Dow Jones Private Equity Analyst

Secondary Firms Still Find Gems In Difficult Pricing Environment

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Although discounts are narrowing in the secondary market, buyers still have managed to find some gems, according to a panel of four at the Dow Jones Private Equity Analyst conference.

"There are a lot of bad deal opportunities in the market and a lot of us have to only invest a fraction of what is available," said Jonathan Gutstein, a partner at Coller Capital.

In recent months, pricing on secondary assets has risen to heights of single digit discounts or even par which has led some to question whether pricing is too rich. Scott Connors, a partner at Landmark Partners said that it is tough to make a lot of money from deals that are bid at 90 cents on the dollar.

Much of the opportunity has come from financial institutions but some panelists agreed that regulation on both sides of the Atlantic isn't the primary driver of sales. The Basel III Accords make private equity investments more expensive for banks to hold, while the Volcker Rule limits bank holdings of certain alternative assets to 3% of a their Tier 1 capital.

Gutstein said banks are saying that they don't know how rules will play out but they're not sure that it matters. The movement by banks away from private equity began even before the Volcker Rule, he added.

David Wachter, a managing director at W Capital Partners, a New York firm that focuses on direct secondaries, said his firm has executed two bank deals this year, neither of which was driven by regulation.

One bank sold private equity assets for liquidity reasons, although the deal still earned the bank a three times return on its investment in the asset, according to Wachter. The other bank conducted a sale as part of a portfolio management move following a corporate merger.

Secondary buyers have also turned to hedge funds as a source of deal flow although deal volume has failed to live up to initial expectations. When asked whether they bought assets from hedge funds in the past year, all the panelists raised their hands.

Wachter pointed to a high profile deal with a large hedge fund that held a seven or eight year investment in a side pocket. The firm also completed two general partner deals where one fund wanted recycling and the other had excess leverage.

-Laura Kreutzer contributed to this article.