# Secondary Buyouts

Continuing financial uncertainty, as well as a turbulent public equity market, have impacted secondary buyout activity in recent years. Kevin Smith explores the private equity industry's use of secondary buyouts as an exit strategy, and how this might impact the future of secondary buyout deals.

## Secondary Buyout Deals

Deals in which a private equity-owned company is sold to another private equity firm are known as secondary buyouts, or sponsor-to-sponsor deals. These secondary buyouts now account for 30% of this year's aggregate deal value, worth a combined $55.7bn, and are set to overtake the aggregate value of secondary buyouts in 2011, recorded at $62.2bn.

Secondary buyouts activity has been rising since mid-2011, driven by key factors such as tentative public markets, an overhang of capital raised during the buyout boom era, and pressure on private equity firms to return capital back to their investors on deals made during this period.

## Secondary Buyouts: Positives and Negatives

Secondary buyouts provide an attractive investment opportunity for private equity firms, which are under pressure to invest the large amounts of capital at their disposal, and view sponsor-to-sponsor deals as a prime opportunity to add value to a familiar asset held by another private equity firm. The buying firm will seek to scale up the company, adding value to it by taking it to the next level of development. They may accomplish this by utilizing their industry knowledge, network, and contacts to grow the company or implementing different debt or management strategies.

Additionally, the company may have reached a size now that falls within the buying private equity firm's expertise, making it more ideal for them to develop further. A private equity firm that specializes in growing mid-market companies can acquire and grow a company and then sell to a larger private equity firm that specializes in acquiring larger companies. This process can even be repeated several times, where the portfolio company is 'passed' up the chain as different private equity firms with different specialities add value to a company, with the chain eventually culminating in an exit either through the public markets via an initial public offering (IPO) or through a sale to a strategic buyer.

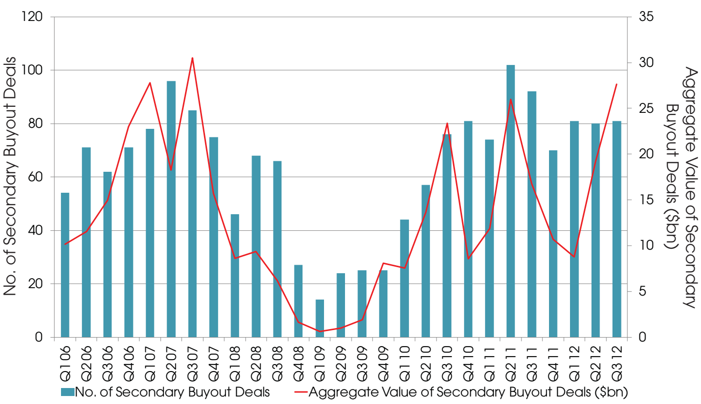
The premise of a secondary buyout has often proved a contentious issue, particularly for some institutional investors that have exposure to both the fund involved in the purchase of a particular interest on the secondary market and the vehicle involved in the sale of that same interest. This has led to some critics dubbing these buyouts as 'pass the parcel' deals, proposing that the institutional investor essentially still has exposure to the asset and assumes the same risk as before. In addition, questions have been raised as to whether substantial returns can be made, since many value added improvements would already have been implemented previously by the selling firm; another concern is that some of these assets may be overpriced. Despite these doubts and criticisms in some circles, secondary buyouts remain attractive to many within the buyout community.

## Secondary Buyouts, 2006 – Q3 2012

As of the end of Q3 2012, 242 secondary buyouts valued at $55.6bn have been announced globally, a value that is likely to surpass the post-Lehman high of 2011, where $65.2bn secondary buyouts were completed globally. As shown in Fig.1, secondary buyout levels have witnessed a surge in activity in recent years, rebounding from the marked decline in activity that occurred following the onset of the financial crisis in late 2008 and 2009.

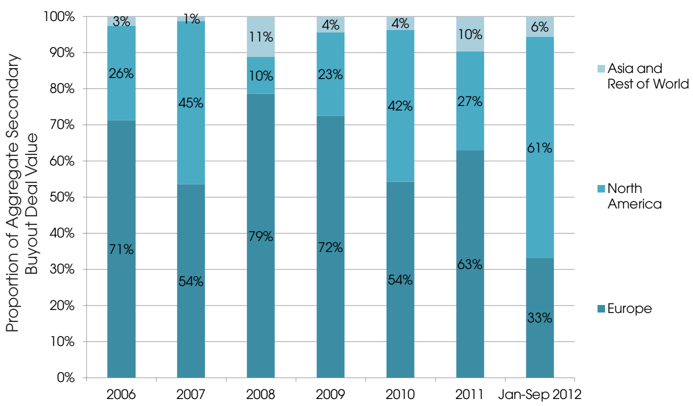
Interestingly, the $27.6bn in secondary buyouts in Q3 2012 represents the highest aggregate quarterly value of secondary

Fig. 1: Number and Aggregate Value of Secondary Buyout Deals, Q1 2006 - Q3 2012



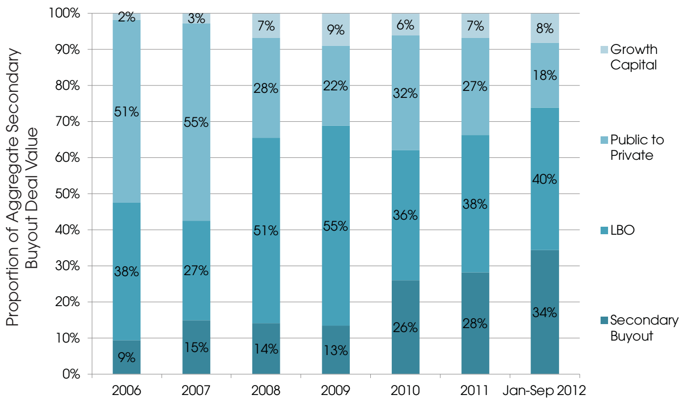

Source: Preqin Buyout Deals Analyst

Fig. 2: Breakdown of Aggregate Secondary Buyout Deal Value by Region, 2006 - Q3 2012



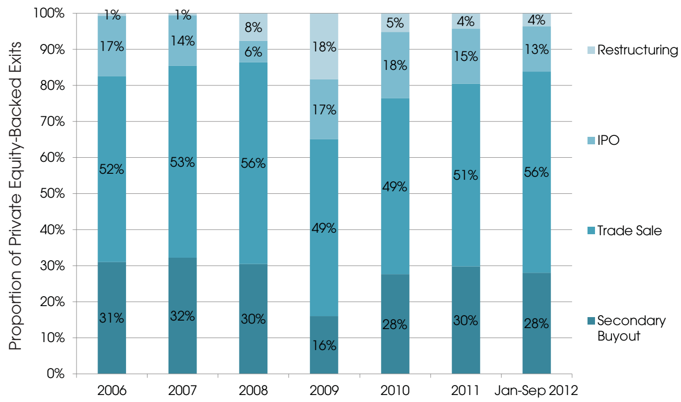

Source: Preqin Buyout Deals Analyst

Fig. 3: Breakdown of Aggregate Secondary Buyout Deal Value by Type, 2006 - Q3 2012




Source: Preqin Buyout Deals Analyst

Fig. 4: Breakdown of Private Equity-Backed Exits by Type, 2006 - Q3 2012




Source: Preqin Buyout Deals Analyst

buyout deals since the emergence of the financial crisis, surpassing the previous quarterly high of $26bn from 102 secondary buyouts in Q2 2011, and nearing the all-time peak of $30.5bn in secondary buyouts in Q3 2007. However, while Q3 2012 secondary buyout figures are near all-time highs, the $55.6bn in secondary buyouts in 2012 to date remains a long way off the full-year high of $92.2bn from 334 secondary buyouts in 2007.

## Secondary Buyouts Deals by Region – North America Surges

In January to September 2012 North American secondary buyout deals overtook European secondary buyout deals by number and aggregate value for the first time since 2006. This shift is likely due in part to easing credit conditions in the US compared to mid to late 2011 and the continuing effects of market turmoil in Europe. As shown in Fig. 2, North America has witnessed 118 deals worth a combined $34bn in Q1-Q3 2012, representing 61% of aggregate value of secondary buyouts in this year so far. This post-Lehman high is double the value of secondary buyouts witnessed in the whole of 2011, and close to the $41bn from 155 secondary buyouts in North America witnessed at the height of the buyout boom era in 2007, a clear indication of the current popularity of sponsor-to-sponsor deals in the region.

The European sovereign debt crisis, which resurfaced in mid to late 2011 and has continued into 2012, has had a visible impact on the secondary buyout market, as evidenced by buyout figures for the region in 2012 so far. The region accounted for just 33% of total secondary buyout deal value in Q1-Q3 2012, with 98 deals valued at $18.4bn. These are the lowest levels of European secondary buyout activity since 2009, and the lowest proportion of aggregate deal value since 2007, when Europe accounted for 54% of the value of secondary buyouts globally.

Secondary buyouts in Asia and Rest of World have typically accounted for 10% or less of the value of these transactions globally, due to the fact that the private equity market is still maturing in the region. Asia and Rest of World buyouts accounted for a far lower proportion of deals during the boom era than North America and Europe.

## Buyout Deals by Type

Fig. 3 displays the proportion of buyout deals globally by aggregate value since 2006, revealing that the proportion of both leveraged buyout (LBO) and secondary buyout deals has been rising year-on-year for the past three years, largely due to the decline in public-to-private transactions over the same period. These pre-crisis public-to-private deals, which were often notable for their highly leveraged nature and mega deal sizes, have declined in prominence in the post-Lehman era, paving the way for a rise in leveraged and secondary buyout activity as a proportion of global deal values.

In relation to secondary buyouts, a key factor for this increased activity is the fact that there are still over 3,300 private equity-backed portfolio companies that were acquired during the boom period of 2006-2007 that have yet to be exited. Private equity firms typically seek to hold portfolio companies for three to five years before exiting, and so this large number of currently held companies, combined with $360bn in dry powder waiting to be put to work, will provide a catalyst for continuing secondary buyout activity going forward.

## Private Equity Exits by Type

For private equity firms seeking to exit their holdings, secondary buyouts are a legitimate alternative to the more traditional trade sale to a corporate buyer or an exit via the public markets, and have remained a consistently attractive as an exit route for many firms since 2006. In particular, some fund managers have stated a preference for selling their holdings via a sale to a corporate seller or another private equity firm, as IPOs often involve a higher level of uncertainty and reliance on market conditions, particularly because share sales are often staggered over a prolonged period.

As shown in Fig. 4, secondary buyouts represent 28% of the total number of exits made this year, with this sale of assets to another private equity firm consistently representing close to a third of all exits for sellers since 2006. Only the immediate post-Lehman year of 2009 bucks this trend, with secondary buyout sales representing 16% of exits.

Fig. 5: Notable Secondary Buyout Exits, Q1-Q3 2012

| Asset | Buyers | Sellers | Date | Deal Size (mn) | Industry | Location |
|---|---|---|---|---|---|---|
| Cequel Communications | BC Partners, CPP Investment Board | Charterhouse Group, Goldman Sachs Merchant Banking Division, Jordan Company, Oaktree Capital Management, Quadrangle Group | Jul-12 | 6,600 USD | IT | US |
| Getty Images | Carlyle Group | Farallon Capital Management, Hellman & Friedman | Aug-12 | 3,300 USD | Digital Media | US |
| AOT Bedding Super Holdings | Advent International | Ares Management, Teachers' Private Capital | Aug-12 | 3,000 USD | Manufacturing | US |
| TransUnion | Advent International, Goldman Sachs Merchant Banking Division | Madison Dearborn Partners | Feb-12 | 3,000 USD | Financial Services | US |
| Party City Corporation | Thomas H Lee Partners | AAH Holdings Corporation, Berkshire Partners, Weston Presidio Capital | Jun-12 | 2,690 USD | Consumer Products | US |

Source: Preqin Secondary Market Monitor

However, trade sales have remained an attractive exit route for private equity firms since 2006, accounting for 56% of exits during Q1 – Q3 2012, and consistently representing approximately half of all private equity-backed exits since 2006.

IPOs and follow-on share sales have accounted for 13% of all exits in January to September 2012, a lower proportion than in every other year since 2006, excluding 2009, due to difficult public equity market conditions during the year to date. Restructurings, where a company enters debt restructuring, often leading to a debt for equity swap with lenders, have accounted for 4% of exits between Q1–Q3 2012, in line with the levels of restructurings in 2010 and 2011, but lower than in 2009, when 18% of all exits were via restructuring.

## Secondary Buyout Outlook

With a turbulent public equity market, it is likely that IPOs will remain largely out of bounds for private equity firms exiting in the near future, leaving trade sales to corporate buyers and secondary buyouts as the primary exit route for private equity sellers. In addition, as buyout firms continue to sit on $360bn of capital, and with over 3,330 boom-era buyouts still to be sold, conditions seem ripe for a continued prominence of secondary buyout activity going forward.

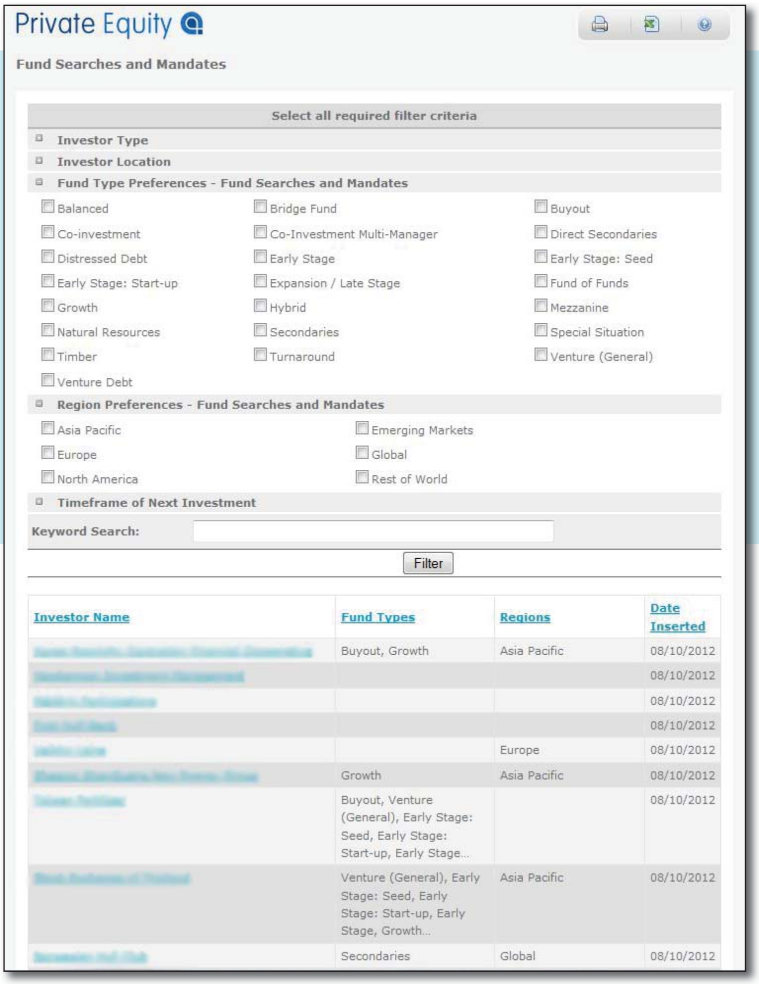
# Future Fund Searches and Mandates

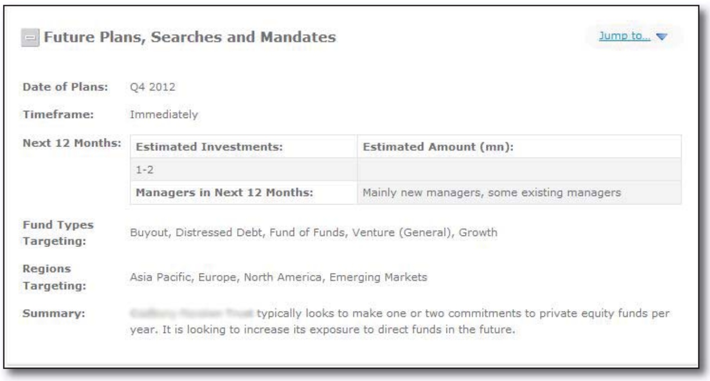
The difference between success and failure in attracting institutional commitments can be the ability to identify which investors are most likely to be interested in your fund.

To help with this task, Preqin's Investor Intelligence now allows subscribers to identify likely investors in their fund by searching for institutional investors by their future investment plans.

Preqin updates these details by speaking directly to investors – saving you time and ensuring our intelligence is up to date and accurate.

- Future Investment Plans - Investor profiles include details of investors' future fund searches, detailing whether they are targeting specific private equity strategies and/or regions of focus, and also contain summaries of their plans for the next 12 months.
- Future Fund Searches and Mandates - Forward-looking search for all the institutional investors that are looking to invest in funds that match your criteria.
- Filter potential investors by location, investor type, fund type preferences for the next 12 months, regional preferences for the next 12 months, and likely timeframe for their next fund commitment.

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Investor Intelligence

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