ROUNDTABLE

SPONSORS

ARDIAN • ARES MANAGEMENT • BLACKROCK • GOLDMAN SACHS ALTERNATIVES
PARTNERS GROUP • STAFFORD CAPITAL PARTNERS • STEPSTONE GROUP

A buyer's market

Infrastructure secondaries are enjoying a surge in dealflow and limited competition thanks to significant barriers to entry, seven specialists tell Amy Carroll and Zak Bentley

The volume of LP secondaries trades in the infrastructure industry tripled in 2023, according to data from Campbell Lutyens. This growth is in large part a reflection of exponential increases in overall AUM, combined with greater secondaries penetration as the asset class matures.

"When I started out in infrastructure in 2008, there was around $100 billion in assets under management. Now we are at $1.4 trillion and with double-digit growth that is likely to grow to $2 trillion in the next few years," says Dmitriy Antropov, co-head of infrastructure partnership investments at Partners Group.

"At the same time, only a small fraction of that AUM is currently trading in the secondaries market when compared to private equity or real estate, which means there is real potential for this double-digit growth to be turbocharged by increased secondaries penetration."

Henry Willans, managing director and head of infrastructure secondaries at Goldman Sachs Alternatives agrees that increased secondaries activity reflects a broader maturation of the industry. "Private infrastructure took off as an asset class in the wake of the global financial crisis. It then took a decade for institutional investors to scale up their portfolios of infrastructure LP interests. Now they are using the secondaries market to manage that exposure and that is why we have seen a steady flow of portfolios coming to market since 2019."

Jérôme Leyvigne, head of infrastructure secondaries at BlackRock, adds that half of all the LPs that brought portfolios to market in 2023, were first-time sellers. "That just goes to show that it isn't only the most experienced and sophisticated investors that are using the secondaries market today. More and more LPs are now proactively managing their portfolios, which is an exciting development."

In addition to routine portfolio management, however, there are a host of idiosyncratic reasons why an investor may look to sell. Willans points to UK pension funds undertaking pension buyouts transactions, for example, as well as fee sensitivities among Australian superannuation funds. "Regulatory changes in Taiwan have also had an impact, as have pension fund withdrawals in Latin America," he explains.

Meanwhile, Edward Keith, partner and head of infrastructure secondaries at Ares Management, points to a concentration of secondaries activity in the Middle East and Asia, which he partly attributes to co-investment appetite among some of the regions' largest LPs. "These investors are making very substantial commitments in order to access co-investment during the early years of a fund. They are then selling those positions once the investment period has expired in order to fund other outsized commitments and access new sources of co-investment. That is a new dynamic that we are seeing."

Asia is also experiencing a comparatively high level of infrastructure secondaries activity due to a preponderance of overallocated investors, according to William Greene, managing partner, infrastructure, at Stafford Capital Partners. "That is partly due to the pain that many investors have experienced in the real estate market, which has been more acute than in some other regions."

In addition to infrastructure secondaries' secular growth, there have clearly also been cyclical factors at play

over the past two years, as private markets in general have been plagued by a lack of distributions and a punishing denominator effect.

"The main engine of growth is clearly structural but there have also been a unique series of events that have occurred over the past four to five years that have driven secondaries activity as well," says Greene, pointing to thematic sales during covid, as an example, as well as a downturn in public markets and a lack of private equity exits. "Looking ahead, the political situation is also likely to create volatility, which will drive dealflow for secondaries players."

> *"Looking ahead, the political situation is also likely to create volatility, which will drive dealflow for secondaries players"*
>
> **WILLIAM GREENE**
> **Stafford Capital Partners**

Discount debates

Infrastructure as an asset class has exhibited relative stability through these volatile times. It is perhaps counterintuitive therefore that the asset class has become a first port of call for investors looking to generate liquidity. However, it is infrastructure's strong and consistent performance that has led to a surge in secondaries sales.

"Through the recent market volatility, infrastructure has proven its downside protection characteristics and has generally generated steady upwards performance, while other asset classes have seen valuations decline," says Tim Rees, principal at StepStone Group. "That means that as LPs look across their portfolios, it is often their infrastructure positions that offer the best value, with discounts typically in the single or low double digits."

Keith agrees that it is the nominal price that tends to dictate LP behaviour, rather than true value. "Investors will typically look to sell positions where the nominal discount is lower, which has led them to bring infrastructure portfolios to market, rather than venture capital or private equity where discounts have been far wider."

Secondaries buyers, by contrast, are wary of being too heavily swayed by discounts. "Asset quality has to come first, followed by GP quality, and if you

> *"We are also seeing large transactions becoming increasingly competitive this year, while mid-size deals still fly under the radar"*
>
> **JÉRÔME LEYVIGNE**
> **BlackRock**

Edward Keith
Partner and head of infrastructure secondaries, Ares Management

Edward Keith serves as a member of the Ares Secondaries Group's private equity, real estate and infrastructure investment committees. He additionally serves on the executive committee of the Ares Secondaries Group. Prior to joining Ares Management in 2021, he was a partner in the private equity group at Landmark Partners.

Marie-Victoire Rozé
Deputy co-head of secondaries and primaries, Ardian

Marie-Victoire Rozé is primarily engaged in the origination and evaluation of secondaries and primaries investments and the origination of co-investments across the infrastructure and buyout asset classes. Prior to joining Ardian in 2005, she completed various internships at JPMorgan, Keolis and Merrill Lynch.

Jérôme Leyvigne
Head of infrastructure secondaries, infrastructure solutions, BlackRock

Jérôme Leyvigne has over two decades' experience as an infrastructure investor. He joined BlackRock's Infrastructure Solutions team in early 2010 and has since been instrumental in all aspects of the platform's growth. Prior to joining BlackRock, Leyvigne worked at Swiss Re Private Equity Partners and the World Bank.

Henry Willans
Managing director and head of infrastructure secondaries, Goldman Sachs Alternatives

Henry Willans is a managing director in the External Investing Group within Goldman Sachs Asset Management and is head of infrastructure secondaries for the Vintage Funds. He first joined Goldman Sachs in 2005 and held a number of roles until 2014. He rejoined the firm in 2018. In the intervening years, he worked at BTG Pactual and Brunel Partners.

are looking at top quality assets managed by top quality GPs, then the discount is typically going to be narrower," says Rees.

"It is vital to be analytical about your underwriting," adds Marie-Victoire Rozé, deputy co-head of secondaries and primaries at Ardian. "You need to have a rigorous bottom-up approach in order to really understand the assets. If the discount is to mean anything, you need to form a view on the valuation that the assets are being held at."

Indeed, another contributing factor to infrastructure discounts remaining relatively narrow, is that the de-risking that has taken place in the development or operational phase, or from a capital structure perspective, is not always fully reflected in the NAV, according to Willans. "When you do your bottom-up underwriting, you can uncover situations where NAV has been held relatively conservatively."

Meanwhile, Rees says that although discounts are not a secondaries buyer's top priority, it is still possible to secure more heavily discounted opportunities by pursuing less trafficked names, mid-market funds and niche strategies.

Leyvigne adds that while discounts are typically narrow in competitive processes, secondaries firms with strong primary relationships can secure GP intermediated secondaries deals. "These transactions are often more attractively priced," he explains. "We are also seeing large transactions becoming increasingly competitive this year, while mid-size deals still fly under the radar."

Supply/demand dynamics

Regardless of whether transactions are competitive or bilateral in nature, infrastructure secondaries' supply/demand dynamics are certainly favourable to buyers. "If you look at parallels in the private equity secondaries market, there has been a persistent supply/demand structural mismatch over the past 25 years," says Willans. "The buyside has not been able to raise capital quickly enough to satisfy

Dmitriy Antropov
Co-head of infrastructure partnership investments, Partners Group

Dmitriy Antropov is a member of Partners Group's Infrastructure Investment Committee and Global Investment Committee. He has been with Partners Group since 2008 and has 23 years' industry experience. He previously worked at UniCredit Group, LEK Consulting and Apax Partners.

William Greene
Managing partner, infrastructure, Stafford Capital Partners

William Greene has more than 20 years' infrastructure investment experience in direct and secondary transactions and was previously a civil engineer. He has held senior management roles with Macquarie, Etrion, Swiss Re and the Asian Development Bank.

Tim Rees
Principal, StepStone Group

Tim Rees is a member of StepStone's infrastructure and real assets team. Prior to joining StepStone, Rees was a senior associate at Partners Capital, an investment advisory firm, where he conducted due diligence and research on private equity and natural resources funds.

"Existing LPs often want to stay with the assets. What they don't want is to end up paying more fees to own the same asset under a different GP"

EDWARD KEITH
Ares Management

"We are able to cherry pick the assets that we want because the supply/ demand imbalance is working in our favour"

MARIE-VICTOIRE ROZÉ
Ardian

liquidity requirements and less than a third of deals that come to market end up getting closed. The same is true of infrastructure, which is a good indicator of how selective buyers can be."

Rozé agrees that secondaries buyers can be extremely discerning. "We are able to cherry pick the assets that we want because the supply/demand imbalance is working in our favour.

"As a rule of thumb, 10 percent of what is raised in the primary market will come to the secondaries market five years later," adds Greene. "The primary market was doubling every five years right up until 2023 and that has driven volumes in excess of dedicated secondaries capital raised, which means buyers can afford to be picky."

Compelling supply/demand dynamics are not only the result of a significant increase in deals being brought to market. They also reflect buyside constraints.

"The scale of the market opportunity may attract new entrants, but it is not easy to replicate the capabilities and experience of incumbent infrastructure secondaries specialists," says Rees. "You need to have longstanding relationships with infrastructure GPs, an information advantage, and you need to understand what is involved in owning and operating infrastructure assets, because the drivers are very different to private equity."

Rozé agrees. "There are significant barriers to entry. It takes time to build up the necessary scale. You need a big team. You need access to privately held information. You need relationships with GPs and sellers. This isn't an easy market to start out in."

"It is important to have the resources, GP relationships and data to underwrite diverse portfolios, asset by asset," adds Willans. "We have seen some infrastructure managers trying to expand into infrastructure secondaries, but while infrastructure expertise is important, it is not sufficient to be a good infrastructure secondaries investor."

Meanwhile, Antropov believes the job of an infrastructure secondaries investor is only going to get harder. "For the past 10 to 15 years, nearly everyone has been selling at a premium to marks. Infrastructure's track record looks great. But the past two years have been different. It is going to be more difficult to continue to outperform as secondaries buyers, as GPs are having a harder time selling assets at a premium. Difficult, but not impossible. You just need a deep direct-like underwriting skill set and strong long-term relationships. However, it would certainly be challenging for new entrants."

Continuation vehicles

The supply/demand imbalance in the LP secondaries space has been further

exacerbated by a significant increase in the number of GP-led secondaries opportunities. "It is an interesting part of the market. We are seeing high-quality assets that need more time and more capex being placed into continuation vehicles," says Rozé. "This is particularly true in capex-intensive sectors such as digital infrastructure and the energy transition."

Willans adds that private infrastructure's shift towards platform plays, in particular, is driving continuation vehicle activity. "There are lots of opportunities in the data centre, fibre and cold storage and logistics sectors, for example, where more time and more capital are required to execute a roll-out strategy. Continuation vehicles are the natural solution."

"The scale of the market opportunity may attract new entrants, but it is not easy to replicate the capabilities and experience of incumbent infrastructure secondaries specialists"

TIM REES
StepStone Group

Leyvigne, however, warns that it is important for investors to ensure that GPs claiming to want growth capital aren't really seeking rescue capital. "There are certainly fibre-to-the-home and renewable development continuation vehicles coming to market, for example, with assets where business plans haven't been met," he says.

Leyvigne adds that BlackRock likes continuation vehicle opportunities with a "brown to green" narrative. "We believe climate risk is an investment risk and that there is a real opportunity to provide additional capital to help companies looking to decarbonise their businesses to reduce their emissions, potentially providing a more attractive path to exit."

Meanwhile, Antropov says that while the role that continuation vehicles can present for growth assets is now well understood, there is a less clearly defined opportunity for stabilised assets. "The potential to create additional value by giving growth assets more time and more money is certainly perceived as the more attractive opportunity right now. But while the possibility of using continuation vehicles to create solutions for stabilised assets is less developed, it presents potential white space."

"While infrastructure expertise is important, it is not sufficient to be a good infrastructure secondaries investor"

HENRY WILLANS
Goldman Sachs Alternatives

Conflict management

There are, of course, inherent conflicts that need to be managed in continuation vehicle situations. But Keith believes that where high-quality infrastructure assets are involved, these deals can work for all parties. "Existing LPs often want to stay with the assets. What they don't want is to end up paying more fees to own the same asset under a different GP," he explains. "If the valuation is fair, the continuation vehicle will also work for investors that do want to take liquidity. It is when the assets are mediocre or troubled that conflicts start to emerge."

"If there is clear daylight between where the asset sits today and its

> *"It is going to be more difficult to continue to outperform as secondaries buyers, as GPs are having a harder time selling assets at a premium"*
>
> **DMITRIY ANTROPOV**
> **Partners Group**

potential growth, continuation vehicles can certainly be a win-win," agrees Greene, who adds that valuations can be validated through the in-depth information provided as well as through the concurrent sale of a minority stake to a third party. "It is also important to ensure that the right incentivisation is in place for the GP," he says.

Leyvigne agrees that alignment is critical. "It is vital that the GP isn't crystalising its carry and diluting its stake in the business," he says. "We want to see those proceeds reinvested into the continuation vehicle as it embarks on the next leg of its journey."

Where incentives have been adequately aligned, there is an argument that the inherently long-term nature of infrastructure means that it is ideally suited to the continuation vehicle phenomenon. "These are long lifecycle assets so putting them in a vehicle that allows you to own them for longer than the traditional hold period can make sense," says Rees.

However, he adds that this certainly does not give managers a free pass to move every infrastructure asset into a continuation vehicle in order to continue earning fees. "It has to make sense for both the existing LPs and the new LPs coming in."

Supply/demand dynamics dictate that the bar for a successful continuation vehicle transaction is extremely high, according to Keith. "The capital available to fund these deals represents a fraction of the deals coming to market, so the secondaries industry is the arbiter of which assets and situations make sense."

"The market is extremely selective at the moment and so only the highest quality assets are trading successfully," agrees Leyvigne. "Lower-quality assets simply won't find a home."

Fundraising woes

While infrastructure secondaries specialists appear to be luxuriating in ideal market conditions, with an abundance of supply and limited competition, there is one obvious cloud on the horizon. The growth of the secondaries industry is strongly correlated to the primary market and after years of phenomenal fundraising success, the past 18 months have been undeniably brutal.

Greene is unperturbed, however, particularly as more challenging fundraising conditions have also impacted the secondaries market, thereby improving pricing. "For now, I see the net effect as positive," he says, adding that there may be a slight reduction in secondaries volume in a few years' time.

Willans, meanwhile, agrees that the slower fundraising environment has had positive implications for the secondaries industry, in terms of driving dealflow. "One reason for the slower fundraising market has been a lack of DPI. One obvious solution to that lack of DPI has been to create liquidity through secondaries sales. Secondaries buyers are able to capitalise on these periods of dislocation."

Rozé says that challenges in delivering DPI to LPs have also forced GPs to be more creative, adding fuel to the continuation vehicle space.

"Slower fundraising equals a buyer's market, which is creating opportunities for us to partner with GPs, providing structured solutions," adds Leyvigne. "For our current Global Infrastructure Secondaries fund, that might lead to LP-led secondaries transactions or continuation vehicles, but it might also mean a broader conversation around the challenges the manager is facing and how we can help by providing constructive capital. Only investors with deep knowledge and understanding of both secondaries and infrastructure can make that happen." ■

Goldman
Sachs
Alternatives

Urban regeneration?
Look again

See Alternatives from a new perspective at
am.gs.com/alternatives

Growth Equity | Hedge Funds | Infrastructure | Private Credit
Private Equity | Real Estate | Secondaries | Sustainability

All investing is subject to risk, including the possible loss of the money you invest.

This communication is for institutional or financial intermediary use only and is not directed at or intended for retail investors. It is not an offer or solicitation to buy or sell any securities. Alternative investments are suitable only for sophisticated investors for whom such investments do not constitute a complete investment program and who fully understand and are willing to assume the risks involved in alternative investments. Alternative investments by their nature, involve a substantial degree of risk, including the risk of total loss of an investor's capital.
© 2024 Goldman Sachs. All rights reserved. 330921-OTU-1854099