

# A History of Success

*“Investor interest in the private equity market has grown substantially over the last 10 years. Private equity has now gained wide acceptance as being an attractive, alternative component to an institutional portfolio, generating high absolute returns over the long-term.”*

Established in 2001, Capstone Partners has built a successful track record in raising capital for both established and emerging fund managers. Acquisition International speaks to David Chamberlain, partner in charge of Capstone’s European activities with particular responsibility for business development and secondary market placement services about the firm’s history of success alongside private equity and real estate firms operating across all types of strategies and geographies.

With offices in North America, Europe and Asia, Capstone provides global fundraising and advisory services to private equity and real estate firms around the world.

Capstone serves both investors and general partners for the transfer of interests in private equity funds. The firm aims to build a bridge between long-term strategic investors and general partners to the mutual benefit of all parties concerned. Capstone’s priority is to work with “primary” private equity fund investors, optimising value and securing long-term investor relationships.

For investors seeking to dispose of their interests in private equity funds, the firm brings clarity and help develop a coherent strategy. David Chamberlain added: “We optimise value for the selling investor, whenever possible, through the transfer of private equity fund interests to replacement long-term strategic “primary” investors. We provide anonymity to the seller, acting in our name on their behalf throughout the process of negotiation, sale and transfer. We also bring experience and professional execution skills to the legal and administrative complexity of transferring ownership.”

For replacement long-term strategic investors, Capstone Partners provide attractive investment opportunities in the secondary market which would otherwise be difficult to acquire. In so doing, they enable “primary” investors to expand their exposure in private equity to mature, invested funds managed by general partners with whom the investor would like to build a long-term relationship.

For general partners, the firm help to ensure a stable base of long-term “primary” investors by providing attractive replacement investors with a strategic interest to develop a long-term relationship with the general partner. In addition, they act as the sole intermediary between the general partner and potential investors, facilitating the supply of information and negotiation of the transfer of interests. Capstone Partners therefore relieve the general partner of much of the time consuming task of managing investor transfers.

## **How does your firm stand out from its competitors in terms of the services you offer?**

David Chamberlain answers: “Investors exposed to long-term alternative assets, such as private equity funds, have an objective to optimise the value and ultimate liquidity of their investment interests. Private equity firms should aim to ensure that their current and future funding are secured by a diversified group of long-term strategic investors. Capstone helps investors and fund managers to fulfil these goals by identifying attractive replacement investors and managing selective auctions to optimise the terms and conditions of sale and transfer.

“Capstone’s role is to act as the interface between the general partner, the seller and potential acquirers of the limited partnership interests, thereby significantly reducing the time and resources that both the general partner and the seller would need to make available to facilitate the sale and transfer of interests. Capstone therefore manages and co-ordinates the following aspects of a transaction:

- Identification of attractive potential investors (subject to prior approval by both the general partner and the seller)
- Establishment of the terms and conditions of the sale and transfer process with potential investors
- Completion of confidentiality agreements with all potential investors
- Preparation of a summary Offering Memorandum for investors
- Handling of all investor questions
- Collection and evaluation of all offers from potential investors
- Recommendation of the preferred acquirer(s) to the seller and the general partner
- Negotiation of all transfer documents
- Co-ordination of the payment of money and transfer of interests
- Co-ordination of the creation of any special investment vehicle to facilitate the transaction

## **David what types of secondary transactions are attractive at this time? Do you focus on a particular asset class?**

“As an experienced participant in the primary fund placement market, we appreciate the effort that general partners must make to secure attractive long-term strategic investors. These investors are



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important for the future continuity and funding of the general partner’s investment strategy. However, as investors increasingly look to the secondary market for liquidity, general partners risk to lose control of certain of these strategic relationships. Capstone’s strategy is to seek to identify attractive replacement investors whose interest to acquire a fund will optimise value for the selling investor and secure a future strong relationship for the general partner. Our understanding of the private equity fund market and our experience in negotiating secondary market transactions allow us to manage secondary offerings in an efficient and unbiased manner, to the mutual benefit of all parties concerned.

“The last few years have been particularly challenging for private equity firms to raise new primary capital. A secondary transaction in an earlier fund, stapled to a primary investment in a new fund, can therefore serve as a valuable means of attracting investors to secure a primary fund raise. Capstone has successfully assisted general partners covering a range of different strategies including buyouts, growth capital, venture, distressed and debt.”

**David, have you witnessed an influx of buyers from the primary market? If so, what are the reasons for this?**

“As investor interest in the private equity market matures, so we see the emergence of a sizeable secondary market with a number of private equity funds dedicated to purchasing secondary limited partnership interests. Although the emergence of the secondary market has improved liquidity

for investors, these dedicated secondary funds are deployed with a high degree of sophistication and aim to maximise profit for their investors. They represent large pools of capital and dominate activity within the secondary market, exploiting the relative inexperience of sellers of private equity funds in dealing with the complexity of valuation, negotiation and closing of secondary transactions.

“More recently, a growing number of traditional “primary” investors have developed an interest to acquire private equity funds through the secondary market. This interest is driven by the strategic importance of combining secondary investments in a traditional “primary” fund portfolio:

- Accelerated cash flows with a rapid deployment of capital and earlier distributions
- Avoidance of the J-curve
- Vintage year fund diversification
- Access to top-tier managers
- Establishment of new general partner relationships

“The objectives of a “primary” private equity investor are therefore multiple and not simply driven by acquisition price. As a result, we believe that a seller of private equity funds can capture a price premium by selling to a strategic investor rather than to a specialised secondary investment fund. We do not, however, exclude specialised secondary investment funds from the process. Their level of sophistication, valuation skills and capital availability may, in certain circumstances, make them the preferred acquirer of a fund interest.”

So at what stage is it common to buy or sell secondary assets? What factors might encourage an individual to do so?

David Chamberlain concluded: “Investor interest in the private equity market has grown substantially over the last 10 years. Private equity has now gained wide acceptance as being an attractive, alternative component to an institutional portfolio, generating high absolute returns over the long-term.

“As the market matures, so the aims and objectives of certain investors change, requiring a more active approach to portfolio liquidity management. Investors will look to divest part or all of their private equity portfolios for a number of reasons:

- Restore private equity asset allocation to target levels
- Optimise investment performance and balance sheet liquidity
- Respond to poor fund performance or changes to the general partner
- Dispose of investments that no longer offer strategic value
- Focus on key general partner relationships
- Exit non-core assets
- Adapt to regulatory changes

“Most investors have not had to deal with the complex process of divesting interests in private equity funds. The inherent illiquidity of the asset class combined with the absence of an organised secondary market can make selling a difficult process. This can therefore deter investors from pro-actively managing their private equity portfolio or result in sub-optimal returns if sales is not skilfully negotiated.”