

# Preqin Special Report:

Private Equity Secondaries Market  
May 2010



Private Equity • Real Estate • Hedge Funds • Infrastructure

# Private Equity Secondaries Market: Overview

Following the onset of the financial crisis, late 2008 and early 2009 saw a number of institutional investment portfolios enter a state of disharmony and distress. With public markets falling, many found themselves over-allocated to private equity as a result of the denominator effect. The expectation felt across the industry was that this would lead to a period of heightened activity on the secondary market, with distressed institutions such as endowment funds being forced to offload private equity interests where they would no longer be able to meet call-up obligations. However, as 2009 unfolded, these expectations failed to materialize in the market.

## The Bid to NAV Chasm

As Preqin research conducted at the time revealed, the lack of deal-flow was certainly not due to a shortfall in the number of potential buyers or sellers in the market. A survey of investors showed that 1% were highly likely to be selling fund interests, with a further 9% considering a sale – not especially high numbers, but within the context of a \$2.5 trillion industry, still indicative of a significant level of activity. The market was not short on demand either, with fundraising by secondary specialists at historic highs, and with a number of investors previously focused on primary transactions now considering secondaries activities.

The major factor restricting the flow of activity was the wide gap between bid prices and fund NAVs. As public equities improved dramatically throughout 2009, institutional investors found themselves at a reduced level of distress, and consequently many

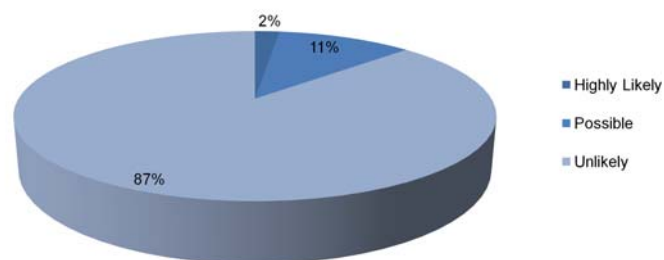
were less inclined to sell off their private equity investments at such a discount. Private equity fund valuations (running on a delay to public market investments) saw downward adjustments bringing them into alignment with other asset classes, thus alleviating the denominator effects for many investors. With continued uncertainty surrounding the market, neither buyers nor sellers were able to find a centre ground and the market stalled.

## 2010: A Potentially Record Year?

Although the economic outlook is improved from 2009, there are still a large number of investors seeking to sell fund interests on the secondaries market. As Fig. 1 shows, our latest research indicates that 2% of institutional investors are looking to definitely sell, with a further 11% possibly selling in the next 24 months. This actually represents an increase from last year, which is due to the lack of activity on the secondary market causing a backlog of potential sellers.

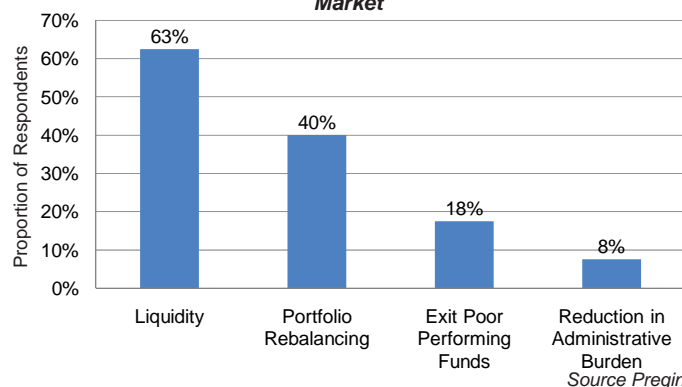
Investors are seeking to exit investments for a number of reasons. Although the denominator effect is now far less pronounced, capital calls far exceeded distributions from existing investments in 2009, and many investors are overcommitted to private equity as a result – especially those with aggressive overcommitment strategies. 63% of sellers state liquidity as a driving factor in wishing to sell. Other important factors include portfolio rebalancing (40%) and exiting poorly performing funds (18%) (Fig. 2).

**Fig. 1: Likelihood of Institutional Investors Selling Fund Interests on the Secondary Market over the Next 24 Months**



Source Preqin

**Fig. 2: Motivations for Selling Fund Interests on the Secondary Market**



# Private Equity Secondaries Market: Overview

The number of potential buyers in the market is also at a high level. While the rest of the private equity market had a torrid time in 2009 in terms of new fundraising, secondaries funds actually had a record year, with 19 vehicles reaching a final close with \$23 billion raised in total. Goldman Sachs closed a \$5.5 billion fund in April 2009, which is the biggest dedicated secondaries fund closed to date. Normal institutional investors are also displaying a preference for secondary transactions, with 6% highly likely to buy, and a further 24% of those interviewed indicating an active interest in the market.

With an increase in the number of buyers and sellers, activity in 2010 has the potential to exceed that of 2009. However, activity in the market will again be dictated by the ability of buyers and sellers to reach a consensus on fair pricing.

## The Bid Ask Ratio is Closing

Fig. 3 shows the discount / premium to fund NAV for listed private equity vehicle pricing. This acts as an excellent proxy for the level of bids forward by buyers for unlisted vehicles, and is well correlated to the bids being seen on Preqin's Secondary Market Monitor Online marketplace. The graph shows a significant rise in the discount to NAV following the onset of the financial crisis, with an especially big discount increase in the early part of 2009. As discussed, this discount proved too great for many sellers, and

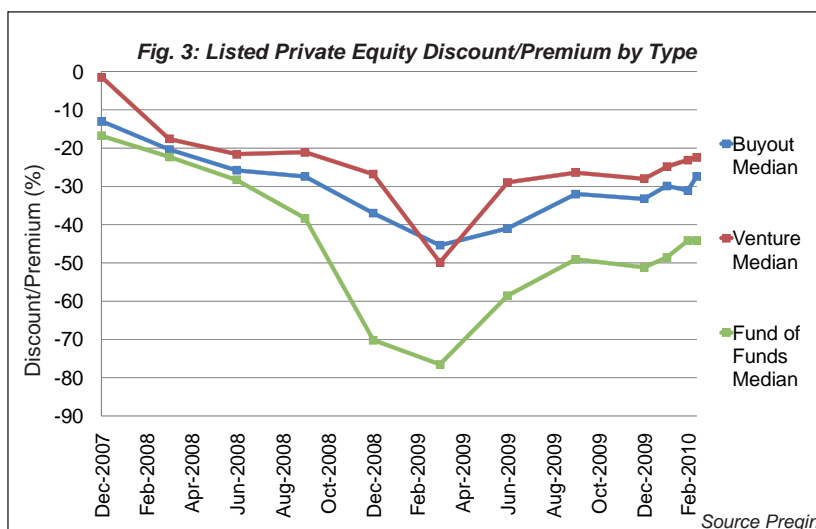
prevented the number of transactions from increasing to expected levels.

Since mid-2009, prices have been steadily improving, and the market is now sitting at just below a 20% discount to NAV. These levels will prove far more palatable for potential sellers, and as the gap continues to close, the number of sellers that will be willing to exit their investments will rise accordingly.

As a result, sellers are currently enthusiastic about the market, with buyers also optimistic towards secondaries. It appears that a viable equilibrium in terms of supply and demand and pricing is close to being achieved.

## Timescale for the Secondaries Boom

This potential is already translating into action - Preqin's Secondary Market Monitor has seen a flurry of activity in recent months, with LPs putting a number of significant portfolios forward for valuation. With secondary transactions requiring plenty of negotiation and time, it will still be some time before the market truly explodes into action, but we are expecting the latter half of 2010 and especially 2011 to exhibit record levels of activity for the secondaries industry.



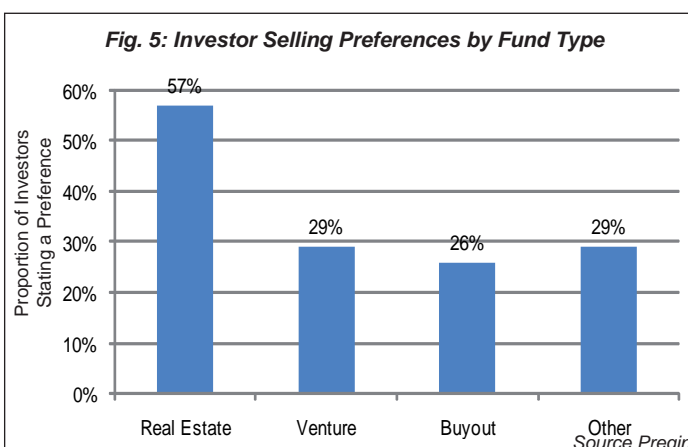
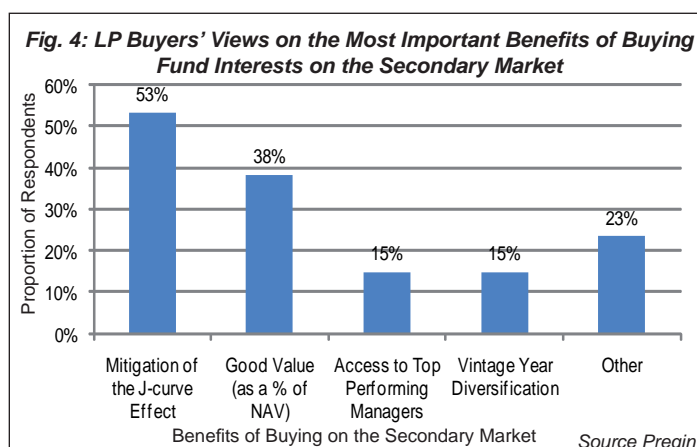
# Private Equity Secondaries Market: Secondary Market Buyers and Sellers

## Potential Secondary Market Buyers

- LPs are now aware of the benefits that come with buying fund stakes on the secondary market and a growing number are incorporating secondaries into their private equity investment strategies. 6% of LPs are highly likely to buy fund interests on the secondary market during the next 24 months, and a further 24% felt such investments were a possibility.
- Several key factors are influencing LPs to buy fund interests on the secondary market. 53% of investors said they would buy fund stakes in order to reduce the effect of the J-curve and improve cash-flow in their portfolios. The potential for purchasing funds at significant discounts to their net asset values (NAVs) is also attracting investors to the secondary market, as 38% of investors stated this as a benefit of buying on the secondary market.

## Potential Secondary Market Sellers

- 46% of possible sellers state specific types of fund in which they are looking to sell interests. Private equity real estate funds are the most common fund type that investors are looking to sell, with 57% of investors that stated selling preferences naming this fund type. Venture and buyout funds are also common fund types investors are looking to sell; 29% stated a desire to sell their interests in venture funds and 26% in selling stakes in buyout funds.
- The secondary market can be used to sell not only interests in funds of particular types but also interests in funds of particular vintage years. 77% of investors looking to sell funds of specific vintage years said that they would like to sell interests in 2006 vintage funds. 62% of possible sellers are looking to sell 2005 vintage funds, and 46% are looking to reduce their exposure to funds with a 2007 vintage.



# Private Equity Secondaries Market: Investors and Fundraising

## Investors in Secondaries Funds

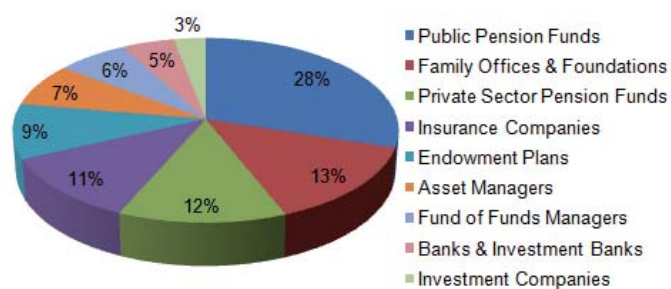
- The secondary market attracted a range of investors in private equity and the LPs in secondaries funds are no less diversified. Preqin's Investor Intelligence database lists profiles for 589 investors that have either previously invested in private equity secondaries funds or are actively seeking to invest in funds of this type at present. In addition, Preqin's Real Estate Online database tracks 76 investors that have an interest in investing in real estate secondaries funds.
- Over a quarter (28%) of these investors are public pension funds, making these LPs an important source of capital for fund managers. Family offices and foundations account for 13% of investors that have either previously invested in or are seeking to invest in secondaries funds and a further 12% are private sector pension funds.
- Secondaries funds are attractive to investors for a number of reasons. Smaller institutions can benefit from being able to make smaller capital commitments than they would to direct private equity funds. They can also gain exposure to a diversified portfolio of underlying funds through a single fund commitment. Secondaries funds invest capital across a range of different vintage years therefore adding a layer of diversification to an investor's portfolio. Distributions are

typically received earlier from secondaries funds than from other types of private equity fund, thus helping to improve cash-flow in investors' portfolios.

## Secondaries Fundraising and Funds in Market

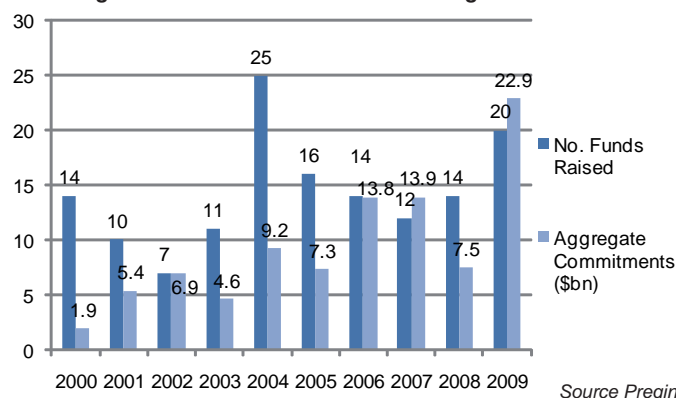
- The annual aggregate amount of capital raised by secondaries funds vehicles has generally increased over the past decade, although fluctuations do occur due to the fairly small number of vehicles that close each year. Fundraising was strong in 2009, with the 20 vehicles that closed during the year raising a total of \$22.9 billion, a record annual total. This figure was helped by a number of very large funds closing during the year, the largest of which was GS Vintage Fund V, which held a final close on \$5.5 billion.
- As of Q2 2010, there are 31 secondaries funds in market targeting aggregate commitments of approximately \$18 billion. While the number of secondaries vehicles seeking capital has increased since last year, there has been a significant decrease in the aggregate capital commitments being sought. At the same time last year, 27 secondaries funds were targeting an aggregate \$31 billion.

**Fig. 6: Breakdown of Investors with a Preference for Secondaries Funds by Type**



Source Preqin

**Fig. 7: Annual Secondaries Fundraising: 2000 - 2009**



Source Preqin

# Private Equity Secondaries Market: Funds of Funds and Market Pricing

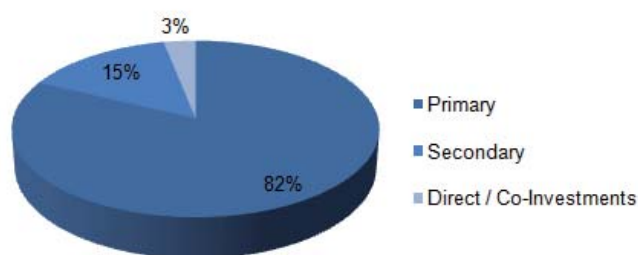
## Primary Fund of Funds Managers

- In addition to setting up dedicated secondaries funds, it is not unusual for traditional fund of funds managers to allocate a proportion of their primary funds of funds to opportunistic purchases of interests in funds on the secondary market.
- 43% of all active fund of funds managers have an allocation to secondaries through one or more of their vehicles. In comparison, 33% of managers had an allocation to secondaries in 2009.
- Fund managers that invest in secondaries through primary funds of funds, on average, look to allocate 15% of capital to secondary market purchases. This is significantly larger than the 3% of capital which is, on average, set aside for direct co-investments by funds of funds with an allocation to secondaries.

## Secondary Market Pricing

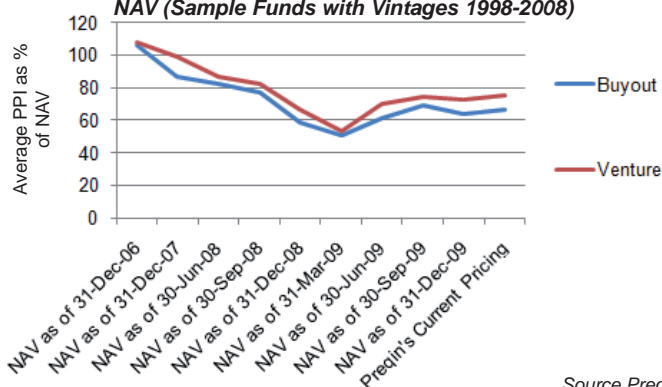
- Secondary market transaction volume failed to meet expectations in 2009, largely because buyers and sellers of fund stakes could not meet over price. Secondary market discounts widened from March 2007, when we would have expected buyout fund interests to have traded at a small premium to NAV, until March 2009.
- Preqin's current pricing for buyout and venture fund interests (66.6% and 75.1% of NAV) is greater than the corresponding values at year end 2008 (58.8% and 66.3% of NAV) and may suggest secondary pricing reached its lowest in March 2009 on 50.7% and 53.0% of NAV respectively.
- As secondary market pricing improves and investors increasingly feel the pressure of capital call-up obligations from GPs, an increase in secondary transaction volume is likely in 2010.

**Fig. 8: Average Fund of Funds' Allocation to Primary, Secondary & Direct / Co-Investments Strategies**



Source Preqin

**Fig. 9: Historic Preqin Price Indications (PPI) as Percentage of NAV (Sample Funds with Vintages 1998-2008)**

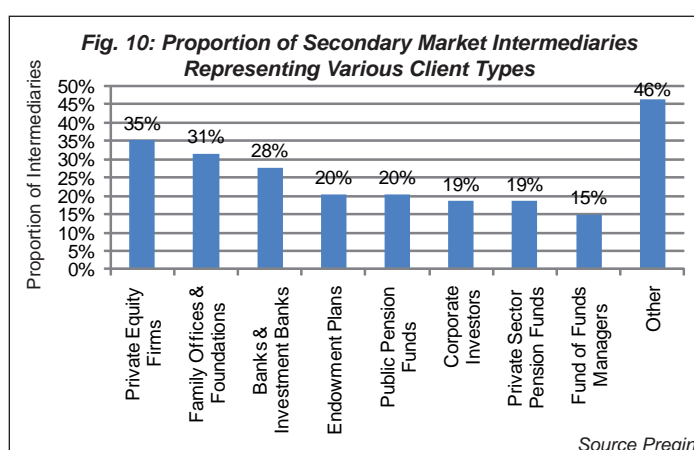


Source Preqin

# Private Equity Secondaries Market: Intermediaries

## Secondary Market Intermediaries

- Secondary market intermediaries often play an important role in bringing buyers and sellers together in what can be a complex and opaque market. For LPs that are unfamiliar with secondary transactions, the knowledge and experience of a secondary market intermediary can provide assurance that they are achieving the best possible deal.
- Private equity firms are the most common client type among intermediaries, with 35% of groups serving fund managers. Approximately 31% of intermediaries count family offices and foundations among their clients, while 28% represent banks, one-fifth serve endowment plans and the same proportion represent public pension funds. Corporate investors and private sector pension funds are each supported by 19% of intermediaries. Fund of funds managers, many of which have considerable experience in secondary transactions and often dedicated in-house secondaries teams, are represented by 15% of intermediaries.



# The 2010 Preqin Private Equity Secondaries Review

Although the considerable potential in the secondaries market failed to translate into increased dealflow in 2009, 2010 looks set to see a significant increase in activity. Secondaries fundraising is at an all-time high, while Preqin's surveys reveal that there are more buyers and sellers than ever before. Although activity has previously been hindered by large gaps between fund NAVs and bids, this is now starting to narrow, and activity is set to increase dramatically as a result.

The newly released 350-page publication represents a vital purchase for all those seeking to buy or sell on the market and all intermediaries involved in the secondaries process. It is also a valuable resource in helping GPs to understand the market, and is essential for all investment consultant and advisors for institutional investors.

## Key features of this publication include:

- Covers all private equity fund types, including private equity real estate.
- Detailed analysis examining the history and development of the industry, historic NAV vs. trading price premiums and discounts, performance of secondaries funds, funds of funds activity in secondaries, institutional investor buyers and sellers, intermediaries, placement agents and more.
- Profiles for 74 specialist secondary fund of funds managers, 106 fund of funds managers with secondaries allocations, 51 institutional investor buyers and 26 sellers, 54 intermediary firms and placement agents, plus details for over 600 investors in secondaries funds.
- Results of surveys conducted with GPs, LPs and fund of funds managers.

- Listings of 77 secondaries funds closed historically since 2005, 34 funds currently in the market, individual net to LP fund performance for 300 funds including secondaries vehicles and funds of funds with a secondaries allocation.

## Benefits of this year's publication include:

- Wide-ranging analysis will help you understand the latest market trends and is essential for producing reports, presentations and marketing materials.
- Our detailed profiles will save hundreds of research hours looking for firm or investor backgrounds and contact details.
- Most comprehensive report available today, with exclusive information all compiled by our team of dedicated analysts via direct contact with firms and investors.

**More information:** [www.preqin.com/secondariesreview](http://www.preqin.com/secondariesreview)

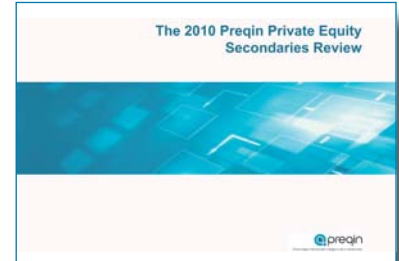
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This year's Review is the most comprehensive guide to the sector ever produced, featuring 350 pages of detailed information:

- Covers all private equity fund types, including private equity real estate
- Detailed analysis examining the history and development of the industry, historic NAV vs. trading price premiums and discounts, performance of secondaries funds, fund of funds activity in secondaries, institutional investor buyers and sellers, intermediaries, placement agents and more.
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Order by Friday 14th May and receive a complimentary copy of the 2010 Preqin Global Private Equity Report

[www.preqin.com/secondariesreview](http://www.preqin.com/secondariesreview)

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