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Waiting For Godot In The Secondary Market

During the first quarter of this year, conditions appear to have improved for investors looking to sell private equity interests on the secondary market, according to a report by secondary intermediary NYPPEX LLC.

But the deluge of deal volume anticipated by many secondary buyers over the past 18 months has failed to materialize so far.

Median bids for limited partnership interests increased by around 3.5% between the end of 2009 and March 31, 2010, according NYPPEX's Q12010 Secondary Market Review and Outlook. Median bids for buyout funds took the greatest leap, increasing 12.8% from 57.2% of a fund's underlying net asset value as of Dec. 31 to 64.5% as of March 31.

Median bids for venture capital funds, meanwhile, rose by a more modest 3.5% in the quarter to 63% of NAV from 60.9% at the end of last year.

Improved pricing was driven in part by the continued stream of new buyers entering the secondary market, namely asset managers and family offices. New buyers accounted for 68% of all transaction volume during the quarter, according to the report.

Meanwhile, improved valuations in underlying private equity portfolios has also narrowed the discounts on bids.

"Valuations are getting closer to their intrinsic value," said Brian Sullivan, partner at New York-based secondary firm Paul Capital Partners, who said his firm expects to see valuations continue to improve by an average of 5% to 10% by the time the December numbers come out.

Despite better pricing, however, the estimated dollar amount of transaction volume declined moderately in the quarter even though the number of deals increased, according to the report.

There are several reasons why sellers may be holding out, namely because a strong public market rally combined with a relatively modest level of capital calls has kept the pressure off of their portfolios.

"Deal flow has been much softer than anyone expected," said Brian Sullivan, a partner with New York-based secondary firm Paul Capital Partners. "The reduced uncertainty about the economy is making people feel more comfortable. As long as the public markets are going up, they don't want to sell. Once that's moderated we're likely to see more sellers."

Even so, NYPPEX predicts that transaction volume will begin to pick up during the second quarter and ultimately reach $34 billion for partnerships alone in 2010, citing a number of factors. They include increased a new mindset among institutional investors that is more focused on risk, the overhang of capital from secondary deals that were withdrawn in 2009 and the record volume of capital raised by secondary buyers in 2009.

Paul Capital Partners' Sullivan agreed, adding that his firm is already seeing more assets coming up for sale this year, particularly from banks and financial institutions.

"All of those dynamics that existed in 2009 which people [thought] would lead to a robust market still exist," said Sullivan.

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