KEYNOTE INTERVIEW

All signs point up


Shifting pricing and macro dynamics, record secondaries fundraising, and positive performance indicators are setting the stage for a strong year for GP-leds, say Partners Group's Martin Liew and Robin Shelley

Q How would you describe the quantity and quality of GP-led secondaries that you are seeing in the market right now?

Martin Liew: We have seen a significant evolution over the past decade, with extension secondaries, or so-called 'GP-leds', clearly fuelling the growth of the secondaries market. These transactions account for around 40 percent of secondaries activity today, down from around 50 percent in 2022, with secondaries investors pivoting more towards LP portfolios in recent months. Nonetheless, we believe there is further growth ahead.

There are several reasons why this is the case. In the past, extension secondaries were only really considered for underperforming assets with limited exit prospects. But we have since seen a vast improvement in the quality of assets being put forward. GPs are now using extension secondaries to compound returns in their best performing companies where there is a clearly visible path to further value creation. They are using these transactions to generate liquidity for their existing investors at attractive returns, as well as to expand their investor base, bringing in new LPs with access to both primary and secondary capital.

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Robin Shelley: If you look at the extension secondaries that we have closed in our most recent fund, the companies we have backed have grown revenue and EBITDA at strong compound annual growth rates. We think this demonstrates that these really are some of the best companies that GPs own. We saw relative value shift towards LP portfolios in the latter half of last year given pricing dynamics, but we expect extension secondaries to come back strongly this year, as pricing for more diversified content picks up.

Q Do you believe that trajectory will continue, even when other traditional exit routes open up once again?

ML: Definitely. There are many reasons why GPs are increasingly tapping into secondaries capital, not least that it allows them to invest in management teams, business models and value-creation playbooks that they already know. That makes for a more attractive risk/reward proposition than going out and searching for new transactions.

Having said that, it is important to note that not every extension secondaries transaction that comes to market

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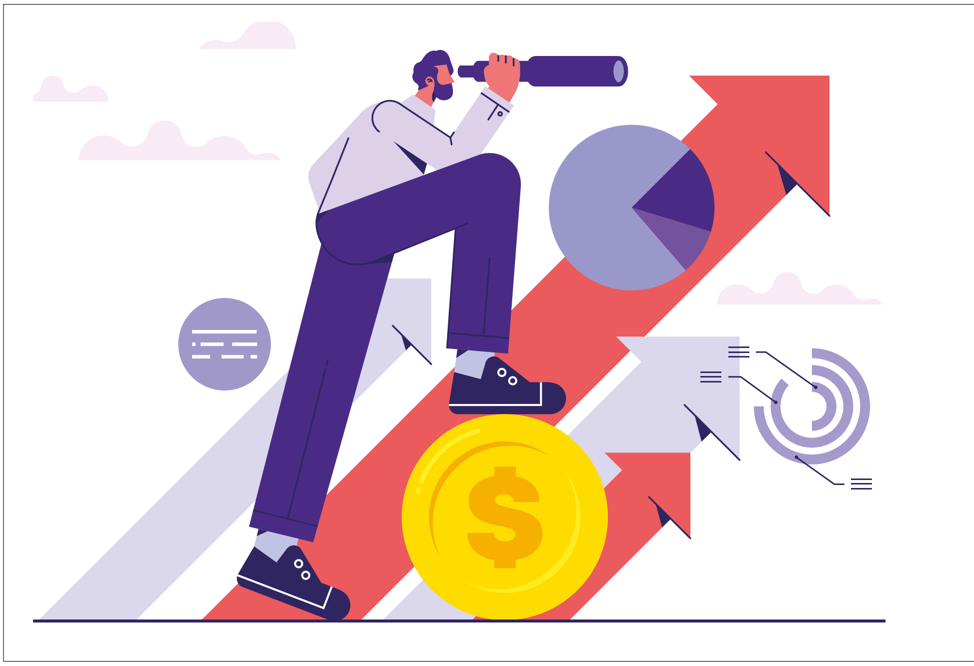
> **MARTIN LIEW**



involves a trophy asset. There are still GPs offering companies with less visibility around future growth prospects, and more limited exit options. You need experience and expertise to sift through everything that is out there to find the most attractive investments.

Q Which strategies and sectors are generating the most interesting opportunities at the moment?

ML: We are rigorous about identifying the best companies with attractive business models that perform across the cycle. We do that through top-down, thematic sourcing, typically in the same sectors that our direct investment platform focuses on: health and life, goods and products, technology, and business services. Within those sectors, we then identify attractive growth themes and target the best companies. We also carry out bottom-up underwriting, leveraging the experience of our direct investment colleagues. If you look at the extension secondaries transactions we have completed in our current fund, 90 percent of those assets were already being tracked by our direct private equity team. This is a great example of how our integrated, global private equity platform works in practice.

RS: For example, one theme that we have been focusing on involves healthcare outsourcing. We identified a company called Sterling Pharma Solutions that we believe is ideally positioned to benefit from this trend. Sterling is a contract development and manufacturing organisation specialising in advanced molecules, allowing its clients to focus on drug discovery and marketing.

The company's customer relationships are sticky due to the critical nature of the services it provides. Our direct colleagues had already identified that business and built a relationship with the management team, but it ultimately ended up being an extension secondaries transaction, which we led on behalf of our clients.

Q To what extent are you seeing increased differentiation in the secondaries industry?

ML: A lot of secondaries GPs today are giving their LPs the option to choose between a diversified LP portfolio strategy or a more concentrated exposure to continuation funds. As a result, we are seeing an increased dispersion in the returns being generated by those secondaries players. Historically, secondaries returns tended to fit within a narrow band, but that is no longer the case. That is partly due to market volatility, but also the increased prevalence of concentrated extension secondaries, where you need a well-defined and proven strategy to outperform.

RS: It is important to think carefully about portfolio construction when it comes to the balance between LP portfolios and continuation vehicles, in the context of relative value in any given market environment. You also then need to choose the right companies to invest in. Continuation vehicles give investors exposure to high-quality assets at a greater concentration than LP portfolios, and also typically at a higher price. You don't get the same discounts that investors may be used to with diversified LP portfolios.

LPs also need to ask themselves if a secondaries manager has the right

Q What supply and demand dynamics are you currently seeing in the market?

ML: On the LP side, we are still seeing a lot of investors looking to rebalance their portfolios due to the denominator effect, the rising cost of capital or else seeking liquidity to support their most important relationships. I think the more stable macro backdrop will mean that sellers that had been waiting on the sidelines are deciding that now is a good time to proceed. Meanwhile, we have just seen another record year for secondaries fundraising. This continues to be one of the bright spots across private markets, so I believe everything is in place for a healthy market in 2024.

RS: A big part of what is driving GPs to consider these types of transactions is the fact that traditional exit routes are more difficult today, or at least more difficult to complete above the valuations where GPs are holding these assets. That has driven GPs to seek liquidity via extension secondaries, or through tender offers or even NAV loans. It is also interesting that, as a result of depressed exit activity overall, there has been significant appetite from LPs to cash out in these processes, rather than rolling into the next hold period alongside the GP.

experience to identify the best assets for extension secondaries. It is a very different style of investing when you are committing capital to a single company at scale, which is partly why we are now seeing this wide dispersion of outcomes.

Q You mentioned that GP-leds don't offer the same discounts that investors may be used to in the LP-led secondaries market. But have you seen GP expectations shift when it comes to pricing?

RS: We are seeing increased openness from GPs when it comes to transacting at a slight discount, but we are not typically seeing significant discounts to NAV for the best companies. It's also important to consider the valuation versus comparables and not just the discount to the GP's mark.

Q Beyond the quality of the asset, what does it take for a deal to get over the line today?

RS: It comes down to three things: the right asset, the right partner and the right situation. In terms of identifying assets, we believe our close collaboration with our direct investment team sets us apart.

We are also focused on being proactive with GPs with whom we have developed close relationships and a high level of trust over many years.

Finally, we will only invest in transactions where there is significant alignment of interest, which, among other things, includes meaningful rollover of carried interest and attractive go-forward economics. We are careful to ensure GPs are also motivated to extend the hold period of an asset for the right reasons.

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Q Given there have been relatively few exits from continuation vehicles to date, is it possible to determine how well this vintage of GP-leds is likely to perform?

RS: We can already see that the last few years of continuation vehicles are outperforming their equivalent buyout vintage benchmarks. That is what we would expect, given that this should be a lower-risk form of investing, with GPs backing companies and management teams that they have already invested with for years and know well.

It is a very different risk proposition compared to underwriting a company where you don't have that same level of familiarity, which is why we are optimistic about the opportunities ahead in this space.

ML: What we have seen so far is certainly encouraging. The fact that continuation funds appear to be performing better than diversified direct portfolios reflects the fact that GPs really are putting forward their very best assets. Of course, we need to be mindful about the ultimate exits, but early indications are very positive. ■

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