



FINANCIAL NEWS

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Spinning off is hard to do

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The long tradition of banks' private equity units leaving their parents to face an independent future has spawned a number of buyout players, including BC Partners, HgCapital and Terra Firma. But despite its success, spinning out can prove a troublesome process for the offspring.



Past examples have proved largely successful, according to Philip Buscombe, co-founder and chairman of buyout firm Lyceum Capital. Firms such as Permira, which spun out of Schrodgers in 2001, and Charterhouse Capital Partners, part of HSBC until the same year, have become some of the best-known in the industry, and spinning off is still proving attractive.

This month, investors in Barclays Private Equity said the company was likely to spin out from its UK parent company Barclays to form Equistone in the coming months. It will follow several other spin-offs in recent months.

Last month, Graham Thomas, head of the private equity arm of South Africa's Standard Bank, left the business, a move which, according to a source, was related to a potential deal to spin off Standard's private equity arm.

It was reported in November 2010 that the planned spin-out was expected to take place in the first half of 2011. However, a source close to the process said there had been disagreements between the bank and the private equity team over the valuation of the portfolio. Thomas and Standard Bank declined to comment.

Meanwhile, LDC, the private equity arm of Lloyds Banking Group, said it had "drawn a line" under speculation that it would spin off from its parent company.

The value debate

Reasons for the firms' delays and aborted plans remained unclear, but senior executives said that spin-outs could be difficult.

A senior London-based financial sponsor banker said that the biggest issue was the valuation of the deal.

He said that in cases where the bank was a forced seller, it would probably have to sell at a discount to the cost of the unit's portfolio. But if the bank instead decided to retain the full cost of the assets by running them off, it would then get no value from the management company. The issue is significant as the Volcker rule in the US forces banks to limit their holdings in certain alternative assets. He added: "[The bank] will get some money out but it is never going to be a fair deal. The banks are always going to be at the losing end."

However, Vittorio Pignatti-Morano, founding partner of Trilantic Capital Partners, which spun out of Lehman Brothers following the investment bank's collapse, argues that the management company has no value without the people who built it.

He said: "Banks have not typically acquired private equity management companies, so they do not have a high cost associated with them. They simply hired people to do the job. When the time to separate comes, the negotiation is more about what to do with the existing investments, the fees to manage them or how to split any embedded carried interest."

Parental dependence

Stephen Robinson, partner in the funds team at law firm Macfarlanes, cited fundraising as the biggest issue facing firms during a spin-out, as captive firms rely heavily on their parent company for investment. Plugging the funds gap left after a firm had become independent, he said, was "vital".

Those taking the independence route face one of the worst fundraising markets for a decade and will have competition from a wave of large firms returning to the market at the same time, including Apax Partners, which is targeting €9bn, Cinven, which is targeting €5bn, and CVC Capital Partners, whose next vehicle is expected next year. Robinson added that it was important for firms previously owned by banks, with third-party investors, to make their investor base comfortable during the transition to independence, with succession management plans seen as a key issue.

Staff retention was another challenge, according to Pignatti-Morano, who said that firms needed strong leadership to persuade a whole team of people who had chosen to work for a bank to move to a small company.

One of the differences between a captive firm and an independent firm that may influence an executive's decision is remuneration. Pignatti-Morano said banks tended to pay a lower proportion of carried interest but offered shares in the company and paid a cash bonus based on its performance.

However, he said that compensation cuts across the banking industry had probably made banks less attractive.

Gail McManus, founder and managing director of headhunter Private Equity Recruitment, said that bank-owned divisions with third-party capital offered carried interest but normally at a lower level than non-captive firms – between 12% and 15% rather than the traditional 20%.

Independence offers advantages as well as obstacles, according to Pignatti-Morano, who said that investors usually preferred independent firms to captive houses because they felt that the team's interests were more in line with their own. He said: "With a captive firm, you never know if the entire team within the bank is working twenty four-seven for the fund you have invested in."

- To spin out or not to spin out

Captive firms

Bank: Barclays Bank

Private equity activities: Barclays Private Equity – expected to spin out as Equistone Partners Europe by mid-autumn – and Barclays Ventures, whose new investments have been limited amid a strategic review

Bank: BNP Paribas

Private equity activities: BNP Paribas Private Equity's activities include funds of funds, direct investment and fund administration

Bank: Credit Suisse

Private equity activities: Buyout arm DLJ Merchant Banking Partners, a fund of funds arm and a secondaries unit

Bank: Goldman Sachs

Private equity activities: Businesses include Goldman Sachs Private Equity Group and GS Capital Partners

Bank: Morgan Stanley

Private equity activities: Morgan Stanley Private Equity and Morgan Stanley Private Equity Asia

Completed spin-outs

Firm: InfraRed Capital Partners

History: An infrastructure and real estate investment firm, spun out from HSBC in April

Firm: New MainStream Capital

History: Formerly Goldman Sachs' Urban Investment Group, spun out in December

Firm: NewQuest Capital Partners

History: Hong Kong-based firm, spun out from Bank of America Merrill Lynch in April

Firm: Nixen Partners

History: A merger of Natixis's Natixis Private Equity and NI Partners, spun out in October

Firm: Ridgemont Equity Partners

History: Formerly Banc of America Capital Investors, spun out last August

Source: firms' websites

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