KEYNOTE INTERVIEW **FONDINVEST**

Q&A: How Fondinvest sees the secondary market

Charles Soulignac, *founder and managing partner of Fondinvest Capital, talks about the wealth of deals on the secondary market today, pricing and the approach the firm is taking to generate the best returns for its LPs*

Explain the Fondinvest approach to the secondary market:

At Fondinvest, the secondary business is dealt with separately from the primary business. The inception of the Firm's secondary investment activity took place in 1996 with the creation of Fondinvest II, a €68 million secondary fund dedicated to the acquisition of seasoned secondary assets. Since then, we have launched three other secondary funds for a total amount of €800 million. Through our secondary funds, we intend to provide investors with an attractive risk-adjusted opportunity to access the strong returns of private equity assets over a condensed cash flow period. Our secondary investment strategy has remained unchanged since the launch of our first secondary fund. We have focused on primarily acquiring European mid-market assets in the global secondary marketplace, targeting small- to mid-sized transactions that range in total deal value between €0.5 million and €50 million. Interests sought include shares in existing private equity funds, tail-end funds as well as portfolios of direct investments. In this specific case their management is entrusted to appropriate teams. We are currently investing Fondinvest VIII, our last secondary vehicle raised in 2008.

Soulignac: *carefully choosing deals*

What are the current challenges to making investments?

At Fondinvest, our secondary investment activities' objective is to provide investors with strong and quick cash returns. Thus, a rigorous and disciplined investment process is required to repeatedly achieve such performance. A high selectivity is necessary to carefully select mature assets that are strongly funded at the time of acquisition, that offer realisation events producing near term cash flows, and that are not using leverage. Leverage has an unfavourable impact on the overall performance as it "confiscates" the early distributions received by the fund to first reimburse the incurred debt.

What is currently happening to secondary pricing in your view?

In the last 12 months, the secondary pricing for private equity funds has been showing a continued strength and therefore resulted in a decrease in discounts to net asset value. This is due to a combination of two factors: first, a better alignment between buyer's and seller's expectations on secondary prices; second, the maturation of the market as more investors are aware of the benefits of buying fund interests on the secondary market and therefore are inclined to acquire assets at smaller discount to NAV to take advantage of these benefits. Pricing for secondary transactions is likely to stay strong over the coming years, with non-price factors like execution speed and confidentiality that will play a significant role within secondary sales processes.

Is secondary investing still flavour of the month with institutional investors or have they been put off by the sheer volume of capital committed to the strategy?

Investors' appetite for secondary investing is still huge as secondary investing is an attractive alternative to primary investing. It enables J-Curve mitigation thanks to an

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accelerated deployment of capital coupled with a shorter duration, offers a stronger diversification in terms of vintage, and is a way for investors to gain further exposure to certain GPs they value. It also reduces risk.

> "Our secondary investment activities' objective is to provide investors with strong and quick cash returns"

Are you seeing the effects of a capital overhang in the market?

In recent years the secondary market experienced similar growth to that of the primary market over the last four to five years, with about 20 pure secondary players raising funds bigger than ever and looking for a way to further enlarge their investment capacities. In addition to this, an increasing number of buy-side participants (non-specialist, primary-focused private equity investors) entered the market to enjoy the benefits of buying on the secondary market. However, their motivations differ from those of the pure secondary players. They consider secondary investments a marginal activity and use them to reduce the J-Curve effect of their investment, whereas secondary specialists seek outstanding performance.

Who are the most active sellers in the market today?

Sellers' profiles differ from one to another depending on the asset type you are willing to buy. When looking at our 2010 deal flow that relates to European assets, the most active sellers were banks, insurance companies and investment structures. Banks and insurance companies were coming to market to offload non-core and illiquid assets due to new regulation pressure, whereas investment structures were much more in an active portfolio management position trying to rebalance their portfolio and exit poor performing funds.

Now that discounts have narrowed, have you sold any fund interests?

The discount results from an analysis of the underlying assets in terms of potential exit, exit timing and expected gains from investments, with regards to the performance expected by the investors in secondary funds. To my point of view, the quality of assets as well as the quality of the general partner are key criteria to assess rather than simply assessing the size of the discount when considering selling fund interests. Concerning our current position as a seller, I would say that we generally do not sell any fund interests during the early stages of the life cycle of the vehicles we manage (primary funds of funds/secondary funds). This topic only appears at the end of the life of the vehicles when net asset value is very low. So discount levels have no impact on our appetite to sell fund interests.

Is the supply of deals out there increasing or decreasing?

The supply of deals increased in 2010 compared to 2009 and this will continue over 2011. More than a simple matter of deal volume, of more significance is the type and quality of assets now available on the market. If early secondary interests (lightly funded positions) once accounted for a significant portion of secondary deal flow volume, it is not true anymore.

What differentiates Fondinvest from other fund of funds who are playing in the secondary space? How do you avoid being seen as a "tourist" from the world of primary funds of funds?

Fondinvest created one of the first secondary funds in Europe in 1996 and is recognised as a seasoned player on the secondary market, having executed more than 120 secondary transactions during the past 15 years. As explained previously, our primary and secondary businesses are dealt with separately and therefore we are not considered a fund of funds manager making secondary investments but a proper secondary fund manager. Today, Fondinvest Capital is recognised as a well-informed buyer, sensitive to the seller's needs and capable of making an offer at fair asset value.

What is your prediction for the next 12 months: will you be more focused on primary or secondary deals?

The two businesses (primary investing and secondary investing) are both based on opportunities in the market. And now that investment activities have recovered on the primary side and since deal flow is still strong on the secondary side, the timing is good for us to pursue the two parallel activities as we did in the past through separate vehicles. ■

Charles Soulignac is the founder and managing partner of Fondinvest Capital. He joined CDC Participations as an associate in 1989, where he managed investment in private equity funds and direct equity investments. He has also previous experience in industry (Potain), consultancy (Maynard) and finance (BRED). He started the fund-of-funds business in 1994. He has been a member of the European Private Equity and Venture Capital Association's board of directors and investor relations committee.