PRIVATE EQUITY ONLINE

Redemption song

Hedge funds scrambling to get out of the private equity business will be a boon for secondaries firms, writes David Snow.

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Is that some private equity in your side pocket, or are you just happy to see me?

It's a line that buyers of private equity direct secondaries will be saying with greater frequency as the numerous hedge funds to have done one-off private equity deals feel the pressure to liquidate these investments.

The way that hedge fund accounting works does indeed support the view that private equity will be bulging within shrunken portfolios. Because most hedge funds tend to invest in liquid assets like stocks and bonds, they can offer redemptions to investors, sometimes as frequently as monthly. Some of these funds did private equity-style deals or coinvestments during the buyout boom, which has left them with illiquid positions in private companies. Typically deals of this nature were placed in "side pockets" within the portfolio, where a different set of valuation rules applied.

The hedge fund herd is rapidly thinning now as investors yank their assets from under-performers. In order to meet liquidity demands, hedge funds are forced to sell assets. As this trend continues, many secondaries pros expect hedge funds to sell off whatever private equity interests they hold.

A number of secondaries specialists interviewed for the upcoming September *Private Equity International* report on this vibrant market said the wave of hedge fund side-pocket emptying had not yet arrived. But there are early indications it's on its way. A number of hedge funds have approached buyers of secondary directs seeking education about the sale process.

Some of the companies backed by hedge funds during the buyout boom are no doubt toxic. But at the right price, an interest in a lousy company is a good deal.