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Private Equity Beat

Lexington Partners' Brent Nicklas On The Citi Deal And Secondaries

By Laura Kreutzer

Today, Citigroup formally announced its sale of some $1.1 billion in private equity interests to secondary firm Lexington Partners Inc., with La Jolla, Calif-based Stepstone Group managing a portion of the assets. (We covered this deal a few days ago.) We sat down with Lexington Managing Partner Brent Nicklas to find out what this deal and others like it mean for the secondary market.

Q. Why did you decide to pursue this deal?

We were attracted by the quality of the assets and were able to buy them off of reasonable marks. [A lot of] the GPs already know us, because they are in our funds.

Q. In 2008 and 2009, there was much anticipation among secondary buyers of vast volumes of deals hitting the market, but reality failed to measure up. In 2010, however, the Citibank deal is at least the second $1 billion-plus sale of PE assets by a large bank. Has the long-awaited tidal wave of deal flow finally arrived?

The wave has arrived. We're projecting $20 billion [in secondary deal volume] for the year and we're tracking the first six months at close to $9 billion [including Citi]. We think next year will be another $20 billion [in deal volume] because it's not going to happen all this year. There's still some big deals that we know are going on that might sell later.

Q. Where is all of this deal flow coming from?

I think it will continue to be the banks and financial institutions, primarily in the U.S. and Europe. The hedge funds are still selling. They usually offer up a list [of assets] and you have to go in and cherry pick what works [for your firm]. We're also seeing individual co-investments trading in the secondary market. We just picked up a nice piece of Alliance Boots. The hedge funds are getting a lecture from LPs that [investors] don't want side pockets [of illiquid investments]. It's back to basics for the hedge fund world.

Q. As prices for secondary transactions have risen over the past two quarters and the discounts to underlying net asset value narrow, are there still bargains to be found?

Pricing has risen but part of it is cosmetic, because you're buying off of trailing values. What looks like a small discount is a bigger discount [due to improvements in intrinsic values of portfolios since the end of last year]. Discounts that look like 10% [to year-end valuations] are really 20% and discounts that look like 20% are really 30%. There are still bargains out there if you're a believer in private equity and you believe that these sponsors have done a good job improving their companies. You can see some near-term liquidity, if things go right, and you can see some longer term value.

Q. So what are the biggest challenges for secondary buyers in the coming months?

The biggest challenge is to avoid getting over-concentrated [in the portfolio]. We've addressed it by having large funds and having large separate accounts. To the extent that these assets involve people, that's always a challenge. [In the Citi transaction] we chose to deal with it by working with Stepstone, because we consider ourselves very good at underwriting asset values, but not particularly good at managing [individual portfolio] companies. We don't know how to run a lawn care company in Manchester, England and we don't want to take on the people that do know how to do that, because we would end up with hundreds and hundreds of employees.