

## Pressure Builds

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Differences in valuation expectations between would be vendors and acquirors are proving to be contentious and slowing down sales of private equity portfolios to secondary buyers. The need to free up liquidity, however, means secondary specialists believe a highly fruitful period lies ahead.

Financial institutions are particularly in need of liquidity as they increased their commitment to private equity between 2004 and 2007. Banks are seen as a likely source for the bulk of future deal flow as they seek to ease the pressure on their balance sheets. In this context, it is believed there will often be high quality assets involved.

The secondaries market is also used for portfolio management, particularly among the larger pension funds. Last year, the California Public Employees Retirement System (CalPERS) was planning to sell a legacy portfolio reportedly worth around \$2 billion. "There are so many pension funds with a large number of different private equity investment lines – significant housekeeping is badly needed," says Marleen Groen, chief executive of London-based secondaries specialist Greenpark Capital. Portfolio management is increasingly being embraced by GPs as well as LPs.

There is also a drive to reduce the number of GP relationships to more manageable levels. With the slowing of distributions, non-core assets are being sold to free up capital to meet the requirements of capital calls. Another concern is large buyouts and deals done in recent years at high multiples. Groen says "Investors have been very keen to get into the LBO space and get their feet under the table with certain funds but investments are now taking a longer time and fees are ticking along. Larger investors have little choice but to allocate to larger funds – and they just have to try and select the best. But smaller investors have the option to invest predominantly in the mid-market instead and not face the same issues."

The differences in vendor and acquirer valuations on the primary market have had a knock on effect of slowing down the secondaries market. "A lot of sellers are hanging in there to see what will happen, including as to the expected reductions in valuations," says Groen. "It will still take some time before valuations get to where they probably should be." This difficulty for sellers in adjusting their pricing expectations is understandable given that, in the 18 months prior to the credit crunch, Groen estimates that "the auction market in secondaries had an average premium to book value of 10 percent."

In the current market, pricing is variable and determined by liquidity pressures, the quality of the assets and the need to maintain good relationships with GPs. If sellers are unable to achieve the price they want and unwilling to sell at a discount, they may prefer to wait. Buyers may also choose to wait in the belief that prices will reduce further. It is predicted that substantial dealflow is on the horizon and some commentators believe that the world's largest private equity fund could be a secondaries fund.