

Good things in small packages

Valuation issues and the bid-ask gap have made inking secondary transactions a rarity – for now. But as secondary houses prepare for an ‘avalanche’ of closable deal flow that might hit \$50bn, Greenpark tells **Amanda Janis** it is confidently sticking to its tried and true strategy

Visit Green Park, one of London’s royal parks, and you’ll encounter people from around the world traversing its 53 acres. Just a few blocks east in London’s St. James’s neighbourhood, which Greenpark Capital calls home, the same experience can be had on a smaller scale.

An observant visitor to the secondaries firm’s serene offices will detect an array of accents from around the globe. This is, however, no coincidence. Since its founding in 2000, the firm has sought to carve a niche for itself predominantly in the European mid-market buyout sector, which, by definition, encompasses many different languages and cultures.

Given such a strategy, employing individuals with diverse language skills and backgrounds is a “core part” of how Greenpark’s 25-person investment team is configured, says investment director Matthew Arkinstall. “Team members come from a variety of relevant financial backgrounds and cultures with all main European languages being spoken by at least a number of investment team members.” He also notes the team has skills associated with both general partners and limited partners, given that secondaries deals are effectively a hybrid of GP and LP functions.

These requirements are in part why the team is so big for a €1.3 billion firm investing its third fund. This, says Principal Founder and Chief Executive Marleen Groen, “is so we can properly resource transactions at junior as well as senior level, language-wise and culture-wise, which is very important for



Marleen Groen



Matthew Arkinstall

European transactions. We can mix and match skills and experience as needed from within the firm.”

Smaller is beautiful

The bulk of the firm’s assets under management comprise interests in European buyout funds around €500 million or smaller in size. “That’s not by accident,” stresses Groen. “It’s very much pursuing the strategy we set out at the start of Greenpark which is: smaller, rather than big, can actually be extremely beautiful.”

She estimates 90 percent of Greenpark’s portfolio is invested in funds smaller than €1 billion. In terms of geography, about 60 percent of the firm’s fund interests are held in European funds, with most of the balance weighted toward US vehicles. It tends to purchase interests in funds that are on average approximately four years old, or about 80 percent drawn. “We like the visibility on the assets and the early liquidity of these transactions,” Arkinstall says.

“Yes, even in the current market we are getting exits as buyers can still get financing for quality mid-market companies.”

The mid-market’s praises are sung repeatedly by Groen and Arkinstall, with the profile of underlying assets, initial investment costs and restrained leverage use factoring high into their praise.

“Mid-market general partners are doing old-fashioned private equity – taking an attractive mid-size company and making operational enhancements,” Groen explains.

“What we also like about the mid-market is the fact that deal flow is far less transparent, it’s relationship-driven, it’s personal,” Arkinstall adds. “If you’ve got a team like we have at Greenpark, with our cultural and language background, then you can find very attractive deals in say Milan, Paris or Frankfurt.”

Another favourable mid-market trait is that in Greenpark’s experience these are very largely non-auction transactions, contrary to the typical two-thirds of secondaries going through a process governed primarily by price. “In the mid-market, it often is more important to get something done quickly, quietly and to find a solution to the LP’s or the GP’s problem”, says Groen. “Take for example a GP who doesn’t have add-on capital to buy other

shareholders in their existing portfolio companies out. They need an annex fund to provide the capital for these transactions.”

Greenpark has done a number of such annex deals, where the GP discreetly gets its add-on capital while Greenpark gets a secondary in the fund as well as assets in the annex fund, she adds.

As for specific sectors, Greenpark targets them opportunistically, and has thus far avoided having too much exposure to sectors currently being adversely impacted by industry contractions and economic conditions. “Luckily, and by virtue of buying mature portfolios as well as good conduct on the part of the underlying GPs, we have relatively minimal exposure to industries like retail and financial services,” says Arkininstall.

Though Greenpark has doubled its fund size with each new vehicle – its third fund closed on €730 million in 2006 – it has declined “raising as much as one possibly could” and maintained its mid-market strategy that Groen characterises as “value-focused instead of volume-focused”.

Maturing market

Speak to any secondaries investor and they will confirm that, slowly but surely, the negative stigma previously associated with the secondaries market is falling away. No longer are assets for sale automatically assumed problematic, nor is every seller assumed distressed. “All maturing primary markets develop secondary markets,” notes Groen.

Arkininstall uses public markets as an analogy. “Do any of the guys on the FTSE-100 get angry because someone’s bought some of their shares and someone else has sold them? No, in fact it’s a necessary aspect of a functioning, healthy economy and private equity is no different,” he says. “In a way, you could say that the existence of a secondary market actually encourages the growth of the primary market if it becomes known there are ways of managing your risk profile.”

The fact that secondary players might be able to assuage the problem of a potential LP

default, for example, has lately enveloped secondaries firms in a rosy glow. This is an issue that has grabbed industry headlines, but is it really driving secondaries deal flow?

“It’s happening occasionally,” confirms Arkininstall. “I was shown a limited partnership position where we were essentially asked if we wanted to take it up for free. As it turned out, in that case it was still too expensive for us, so we declined. But yes, that’s happening occasionally.”

It will probably happen increasingly, adds Groen, as LPs serious about continuing their private equity programme would not want to default and risk being turned away from future funds.

“The secondaries market is a problem solver in that context, because the GP wants to preserve their fund’s LP structure – they don’t want any reduction in commitments, reduction of their fee, or the stigma that goes with people having walked away from their fund,” explains Arkininstall. “For the GP, we can add real value and then it gives us the opportunity of being the first port of call in the future if they know other LPs need to sell.”

Looking ahead

Limited partners’ increasing need for liquidity is one of many reasons the secondary market is expected to explode this year, with estimates as high as \$130 billion being tossed around in terms of potential deal flow. Add in the modifier “closeable”, and that number comes closer to between \$30 billion and \$50 billion, still a significant increase from the \$12 billion to \$30 billion believed to have closed in 2008. “There’s an avalanche of holdings in funds waiting to be sold,” Groen agrees.

But at the moment, not many deals are closing as valuations remain opaque – with 2008 year-end numbers only now beginning to come out – and sellers and buyers still failing to agree on pricing. For sellers, particularly, it means getting used to a whole new rule set; contrary to the premiums to net asset value commonly paid by many secondary buyers in recent years, discounts

to NAV are now averaging between 40 percent and 80 percent depending on the fund in which an interest is being sold.

“It’s an entirely understandable predicament,” Arkininstall says of the bid-ask gap. “We should keep in mind that private equity is a long-term game, limited partners invest in it with long-term expectations of profit. So when markets are as volatile as they currently are and have moved as quickly as they have, LPs can take a while to acknowledge the new re-based reality about what portfolios are actually worth.”

Vendors are expected to be feeling better about doing deals once the 2008 NAV adjustments are fully priced in, and as more NAV adjustments are made in March. “Sellers are very much inclined to wait until valuations have been adjusted at least somewhat to then be able to sell at a perceived smaller discount. The absolute pricing might be the same, but the discount will look smaller and hence more acceptable,” Groen says.

As deal flow picks up and choice of assets increases, expect Greenpark to zero in on its core strategy rather than doing riskier, greater effort-consuming transactions like synthetic or direct secondary deals (buying a portfolio of assets that sometimes requires helping an incumbent management team spin out or putting a management team into an orphan portfolio).

“In a world in which we are expecting an enormous amount of deal flow, there is likely to be a shift to less complex types of secondary transactions,” says Arkininstall. “Direct secondaries have to stack up on risk and return terms to justify the effort.”

When it comes to risk and returns for Greenpark’s LPs, the nine-year-old firm says its conservative portfolios consistently produce returns “at the higher end of the secondary spectrum”.

“It certainly limits the bandwidth of our returns,” Groen admits. “We probably won’t ‘shoot the lights out’ but that’s fine, as equally, we’re not going to end up with low or negative returns. It is vital to Greenpark that we focus on what fits our strategy.” ♦