or to book a loss on the sale."

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