

Benchmarking Secondaries Investments using PERACS Secondaries Benchmarks

We take a look at the performance of two hypothetical managers targeting secondary investments in mature, tail-end funds using the PERACS Secondaries Benchmarks tool.

The **PERACS Secondaries Benchmarks** tool available on Preqin's **Secondary Market Monitor** allows investors to benchmark actual secondary investments against the performance of a simulated secondary investment.

The benchmarks utilize Preqin's performance data – detailed cash flows and net asset values (NAVs) – on funds over time. This data is used to simulate the performance of a hypothetical secondaries investor buying a given subset of funds at a given age and at a given price (relative to NAV).

Each simulated secondary investment has a typical four-year investment period, and targets primary funds of different ages (less than four years old, 4-7 years old or eight years and older), of different quality (measured as the actual future performance quartile of the investment opportunity) and at a specific price relative to the most recent NAV.

Consider the case of an investor that performs due diligence on two fund managers specialized in tail-end secondary investments, which have developed over the past years as a distinctive sub-segment of the secondary market. Both managers are specialized in the purchase of mature stakes in US-focused buyout funds, i.e. funds of at least eight years of age. Manager A acquires stakes in funds of all performance

quartiles, with an average discount of 30%, i.e. an entry pricing of 0.7x of NAV. Manager B focuses on stakes of poorly performing funds, i.e. the lowest two performance quartiles, with an average discount of 50%, i.e. an entry pricing of 0.5x of NAV. The track records of the two managers are shown in Fig. 1.

These two track records are difficult to compare. Considering likely timing effects, manager A tends to have higher IRRs and TVPIs and also a higher PERACS Alpha (an unbiased measure of outperformance over public markets). We can gain further insight into the actual skills of the two managers by comparing their performance fund-by-fund to the simulated performance of hypothetical secondary fund investment opportunities with comparable characteristics. The corresponding PERACS Secondaries Benchmarks are shown in Fig. 2.

This makes it possible to compare, fund-by-fund, the actual secondary investments against the simulated performance of hypothetical secondary fund investment opportunities with the exact same characteristics in terms of secondary vintage, strategy (stage, geography and age of the target primary funds), pricing and the quality of the acquired funds. Such a comparison makes it possible to identify to what extent a given manager made choices among theoretically available

Fig. 1: Track Record of Manager A and Manager B

| Manager | Secondary Vintage | TVPI | PERACS Alpha* | IRR |
|---------|-------------------|------|---------------|-----|
| A | 2007 | 2.10 | 19% | 24% |
| A | 2009 | 1.90 | 16% | 30% |
| A | 2011 | 1.50 | 35% | 41% |
| B | 2008 | 1.75 | 18% | 21% |
| B | 2010 | 1.80 | 30% | 29% |

Fig. 2: PERACS Secondaries Benchmarks for Strategies Employed by Manager A and Manager B

| Secondary Vintage | Price (% of NAV) | Minimum Age | Quartile Range | Geographic Focus | Type | TVPI | PERACS Alpha* | IRR |
|-------------------|------------------|-------------|----------------|------------------|--------|------|---------------|-----|
| 2007 | 70% | 8 | All | US | Buyout | 1.83 | 20% | 25% |
| 2009 | 70% | 8 | All | US | Buyout | 1.79 | 17% | 33% |
| 2011 | 70% | 8 | All | US | Buyout | 1.61 | 37% | 45% |
| 2008 | 50% | 8 | <3Q | US | Buyout | 1.70 | 17% | 24% |
| 2010 | 50% | 8 | <3Q | US | Buyout | 1.75 | 28% | 38% |

Source: Preqin Secondary Market Monitor

* PERACS Alpha = $(\text{Present Value of Distributions} + \text{Present Value of Remaining Value} / \text{Present Value of Drawdowns})^{(1/\text{Duration in years})} - 1$.
MSCI ACWI is the discount rate.

Fig. 3: Results of Manager A and Manager B vs. PERACS Secondaries Benchmarks

| Manager | Secondary Vintage | TVPI | PERACS Alpha* | IRR | Outperf. in Terms of TVPI | Outperf. in Terms of PERACS Alpha | Outperf. in Terms of IRR |
|---------|-------------------|------|---------------|-----|---------------------------|-----------------------------------|--------------------------|
| A | 2007 | 2.10 | 19% | 24% | TRUE | FALSE | FALSE |
| A | 2009 | 1.90 | 16% | 30% | TRUE | FALSE | FALSE |
| A | 2011 | 1.50 | 35% | 41% | FALSE | FALSE | FALSE |
| B | 2008 | 1.75 | 18% | 21% | TRUE | TRUE | FALSE |
| B | 2010 | 1.80 | 30% | 29% | TRUE | TRUE | FALSE |

investment opportunities that enhanced the returns above the simulated averages. Fig. 3 shows the results of the study for each of the five funds that are relevant to our example.

The analysis shows that the managers differ in their ability to make favourable choices. While none of their funds beat the PERACS benchmark in terms of IRR, both funds of Manager B outperform this benchmark based on the more relevant PERACS Alpha and TVPI measures, while Manager A can point to such outperformance in terms of TVPI for only two of three funds – and all three funds underperform in terms

of PERACS Alpha. As such, this analysis sheds light on two different elements that investors may want to consider. First, the structural attractiveness of a given investment approach in the secondary space: in our example this would be the choice between a mature secondary strategy that maximizes the discount to NAV while accepting poor quality managers versus a strategy that accepts a lower discount to obtain a mix of primary funds of all performance categories. Second, the ability of given managers to make choices among theoretically available investment opportunities that enhance the returns above the simulated averages of their chosen strategy.

PERACS Secondaries Benchmarks

PERACS is a leading provider of quantitative analytics for the private equity industry. PERACS helps investors achieve a better understanding of the value drivers behind private equity investments and, subsequently, to make better investment decisions. PERACS offers specialized consulting services to institutional and other sophisticated investors by providing detailed insights into the key aspects of private equity investment performance.

The **PERACS Secondaries Benchmarks** tool is available through Preqin's **Secondary Market Monitor**, the industry's leading source of data and intelligence on the secondary market. Create benchmarks for secondaries strategies, varying the age of underlying investments (early, mid and late secondaries), price paid for the funds as a percentage of NAV, quartile of the underlying funds and fund types (buyout, venture capital and fund of funds).

For more information, or to arrange a demonstration, please visit:

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