PRIVATE EQUITY

Better late than never

Under pressure from LPs, private equity firms exit record portfolio buildup

BY MAX FRUMES

Private equity firms of today have held onto their portfolio companies longer than any time in the past decade as limited partners have shown patience due to the extraordinary circumstances of roughly two years of illiquid and down markets.

Yet now, with pretty much every avenue bursting wide open in 2011—initial public offerings, strategic sales, secondary buyouts—LPs are expecting to see an increase in exits.

"The situation is under control, now PE needs to sell some assets," said Vincent Gombault, a member of **AXA Private Equity**'s executive board. AXA manages $10.65 billion in private equity fund-of-funds investments.

Private equity firms held onto their investments for a median time of 5.12 years in 2010, according to Seattle-based data provider **PitchBook Data Inc.**, up from 4.34 years in 2009 and way off the bubble years of 2005 through 2007, when median hold times hovered under an average of four years.

Time to exit is a trailing indicator of the activity of capital markets; the longer the hold time tends to reveal just how stagnant the market is. In many respects, private equity firms are positioned to weather these types of downturns by having control over companies outside the public sphere. As market conditions improve, there's no reason for PE firms to continue to hold onto portfolio companies that have been lingering on their books past the agreed-upon investment period. For those that don't exit these investments on time, good luck with the next round of fundraising.

Some funds have shown complete impotence. **Friedman Fleischer & Lowe LLC**'s $750 million 2004 fund Capital Partners II and **Welsh Carson Anderson & Stowe**'s $3.4 billion 2005 fund WCAS X have yet to exit a single investment, according to PitchBook. Friedman and Welsh Carson did not respond to requests for comment.

Others still have a high portion of their investments left unexited, including **Freeman Spogli & Co.**'s 2004 vintage FS Equity Partners V $1 billion fund that has 80% of its value still held in its portfolio, according to PitchBook. **Warburg Pincus** still holds 40% of the value in its 2001 vintage $5.3 billion eighth fund and 62% of the value in its $8 billion 2005 ninth fund, according to Warburg's own numbers.

Jordan Co. LP, meanwhile, has certainly lived up to its billing as a long-term investor. The firm still has 70% of its 2002 vintage $1.5 billion Resolute Fund unexited and has since raised a $3.6 billion fund in 2008, according to PitchBook. Jordan declined to comment. Freeman did not respond to requests for comment, and Warburg declined to comment beyond providing updated data.

Holding onto a company for too long has mixed results for private equity firms, according to a PE professional speaking on the condition of anonymity. After four or five years, a firm can hit a wall as far as adding value to a portfolio company. After that, the rate of return decreases the longer an investment is held. Yet the longer a PE firm owns a company, the more comfortable it becomes with it and can better identify the best price and time to sell, the source said.

Fortunately, some of the larger LPs, such as investment managers of pensions and mutual insurance assets, are more concerned with a cash-on-cash investment rather than an internal rate of return. That means they would look more for a larger return, even if it takes longer.

"It's a return multiple at the end of the day," said David Turner, managing director and head of private equity at **Guardian Life Insurance Co.** Guardian allocates about 2.5% of its $31 billion in assets for investment, including to private equity. "If for that extra two-to-three years the company is cooking on the back burner [creating a better return], we're OK with that."

Gombault also sees the possibilities for better investing practices following the 2006 to 2007 bubble.

"We are not doing trades, we are doing investments," Gombault said. "We need to come back to something more reasonable, and the GP needs to create value ... and they will need time for that. The time period is reasonable and it's a better business."

Gombault added: "Even for [the average exit time] to rise to six years would not be a big disaster."

However, that's no excuse to not exit if the time is right.

"It's a good time to have maturing or mature assets in a portfolio to sell, because liquidity is picking up," Turner said. Turner spoke in a follow-up interview to his participation in an LP panel at The Deal's 2011 private equity conference.

Furthermore, given the urgency to sell due to fears last year of an increase in the capital gains tax, if there's not a sale process at least under way, an LP might think there are reasons that company is not selling, according to Richard Lichter, managing director of PE secondary firm **Newbury Partners LLC**.

"GPs tried to sell whatever they could realistically sell because of capital gains [taxes]," he said. In instances where "companies that should have gotten sold but did not, that tells me that those companies are probably pretty difficult to sell."

Lichter has a vantage point as a secondary investor, or someone who purchases interests from existing investors in various PE funds. Quite simply, the longer it takes for an exit, the less valuable the investment is from an internal rate of return perspective. He noted LPs that invested in 2004 and 2005 funds expected quicker exits, and said Newbury will be busy in buying up those interests from impatient

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iGate takes majority stake in Patni for $1.22B

U.S. software company's investment underscores the growing clout of India's outsourcing sector

BY JONATHAN BRAUDE IN LONDON

Silicon Valley software company **iGate Corp.** agreed Monday to buy about 84% of Indian software and business process outsourcing company **Patni Computer Systems Ltd.** for about $1.22 billion, and it said it would finance the deal with a $480 million investment from London buyout firm **Apax Partners LLP**.

The stake sale, which has been the subject of on-and-off discussions for the better part of two years, underscores the growing clout of India's outsourcing sector. IGate said in a statement that the merger would create a company with combined sales of close to $1 billion and a head count of almost 25,000 people worldwide, and both sides hailed the deal as an opportunity to sell a wider range of products to a broader customer base.

"It has been our stated intent to scale revenues, customers and expand our vertical capability. We believe the threshold of a billion-dollar revenue will facilitate faster adoption of our iTOPS for Business Outcomes model," iGate CEO Phaneesh Murthy said. "We also believe that the combination will help customers get better service, access to more service lines and deeper pools of expertise."

That assessment was reaffirmed by Patni CEO Jeya Kumar, who said in a conference call Monday that the two companies were similar culturally and in their cost structures, but had very little overlap in either their customer base or geography, even within India. He said there would be "no cannibalization" of products or customers, adding that Patni lacked depth in the financial services products where iGate was stronger, but would bring its own strength in insurance and telecoms software products to the table.

IGate generated sales of $252 million for the year to Sept. 30, 2010, while Patni announced revenue of $689 million for the same period. But in an interview, Murthy said that while his company was smaller in revenue, the two businesses were more similar in size when measured by market capitalization. Dismissing suggestions that his company might lack the management resources to integrate a bigger company, he said the objective was not to put in his own management team, but to build a leadership team from both companies.

At close of play on Monday, Patni's market cap was $1.38 billion, while iGate had a market cap of $1.05 billion. Patni is listed in Mumbai and New Delhi and has a secondary listing on the New York Stock Exchange. Murthy said Indian rules demanded only a mandatory general offer for 20% of a company's free float, and he doubted whether Patni shareholders would actually offer anything like that amount. IGate has no immediate plans to delist Patni.

Murthy said iGate was the fastest-growing player in the sector, with revenue up about 45% during 2010 and earnings up roughly 35%. He said the deal would be cash accretive after one year and the benefits would be even greater over the longer term.

The agreement was delayed for more than a week while last-minute disagreements were settled with the sellers. Murthy said there were bound to be "emotional issues" when a group of founders were selling control of a company they had built up over 35 years, but that patient negotiating had won the day.

"So long as you have patience, things get done," he said.

Under the terms of the deal, the founding Patni brothers will sell about 45.6% of the Mumbai-based business, while the company's existing private equity backer, **General Atlantic LLC**, will sell its 17.4% holding. IGate of Pittsburgh and Fremont, Calif., will pay 503.5 Indian rupees ($11.05) a share, or a total of around $921 million. It will also launch a mandatory general offer to other shareholders for a further 20.6% at the same price, or about $301 million.

Nasdaq-listed iGate said it would finance the acquisition of the larger company by a combination of cash-in-hand, debt and equity financing, including a potential public offering of up to 10 million shares.

Rather than buy directly into Patni, Apax, through its vehicle Viscaria Ltd., will buy $270 million of preferred iGate stock, convertible into common stock at a conversion price of $20.30 per share. It will make a further investment of up to $210 million into iGate's planned share offering.

IGate said it also has commitments for debt financing of up to $700 million from **Jefferies & Co.** and **RBC Capital Markets**.

IGate is taking financial advice from Tina Longfield of **Jefferies & Co.**, while its legal advisers are Srinivas Kaushik of **Kirkland & Ellis LLP** and Haigreve Khaitan of the Indian legal firm **Khaitan & Co. Kotak Mahindra Capital Co. Ltd.** is manager for the open offer. Kirkland & Ellis partners Fred Tanne and Sue Zachman are representing Apax on its investment, and Jay Ptashek and a Kirkland & Ellis team are also advising iGate on debt financing.

The Patni brothers are advised by Mumbai corporate finance house **Ambit Holdings Pvt. Ltd.** and the law firm **J. Sagar Associates**. General Atlantic is advised by **Credit Suisse Group**.

Apax did not return calls for comment. ■

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LPs if the first quarter isn't as active as others predict.

And if an asset has been in a portfolio for an extended period of time, that could present an opportunity.

"If it's been on the books for six years, at that point you have a lot of data on the company," he said. ■