



## Legacy Assets

### ► Is it time to spring clean your portfolio?

**A typical private equity fund structure comprises a 10 year limited partnership with provision for limited extensions to allow for the liquidation of the last remaining investments.**

In most funds, there are a small number of residual investments that, for a variety of reasons, are not realised in accordance with their original investment strategy. This results in a large number of funds having to be extended beyond their intended term. From the perspective of the GP, this can result in an unwanted distraction from the management of more recent (and usually higher value) investments. For LPs, the result is a growing number of small residual fund interests which require administration and a similar diversion of resources.

As private equity firms generally raise larger successor funds, the assets remaining in their older funds, and the consequent value of LP holdings in such funds, tend to be relatively small. The natural consequence of this is that residual investments have a relatively low priority for both GPs and LPs, and opportunities to maximise the value remaining in such assets can be overlooked.

### ► From the LP Perspective

**Investors who have been active in the private equity asset class for any length of time are likely to hold interests in a wide range of funds.**

An investor's portfolio will reflect the original objective of diversification by geography, type of investment and other specific criteria. It is also likely that the portfolio will reflect periodic changes in strategic priorities and asset allocation policy. As a consequence, after a number of years, a substantial majority of investments by number are likely to only account for a relatively small proportion of the portfolio by value – in general, the 80/20 principle applies.

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The argument against selling the legacy assets has historically been that “they don't take much time to manage”, and that the discount a purchaser would seek would require an unacceptable write off. Recent growth in demand for secondary assets has, however, seen a narrowing of discounts, and in some cases buyers paying a premium to Net Asset Value. While a passive approach to the management of such positions is common, an alternative approach can improve investment returns. Furthermore, it is not unusual for there to be a time consuming requirement to restructure old partnerships. There are also often opportunities for active investors to work with GPs to create value from the last remaining assets in funds – clearly this is not possible for a passive limited partner.

For example, Hollyport Capital recently purchased a portfolio of over 30 fund interests in mature funds from an institution looking to streamline its private equity portfolio. The attraction to the seller was its ability to secure an attractive price and the opportunity to be released from the ongoing administrative burden. From our perspective, the acquisition is providing the opportunity to work with a number of the GPs to explore value creation opportunities from the remaining fund assets.



### ► From the GP perspective

There are considerable advantages to the GP from selling the remaining assets in an old fund and focussing on the next generation of investments.

**For fund managers, taking mature funds through the final process of an orderly liquidation is rarely a straightforward or smooth process.**

There are almost invariably some investments that, for whatever reason, fail to achieve their original business plan and associated realisation objective. The GP is rightly focused on later funds where his principal responsibilities lie.

Tired investments require a new strategy and often additional investment under the direction of a focused and motivated manager if they are to achieve tangible value growth and an attractive exit. From the GP's perspective, its attention is likely to be focused on more recent funds, which are likely to contain higher value assets and represent a far greater proportion of its funds under management.

There are therefore considerable advantages to the GP from finding a way to sell the residual assets from old funds at an acceptable price, winding up the fund and concentrating on the next generation of investments.

Hollyport Capital works with GPs to put in place solutions to facilitate the closure of funds which are beyond the end of their original term. We are, for example, currently working with a GP who has one remaining asset in a fund that is over 12 years old. The Company is operating in an exciting growth market and requires further investment to exploit the opportunities available to it. Hollyport Capital has introduced a new financial package for the Company and is simultaneously reorganising the old limited partnership. Under this arrangement, existing limited partners can either sell their interest to new investors introduced by Hollyport Capital, or roll over on the same terms. This is enabling the GP to wind up the fund, while offering ongoing participation for limited partners who wish to maintain an investment in this growth opportunity.

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