Q&A

Why these French retail vehicles are spurring secondaries dealflow

Ludovic Douge, head of secondaries at advisory firm and placement agent Jasmin Capital, discusses FIPs and FCPIs and why an inability to extend the vehicles' lives is spurring restructuring opportunities.

By Adam Le - 10 mins ago

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Ludovic Douge

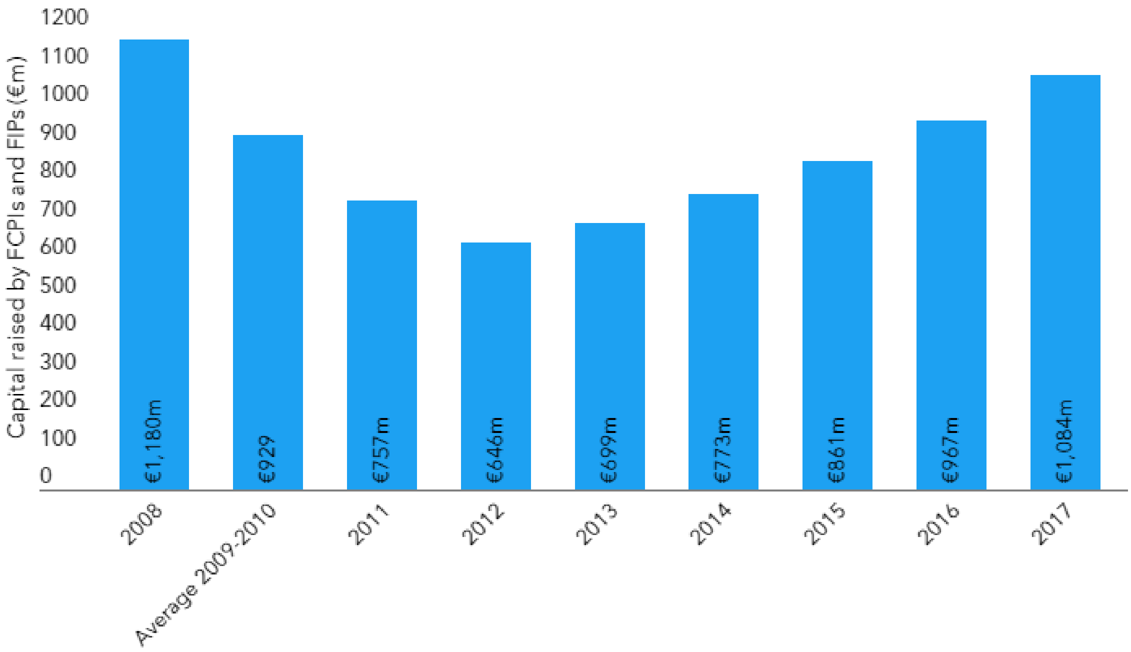
What are FCPIs? How much capital have they raised in recent years?

FIPs (Fonds d'Investissement de Proximité) and FCPIs (Fonds Commun de Placement dans l'Innovation), not to be confused with FPCI (Fonds Professionnel de Capital Investissement, a common institutional fund structure in France), are private equity vehicles dedicated to retail investors willing to invest in innovative and local SMEs while getting a tax incentive. Unlike traditional PE funds that are raised every four or five years, FIPs and FCPIs are raised every year with investments mostly in European VC and Growth companies.

As shown in the chart, in 2017, for the first time since 2008, more than €1 billion was been raised through 31 FIP and FCPI vehicles, a 12 percent increase compared with 2016, according to France Invest/AFG.

A GROWING OPPORTUNITY

Capital raised by FCPIs and FIPs from retail investors



Source: France Invest/APG – March 2018

Can you explain why FIPS and FCPIs have been driving secondaries deals?

We see three main factors:

1. Regulatory: constraints about liquidity from the regulator are strong. Compared with a traditional PE fund where the GP can ask for an exceptional extension to its LPs, FIP and FCPI managers are expected to strictly observe the deadline of their funds. It is not possible to extend the life of an FIP or FCPI past the eight to 10-year period plus two one-year extensions.
2. Valuation: secondary pricing for VC and growth companies has increased substantially over the last five years, which has resulted in secondary transactions closing at around a 15 percent discount to net asset value on average.
3. GP diligence: an increasing number of FIP and FCPI managers are seeing the secondaries market as an efficient way to manage their portfolio and to comply with business and regulatory obligations. An increasing number of them are now pro-actively considering secondaries processes in this context.

How big is this opportunity? What type of deal volume have you seen in recent years?

We estimate the secondaries market for FIPs and FCPIs is between €300 million and €350 million in NAV traded every year.

Over the last two years we ran more than 20 secondaries processes where the underlying assets were held by either FIP or FCPI funds, for an aggregated NAV of €250 million.

What’s attractive about FCPIs to secondaries buyers? Which types of buyer typically participates in deals involving FCPIs?

There is one point that is quite complicated to assess when you are secondaries buyer: how committed is the seller to the transaction? When you are working on portfolios of LP positions or single LP interests it can happen that you realise at the very end of the process that the seller was just looking for valuation and not really pushing for a sale.

When it comes to FIP/FCPIs, we do not have this kind of problem for a very simple reason: the seller is under a real and strong regulatory pressure to dispose of the assets, which means both the seller and the buyer are pushing in the same direction to find a fair deal. In a sense, these processes are quite similar to traditional GP-led transactions.

On top of that you also have an asset class slightly less competitive than the traditional buyout process, which results in more attractive pricing.

With respect to the buyers' typology, this has evolved over the last three to four years where only few specialised investors were considering such opportunities. Today, more and more well-known and established funds of funds with large secondaries programmes are willing to take part in these transactions.

What are the challenges in such deals? Are there any specific regulatory or tax issues to navigate?

As mentioned, regulation is a challenge for the seller but also represents a clear opportunity for the buyers.

Apart from the regulatory issues, the biggest challenge in such deals is to handle properly the potential conflict of interests that can arise for the GP. The GP is indeed taking the decision to sell and most of the time will continue to manage the assets after the transaction.

To ensure fair treatment for all underlying investors, we run the process from the beginning to the end focusing exclusively on the pricing proposed for the sole assets. Once the LOIs are received, we advise and select the offers that are, overall, the most interesting for the investors. We then start working on the new SPV structure, which has to be approved by the French regulatory body (AMF) before transferring the assets

From our experience, the best way to mitigate the regulatory and conflict of interest risks is by using a very systematic and processed approach. Otherwise, the GP can find himself unwillingly conflicted.

Ludovic Douge is head of secondaries, covering the secondaries market for funds and direct stake portfolios in private equity, private debt and infrastructure for Jasmin Capital, a Paris-based placement agent and advisory firm.