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Demand Is Strong For Private Equity Investments On Secondary Markets

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Secondary markets in the private equity space continue to grow, and according to experts this trend is set to continue.

Elm Capital, a London-based secondary sales advisor, recently released its bi-annual report detailing the strength of the secondary market in the second half of 2013 and the conditions that have led to its rise.

According to Elm's proprietary database, the median of the highest bids for buyout funds increased to 95% of Net Asset Value, a sharp rise from the 89% recorded in the first half of 2013. These bids outperform the previous high of 92% of NAV, which was recorded in the first half of 2011.

Elm attributes the rise in bids to the lack of deal flow in the first half of 2013. With so many secondary funds not making deals, a significant amount of dry powder was left on their balance sheets, creating strong demand for some of the more premium funds.

Etienne Deshormes, a managing partner at Elm Capital, suggests that managers are willing to pay higher prices and accept lower returns on good quality funds or funds with which they have an existing relationship, in order to mitigate risk.

Deshormes explains that these high prices do not extend to every secondary offering, as funds that are nearing the end of their life or those managed by lesser quality general partners tend to receive offers at a wider discount, ranging from 15-25%.

Addressing the relatively high median bid received for the firm’s energy funds, Deshormes believes that looking only at the median may be misleading.

“Prices tend to vary based on vintages,” says Deshormes. “Another issue energy funds face is the additional tax the United States government levies on a non-U.S. investor investing in U.S. natural resources. In that aspect, the impending tax penalty and lower returns makes many outside investors wary of U.S. energy funds, leading to lower bid prices.”

The report also highlights the emergence of family offices as some the primary sellers on the secondary market, as these offices are looking to diversify into other asset classes. Deshormes attributes this movement out of private equity to the most recent financial crisis.

“Family offices have made many investments in private equity over the last 10 to 15 years. However, they realized during the crisis that when they needed liquidity their money was stuck in these funds…[t]he people we see selling realize that they have better liquidity and control [over] the assets in which they control the investment decisions,” says Deshormes.