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FOR THE WORLD'S PRIVATE EQUITY MARKETS

PORTFOLIO MANAGEMENT ATLAS 2012

A PEI supplement

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Secondaries in Asia
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KEYNOTE INTERVIEW **CAPITAL DYNAMICS**

Big value in small deals

Switzerland-based Capital Dynamics typically operates at the smaller end of the secondaries market. The firm's Martha Cassidy and Joseph Marks tell PEI this allows it to work with individual sellers and GPs it knows well through its primary fund business

In a secondaries market that continues to break records, as the biggest players raise huge funds and complete headline-making mega-deals, firms that operate out of the spotlight at the smaller end of the market may have the best opportunity to find great deals.

Take Capital Dynamics: the Switzerland-based private equity asset management firm likes to mine its opportunities in the quiet world of small sellers, where intermediaries and big players tend not to tread. In this segment of the market, deals are often one-off transactions for specific, individual stakes.

SOMETHING FOR EVERYONE

The secondaries market is booming; deal flow was estimated to be about \$25 billion last year, and many observers expect this number to break the \$30 billion barrier in 2012 (although that clearly depends on the health of the overall financial markets – heavy volatility can scare potential sellers, who then back off from bringing offerings to the market as they lose confidence in the ability to get attractive pricing).

One key driver is regulatory reform, which is forcing banks around the world to reduce their exposure to so-called “risky” assets like private equity. The result has been some massive, multi-billion dollar secondary offerings from



Marks: *smaller deals mean fewer intermediaries*



Cassidy: *mid-sized bank portfolios interesting*

banks – like Bank of America’s \$1.9 billion sale to AXA Private Equity in 2010. These tend to be intermediated and highly competitive.

It’s a similar story with the big US public pension systems, which have increasingly been using the secondary market to sell down their private equity portfolios. The California Public Employees’ Retirement System got the ball rolling when it sold more than \$2 billion of its portfolio in 2007; more recently New Jersey’s state system has sold more than \$600 million of its portfolio, while New York City’s pension system wants to ultimately sell about \$2 billion of interests. Again, these offerings are usually large, competitive and fought over by big buyers.

But while these huge portfolios have represented a large part of transaction volume over the past year, there is no shortage of opportunities for those focused on the smaller end of the market, according to Martha Cassidy and Joseph Marks, co-heads of the secondaries team at Capital Dynamics. Beyond these big offerings are billions of dollars-worth of smaller portfolios and one-off sales brought to market by smaller LPs, who typically want to remain anonymous to avoid damaging relationships with general partners.

“Some 70 percent of the market is estimated to be intermediated today...

KEYNOTE INTERVIEW CAPITAL DYNAMICS

However, that still leaves roughly \$9 billion this year of dealflow for us that is not intermediated,” says Marks. “That’s still a big market for a \$276 million fund, and we can be very selective on that \$9 billion.”

What’s more, these opportunities can often be very attractive from a financial point of view, he says. “The smaller deals tend to be less intermediated, often less efficient in price discovery and they’re often negotiated directly between buyer and seller. That’s the kind of competitive dynamic we don’t mind engaging in.”

AN EVOLVING MARKET

The private equity secondary market has evolved slowly over the past 25 years or so. Once it was purely an outlet for distressed LPs to unload their obligations; now, it’s also an essential tool used by investors to manage their portfolios.

“There was this little tag of shame associated with having to do a secondary sale,” Cassidy says. Sellers “wanted to make sure the process was highly confidential, so ‘If I can’t fund my capital calls, I don’t want anyone to know.’”

Equally, GPs’ views on secondaries have also evolved over the years. Once there would be consternation at the thought of one of their LPs contemplating selling out of their fund. These days, GPs are generally happy to know they have an outlet to allow an unhappy LP to get out of their obligations, potentially in favour of another more suitable partner.

“Secondaries allow [GPs] to enhance their LP base... GPs realise secondaries sales are an opportunity for them,” Marks says.

And while big portfolio sales tend to grab the headlines, another important change is that sellers now realise they don’t necessarily have to sell whole portfolios in one go; instead, they can chip away at offerings by passing on smaller stakes to numerous buyers, according to Cassidy and Marks.

Capital Dynamics has taken advantage of this development to “cherry pick” their favoured GPs from larger offerings, they add. “That’s what we do and we see others doing it,” says Cassidy. “If I’m keen on a geography or a sector, I’ll look for those particular funds.”

Adds Marks: “Sellers are becoming more mosaic in situations; they’re not always willing to take a portfolio discount if they can do better.”

CAPITAL DYNAMICS’ WORLD

With a \$276 million secondaries vehicle that is less than half invested, Capital Dynamics has plenty of firepower – and a big universe of supply from which to choose. So the fund of funds narrows down its opportunity set by working with certain sellers – like small family offices, pensions and endowments and even mid-sized banks.

The latter is a particularly interesting area, says Cassidy. Many mid-sized banks built private equity exposure either because they were interested in building relationships with firms so they could get involved in deal financing, or because they had a senior executive not with the bank anymore who once liked the asset class.

“You’d be amazed at what’s in some of these small banks’ portfolios,” she says. “They’re not what anyone would classify as strategically composed portfolios; they’re not necessarily designed as a balanced private equity portfolio. It’s like a dog’s breakfast.”

Now, the banks want to sell. “We’re at the beginning of seeing it from all other mid-sized banks out there in America, of which there are loads that have private equity for sale,” Cassidy says.

This “phenomenon” of small banks trying to offload their private equity portfolios is mirrored by small endowments, small family offices and even small pension funds, according to Marks. As a result, “there’s a very meaningful role to play in the much less efficient sections of all those markets,” he says.

The vast majority of Capital Dynamics’ deals involve GPs that it already knows. Here, the firm has an in-built advantage thanks to the information it gets from its primary fund of funds business. “We have a treasure trove of information,” Marks says. As such, both sides of the business work together to make sure the firm is chasing the best deals.

What’s more, he adds, the firm can bring “world class” research capabilities to its investment process. And then there’s its global presence; although headquartered in Switzerland, it has offices in London, New York, Zurich, Tokyo, Hong Kong, Silicon Valley, Sao Paulo and Munich, among others.

“When you look at those three factors, that gives us a good advantage at what we think is the more attractive part of the secondaries market because of its inefficiencies,” Marks says. ■

COMPANY PROFILE CAPITAL DYNAMICS

Capital Dynamics* is an independent asset management firm focusing on private assets including private equity, clean energy and infrastructure, and real estate. Capital Dynamics offers investors a range of products and services including funds of funds, direct investments, separate account solutions, and structured private equity products.

Our senior investment professionals hold an average of over 20 years of investing experience and due diligence expertise, gained through diverse backgrounds as fund investors, direct investors, and co-investors. With 160 professionals and 10 offices worldwide, Capital Dynamics is able to deliver top-quality service to its client base of sophisticated institutional investors such as pension funds, endowments, family offices, high net worth individuals, and advisors.

Headquartered in Switzerland, Capital Dynamics has offices in London, New York, Zurich/Zug, Tokyo, Hong Kong, Silicon Valley, Sao Paulo, Munich, Birmingham (UK) and Brisbane.

Secondaries

Our Secondaries team is led by Managing Directors, Martha Cassidy and Joseph Marks; with five dedicated professionals in New York and Zurich, and additional support as needed. The team is fully integrated in the broader investment management team, and leverages our entire global platform, network of contacts and relationships to source, diligence, and transact on a global basis. Our secondary capabilities are further augmented by our portfolio and risk management team's sophisticated tools and extensive quantitative experience.

Focus on innovation and quality

Capital Dynamics is an industry leader in quantitative risk management; an essential component of successful private equity investing. The importance of risk management has intensified due to tighter financial regulations and heightened investor awareness. Our Portfolio and Risk Management team conducts customized, in-depth client portfolio analyses and our Portfolio Servicing team provides comprehensive and dedicated back office services for a diverse set of global investors.

We are proud of our distinguished reputation within the private equity community. In 2011 and 2010, we were voted "Fund of Funds of the Year in Europe" by Private Equity International.

Capital Dynamics is a signatory of the United Nations Principles for Responsible Investment (PRI). Our emphasis on quality has been recognized with the International Standard ISO 9001:2000 certification of compliance.

Investment types²

Primary fund investments – We have invested in private equity funds since the late 1980s, spanning all geographies and strategies. We have

established solid relationships with over 400 General Partners, and monitor 788 active funds.

Secondary fund investments – Active in the secondary market since the early 1990s, we raised one of the first dedicated secondary funds. The combination of our large number of existing fund investments and proprietary databases often provides an information advantage when evaluating secondary transactions.

Direct investments – Our extensive relationships with the globe's top-tier fund managers provide a consistent volume of high-quality investment opportunities. Our co-investment strategy is focused on mid-market buyouts, but also includes select development capital and special situations.

Clean Energy and Infrastructure – Our specialized team of senior industry investors employs a direct investment strategy focused on a diverse mix of clean and low-carbon energy assets that can offer attractive risk-adjusted returns and compelling diversification benefits from this emerging class of real assets.

Real Estate – Members of our Real Estate team have been investing in real estate funds since 1990 and maintain relationships with fund managers around the globe.

Structures

Funds of funds – We offer private equity, primary and secondary funds of funds, allowing investors to implement a global allocation strategy through access to premier private equity managers, in addition to portfolio diversification.

Separate accounts – We assist clients to create individual programs to meet unique risk profiles and liquidity constraint parameters. We offer legal structuring services to meet the regulatory, tax and compliance requirements for each separate account client.

Structured products – We customize solutions one client at a time. Every structured solution is designed to deliver compelling benefits such as early liquidity, enhanced return on investment, reduced risk, lower open commitments and/or decreased risk-weighted capital reserves.

Please contact us at info@capdyn.com, or visit our website www.capdyn.com for further information.

* "Capital Dynamics" comprises Capital Dynamics Holding AG and its affiliates

² History includes 2005 acquisition of Westport Private Equity Ltd., and the Real Estate team's prior experience



Performance: the result of long-term dedication

We understand the dynamics of performance and know that long-term dedication to uncompromising quality is the best route to success. Capital Dynamics is an award-winning private asset manager highly skilled in funds of funds, separate accounts and structured products.

To discover how our extensive experience in private equity, clean energy and infrastructure, and real estate – together with our long-standing industry relationships – can link you to the full potential of private assets, please contact us at info@capdyn.com.

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