

# Buyouts

www.buyoutsnews.com

YOUR SOURCE FOR LEVERAGED AND MANAGEMENT BUYOUTS

## LP PROFILE: NEWBURY PARTNERS PROMISES TO KEEP A SECRET

By David Toll

### At A Glance

**Name:** Newbury Partners

**Founded:** 2006

**Leader:** Richard Lichter

**Investment Professionals:** 8

**How It Got Started:** Lichter went out on his own after closing a debut \$410 million secondary fund for Auda Advisor Associates LLC in 2004; the team he built at Auda left to join him shortly after.

**Debut Secondary Fund:** Newbury Secondary Fund

**Target:** \$750 million

**Raised To Date:** \$500 million-plus

**A** corporate investor in a vintage-2004 buyout fund this January quietly sold its interest on the secondary market. Why would it want to do that? To undo what it thought had been a mistake.

According to **Richard Lichter**, managing director of the buyer of that interest, **Newbury Partners**, executives at the company made their first and only buyout investment based on the prospect of generating 20 percent annual returns. But after more than two years, they hadn't received a single distribution. Their financial statements showed a paper loss. Embarrassed, and perhaps not as familiar with the J-curve as they could have been, the executives sought to dispose of the interest quickly and quietly.

Looking to be helpful, the general partner introduced the investor to Newbury Partners, a one-year-old, New York-based secondary firm that's well on its way to raising a debut \$750 million fund. After taking a magnifying glass to the portfolio, Newbury Partners agreed to buy the interest for something less than \$10 million. The seller also introduced the firm to another company eager to sell its interest in the same fund. Newbury Partners closed on both transactions simultaneously, just over a month after first hearing about the opportunity.

The pair of deals illustrates one of the ways secondary buyers like Newbury

Partners have generated such good returns over the years. Investors looking to sell their LP interests on the secondary market don't always put securing top dollar at the top of their priority lists. Often they value confidentiality and speed of closing just as highly. The sellers in the example above might have landed a higher price by hiring an advisor to shop their LP interests around. But the value of their partnership investments was "almost insignificant" next to their overall asset bases, Lichter said. As such, they happily traded some upside on the sale to work with a buyer that could help them save face.

### Source Of Returns

Institutional investors have flocked to secondary funds since the mid-1990s, especially during bull markets that bring out the contrarian lurking inside many investors. (The secondary market tends to gather steam during troubled times.) A cursory analysis of return data published by public pension funds and endowments demonstrates that such bets often pay off.

From publicly available sources *Buyouts* identified 10 secondary funds spanning vintage years 1993 to 2002 and managed by four well-established buyers—**Collier Capital**, **Landmark Partners**, **Lexington Partners** and **Paul Capital Partners**. (Earlier in his career Lichter did stints at both Landmark Partners and Lexington

## Why Sellers Value Confidentiality

- **They don't want to appear distressed.** It's no secret that one of the main reasons organizations sell LP interests on the secondary market is to address some form of financial trouble. Whether they're in trouble or not, many sellers want to avoid sending this kind of message.
- **They don't want to embarrass themselves.** Sellers unloading what they believe to be a poor-performing LP interest may be looking to avoid public embarrassment.
- **They don't want to embarrass the general partner.** Banks and other investors often have strategic relationships with buyout firms in which they provide investment banking, lending and other services. They may have any number of benign reasons that they wish to sell a LP interest beyond performance; for example, a bank may wish to pare back its exposure to a particular fund to free up money to back other buyout funds. Realizing that selling the interest openly could raise questions about the fund's performance, the bank may seek instead to sell quietly.
- **They may value secrecy as a cultural matter.** Investors in the Middle East, for example, prefer that their investment decisions stay out of the newspapers.

Partners.) All of these funds have made money for their investors as of December 31, 2006, achieving a median investment multiple of 1.6x. To be sure, generating a 1.6 multiple wouldn't be much to write home about for your typical venture capital or buyout firm. But secondary firms typically buy into funds that are well along into their investment periods, or even later; as a result, they return distributions to their investors much faster than other firms do. Hence, the healthy median IRR of 19.8 percent generated by the group as of year-end (minus one fund that did not provide IRR data).

Achieving such returns often requires buying assets at a discount to net asset value. The strategies for doing so are many. One common approach is to seek out motivated sellers desperate to raise

Newbury Partners. The smaller the portfolio up for sale, the fewer companies the firm has to evaluate. This gives the firm a chance to plunge into their financials to really understand what it's paying for. In addition, because smaller sums of money are at stake, sellers—especially deep-pocketed sellers—have less to lose by sacrificing a few percentage points on the purchase price. That means they can concentrate on getting the kind of transaction they want, such as one done speedily, and in confidence (see sidebar, this page). Needless to say, one of the best ways to avoid leaks is by limiting the number of potential bidders, which suits Newbury Partners just fine. According to Lichter, the firm faces competition on fewer than half of its transactions, often sits down directly with the seller to negotiate price,

**“People [sell] all the time, for all different reasons. Because there's no stigma, and because private equity has grown tremendously over the last few years, there's a lot of secondary deals out there.”**

—Richard Lichter

Managing Director, Newbury Partners

cash and unwilling or unable to play hard ball in negotiations; should the economy slow further we may be heading for another period rife with such sales. Another approach is to buy interests in less desirable funds managed by second-tier, third-tier and fourth-tier shops. Such interests command lower prices than interests in the brand-name funds (which often sell at premiums to net asset value) but may nevertheless hold their share of hidden gems.

As the secondary market has grown, buyers have had to get more creative in scratching out pricing advantages. Newbury Partners's formula centers on avoiding competition in a market full of competitors. Newbury Partners averages \$20 million per purchase, but will buy portfolios for as little as \$10 million, \$5 million, or even less. Doing so lets the firm largely avoid clashes with firms managing multi-billion-dollar pools, Lichter said.

Concentrating on smaller deals also produces important side benefits for

and it wins about one in every four deals that it submits a bid on.

Since becoming a partner at Landmark Partners in 1992, Lichter has led about \$200 million worth of transactions per year—a pace he expects to maintain. He's developed particular expertise in Italy and Japan, and about two-thirds of the sellers in his deals have been located outside the United States. Lichter estimates that a healthy percentage of the \$8 billion to \$9 billion in annual worldwide secondary deals fits the profile of a Newbury Partners transaction.

And the future looks promising. Sellers may wish to avoid embarrassment. But so many institutional investors have now availed themselves of the secondary market for benign reasons that selling LP interests doesn't carry the stigma that it once did. Said Lichter: “People [sell] all the time, for all different reasons. Because there's no stigma, and because private equity has grown tremendously over the last few years, there's a lot of secondary deals out there.”