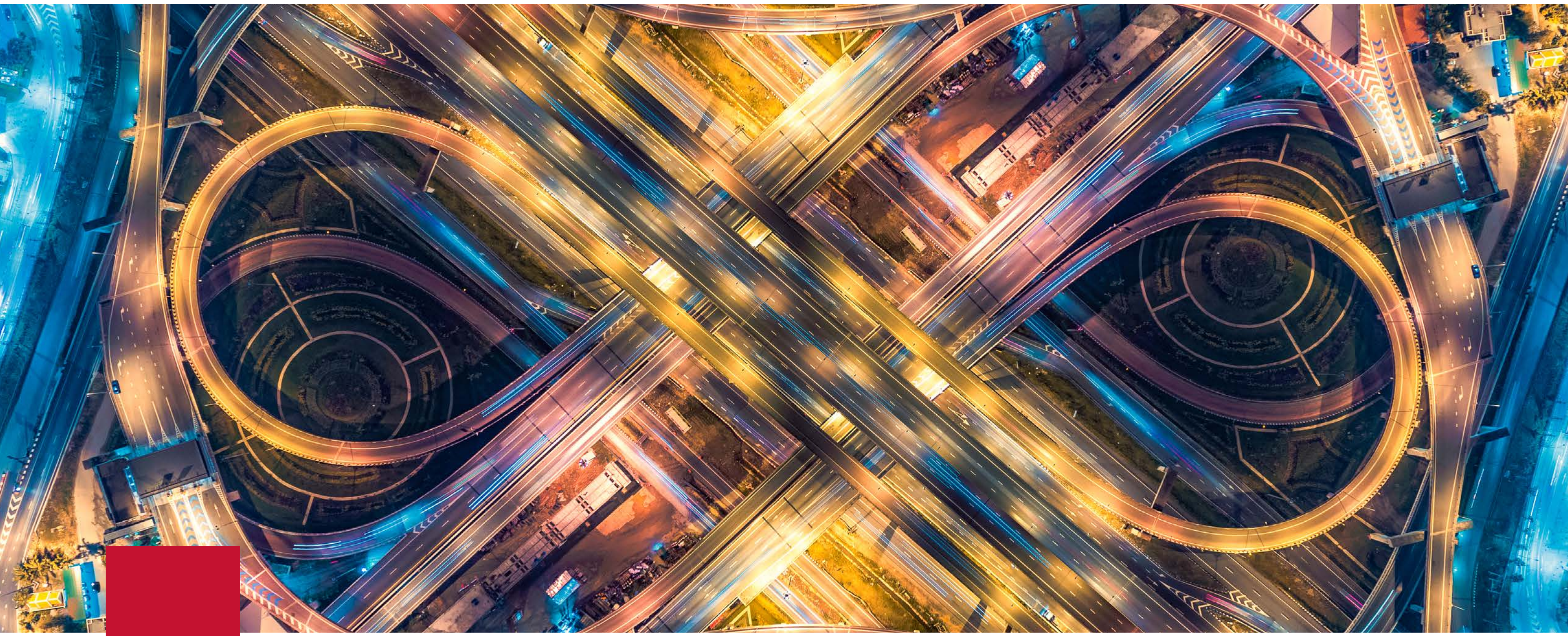

PART 2 OF 3

PRIVATE MARKET INSIGHTS

THE DEVELOPMENT OF COMPLEX SECONDARIES: SPINOUTS AND BUY-INS

Team spinouts and buy-ins first emerged in the mid-1990s as a response to corporations and financial institutions looking to move direct private assets (and the in-house, "captive" teams managing them) off their books for strategic and/or regulatory reasons.

A minority of secondary buyers are capable of structuring and executing these deals, compared to the traditional segment of the market, as – among other challenges – they demand the creation of an entirely new vehicle to manage the acquired assets. Accordingly, fewer firms are able to access this differentiated deal flow and unlock the disproportionate value that typically exists in such complex secondary opportunities.

TEAM SPINOUT/BUY-IN (EMERGED MID-1990s)

In simple terms, team spinouts involve the purchase of a portfolio of direct investments alongside the existing management team.

From a strategic perspective, in the 1990s some private equity investment units within larger businesses were viewed as non-core assets, making them prime candidates for sale for parent organizations seeking liquidity. From a regulatory perspective, new regulations such as the Volcker Rule, implemented following the global financial crisis, often compelled financial institutions to move private assets off their balance sheets.

In many scenarios, "spinning out" the unit wholesale – including the existing captive management team – rather than just buying the assets made sense for a potential secondary buyer. The buyer would immediately have a team in place that is intimately familiar with the assets under management, which creates continuity and could reassure both investors and underlying companies that might be concerned about a sudden change in ownership. For the captive team being spun out, this process can potentially serve as a career-making move, with the right partner helping them to become an independent private equity franchise. Executing on this idea is, however, rather complicated.

THE COMPLEXITY OF SPINOUTS AND BUY-INS

1. Significant challenges associated with the detailed tri-lateral negotiations needed to reach a mutually agreeable price and transaction structure
2. Legal complexity stemming from the buyer's need to create a new limited partnership to manage the purchased assets, with detailed and customized governance and economic terms
3. Managing the transition of the team from a captive in-house investment team to an independent GP

Buy-ins are very similar to spinouts, but the purchased portfolio of investments is managed by a new team rather than the original team. Generally speaking, in such transactions the original team that constructed and managed the portfolio is no longer in place, and a new manager needs to be retained. The challenges presented are similar to spinouts, though with the additional need to select the most appropriate GP to manage the assets.

Case Study: Spinout Transaction
June 2016

Transaction: $377 million acquisition of portfolio of companies based in Australia and New Zealand owned by a financial institution in South Africa. Incumbent team was retained as a new independent GP.

Opportunity: Attractive pricing as the parent financial institution was looking to fully divest the portfolio as part of a broader asset wind-down program. Captive management team had not made new investments for several years and was keen to become an independent manager, with a fresh source of capital, in order to do so.

Challenge: The seller's investment in the largest company in the portfolio was through a minority interest; the majority owners were likewise looking to sell their holding, and they preferred ownership continuity. The profile of the seller and the steps necessary to transfer the underlying assets required a highly bespoke deal structure and a complicated closing process.

Solution: Drew upon relationships to develop a solution that satisfied all stakeholders. HarbourVest capitalized a new fund that acquired both the existing portfolio from the seller and a controlling interest in the largest portfolio company from the majority owners; also provided growth capital for the now independent GP. At the same time, two co-investors were added to the investor base, both of which were given advisory board seats with direct access to the GP. Terms were highly customized to align interests of HarbourVest and the management team.

The deal summary, general partner, and/or companies above are intended for illustrative purposes only. While this is an actual investment or relationship in a portfolio, there is no guarantee it will be in a future portfolio.

For part one of this series, which examined GP-led transactions, please click here. For part three of this series, which will look in more detail at public market transactions and structured liquidity solutions, please click here

For more information on secondary funds, and how HarbourVest may be able to help you achieve your investment goals, please get in touch with your HarbourVest contact or email clientservice@harbourvest.com