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Five Minutes with Nick Hatch

There are a few dedicated sellers in the secondaries market today, but most are opportunistic, said Harken Capital's vice president, Nick Hatch.

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Where is the bulk of secondaries activity coming from? What kind of transactions?

Overall, activity has been slow so far in the first half of 2013 because of high distribution activity and increasing valuations—LPs are feeling no pressure to sell. However, things have been slowly picking up and what is really driving activity right now is competitive pricing—not pension liabilities, Dodd-Frank, or illiquidity risk of private equity. The current high pricing levels are a result of increasing pressure from secondary funds to deploy capital in a slow market. Additionally, we are also seeing a “reverse denominator effect” where traditional LPs now have a unique window to buy funds they have already committed to since they are now under allocated to private equity. We are aware of several such deals which are in process, and will likely close in the second half of 2013. Lastly, although most of our deal flow is on the fund side, we are also seeing an increasing number of GPs open to sell or restructure the portfolio companies they have held for a while.

Who are the sellers in the secondaries market? Who are the buyers?

On the sell side, we work with LPs who follow the secondary market and sell when market conditions lean heavily in their favor. Right now there are few dedicated sellers but a much higher number of opportunistic sellers. Most of these opportunistic sellers maintain a list of noncore or legacy funds, which they are open to selling at specific pricing levels—generally between 10% discount and par. Their list expands as market conditions improve and as more funds hit these competitive levels. On the buy side, we often see traditional LPs outbid secondary funds for single position or small portfolio sales, which is really where buyers get the best pricing. Unless marketing to a large, diversified portfolio, most secondary experts know that three out of four times sellers go to market; the highest bid will come from an existing LP—or a large, traditional LP who recently established relationship with the GP—not a secondary fund.

How would you characterize the market this year compared to previous years?

We are working with a higher number of sellers this year, but those sellers are also selling fewer assets. There are a larger number of funds pricing near par, or slight premium levels, than during the previous years. On the fund side, most of the assets being marketed are buyout and venture, but we have been seeing a lot more real estate, infrastructure, and natural resource funds—a trend likely to accelerate given these categories were more widely adopted starting several years ago.