



Secondary Market for Private Equity Developing in India

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Investors in private equity funds, known as limited partners or LPs, are sensing opportunities to buy-out the positions or commitments to private equity managers from other LPs that want to limit their exposure to private equity, or do not have the money to meet their so-called unfunded commitments.

In industry parlance, such deals are known as secondaries and private equity managers are referred to as general partners or GPs.

LPs are excited about the opportunities as deals are coming at steep discounts. Such deals have been struck frequently in the US and Europe but they are new in the Indian context.

Rahim Penangwala, head of private equity, India, at LGT Capital Partners (Asia-Pacific) Ltd, a Switzerland-based fund of funds that manages at least US\$18 billion (about Rs90,000 crore) in hedge fund and private equity assets, said his firm was offered two such deals at very "attractive prices" last week. He, however, did not name the GPs looking for such deals.

"We're seeing (price) ranges between 50-70 cents to a dollar, which is pretty attractive," Penangwala said at a conference organised by the Asian Venture Capital Journal, recently in Mumbai.

LPs are betting on a further price correction; Penangwala himself has witnessed at least one non-India fund going at 20 cents to a dollar.

"We'll be concentrating a lot on secondaries in India this year. If we liked the manager the last year or the year before, we're seeing the same managers at 40-50% discounts. So now we love them. The balance has shifted towards secondaries," said Penangwala, whose fund has \$200 million committed to India across eight funds. LGT entered the funds when the managers were initially raising them.

A GP gets a commitment of a certain amount from his limited partners while raising funds and this commitment is drawn down as and when the GP invests into a company. LPs include pension funds, endowments, family offices and fund of funds, which allocate a certain portion of their capital to private equity managers.

With other traditional asset classes such as equity and fixed income being severely beaten down since the beginning of 2008, many LPs suddenly find their private equity allocation, which is not marked-to-market, coming in as a large proportion of their portfolio.

Mark-to-market is an accounting practice of valuing an asset at their market price and not the cost at which it is acquired. This has prompted many to rebalance portfolios; they do not want to honour their commitments made to private equity managers.

According to Philip Bilden, managing director at HarbourVest Partners (Asia) Ltd, another private equity fund of funds, there are already US\$60 billion worth of secondary positions available globally today, and this could go up to US\$100 billion by the year-end.

Private equity investors are excited about such deals as these are coming at heavy discounts.

Anubha Shrivastava, managing director (Asia) of CDC Group Plc, the UK government-owned fund of funds investing in emerging market fund managers, first heard of secondaries in India six months ago and was surprised that the seller wanted to get dollar for dollar on the portfolio it was selling. "That's an unusual expectation. As time has gone by, someone told me the other day, the rule of thumb in the Indian market now is a 35-40% discount."

The proposals being pitched at her firm were from managers with whom CDC has already invested. The group, which has US\$4 billion under management globally, with commitments to India being at least



US\$200 million across 15 funds, might hold off trying to buy secondaries being pitched at it by managers of these funds. That's because, if it buys these at a 35-40% discount, CDC's initial commitment will also have to be marked down to that extent.

To avoid such eventualities, secondary deals are likely to happen only when a completely new LP comes into the fund, rather than an existing LP taking over commitments of other LPs in the same fund.

But for that to happen, GPs themselves need to talk more openly about these secondaries. "I find that GPs find themselves somehow responsible, or feel embarrassed to talk about secondaries with LPs. That's very unusual. Secondary market develops and that's the way things are. This is a natural evolution and we should be talking about this," said Shrivastava of CDC.

Olivia Ouyang, investment officer at Washington-headquartered International Finance Corporation (IFC), has also seen a couple of secondaries in India recently, but according to her, the emerging market private equity asset class is so small that there has been little secondary supply available. IFC is a member of the World Bank Group and invests in the private sector in developing countries.

As of 30 June, IFC had a portfolio worth US\$32.4 billion, representing 1,490 investments in 122 countries. Of this, a small portion – \$1.9 billion – is invested with emerging market fund managers. In India, it has committed US\$350 million across 15 funds.

"When we talk to institutional investors that are selling their private equity portfolio, that portfolio is much more European or US-centric than emerging markets," Ouyang said.

One of Ouyang's colleagues is working on a project where IFC can help support emerging market private equity by "organising some sort of a secondaries fund to help LPs transact, and therefore maintain the stability of the LP base, and maybe increase the base of LPs for emerging markets".

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