ROUNDTABLE

SPONSORS
NEUBERGER BERMAN • DAWSON PARTNERS • STAR MOUNTAIN CAPITAL
PJT PARTNERS • DAVIS POLK & WARDWELL

'This is not a market moment'

After another busy year in the secondaries market, demand for capital solutions shows no signs of abating as both GPs and LPs navigate a shifting market backdrop.
By Claire Coe Smith and Chris Witkowsky

After a bumpy few years following the 2021 boom, the global secondaries market looks on course to return to record-breaking levels through 2024, driven by demand from both GPs and limited partners. While the liquidity crunch that fueled activity over the past 24 months looks set to ease, participants at the fourth annual *Buyouts* secondaries roundtable saw no reason to expect a slowdown in a market that remains challenged by undercapitalization.

"We predicted 2024 would be a bumper year and we are holding firm on our prediction that global secondaries volume will reach another high watermark," says Yann Robard, managing partner at Dawson Partners. "As we move through the fourth quarter it looks like the market could end up at $150 to $175 billion, as the level of activity continues to be really robust on both the GP-led and LP portfolio deals."

It is a view shared by Boriana Karastoyanova, managing director and member of the secondaries team at Neuberger Berman. She says: "We subscribe to the view that 2024 will be another very strong year for secondary market activity, bigger than 2021 and with a lot of positive tailwinds taking us into 2025 and beyond. We have observed that there are sustainable drivers for investors' motivations to seek and generate liquidity across their private portfolios, which is why we believe GP-led solutions are here to stay and why their volume could accelerate."

Secular drivers fuel demand

Activity has strengthened throughout the past 12 months across the market, with pricing on the LP side approaching two-year highs as more capital in the system seeks out diversified opportunities. Meanwhile, the appetite for GP-led transactions has also remained strong.

Leor Landa, partner and head of the investment management practice at Davis Polk & Wardwell, says: "There are lots of secular reasons for the popularity of GP-leds, each of which exists outside of a particular market moment. The first is the big shift in liquidity generally out of public markets and into private markets, and that is not changing.

"We have also seen this drop in M&A and IPO activity whereby secondaries are providing a great outlet for liquidity at a time when LPs are clamoring for distributions. That has drawn sponsors to the opportunities created by having secondary exits as an additional tool in the toolchest, using continuation vehicles as a fourth exit option. There are reasons why on certain deals it makes sense for a GP to maintain control for longer."

Landa says GP-leds are also being used by mid-market managers to create distributions where successful deals have become oversized relative to AUM. "There are lots of things running parallel that make these really attractive," he says, "and the infrastructure has now been built out, and the best practice developed, to allow more and more LPs and GPs to get

Yann Robard

Managing partner, Dawson Partners

Robard founded Dawson Partners, formerly Whitehorse Liquidity Partners, in 2015 to provide innovative structured liquidity solutions for private market investors. Since its inception, it has raised $18 billion and deployed $24 billion. Prior to Dawson, Robard spent 13 years at CPPIB, most recently as managing director, head of secondaries and co-investments.

Boriana Karastoyanova

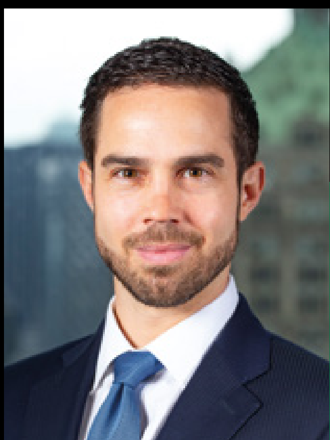
Managing director, private equity, Neuberger Berman

Prior to joining the secondaries private equity team at Neuberger Berman in 2019, Karastoyanova was with Blackstone's Strategic Partners Fund Solutions, where she focused on originating, evaluating, structuring and negotiating secondaries private equity transactions, co-investments and primary commitments.

Collin Zych

Managing director, Private Capital Solutions, PJT Park Hill

Zych is a managing director focused on the secondaries market at PJT Park Hill, based in Dallas.



Brett Hickey

Founder and CEO, Star Mountain Capital

Hickey has been structuring, analyzing and managing private credit, private equity and secondaries investment funds for over 20 years. Before launching Star Mountain in 2010 as a specialist asset manager focused on the US lower mid-market, he was the co-founder and president of a multi-manager investment platform that included four US-state sponsored small business investment funds. Before that, he did financial institutions M&A and corporate investment banking.

Leor Landa

Partner and head of investment management, Davis Polk & Wardwell

As head of the investment management practice at Davis Polk, Landa advises on the formation and operation of private funds and on complex secondaries transactions, as well as related regulatory matters. His clients include private equity funds, credit funds, secondaries funds, real estate funds, hedge funds, funds of funds and advisory platforms.

comfortable with these processes."

Going back a decade to the origins of the GP-led, early deals were a reaction to a moment in time when good assets caught up in the financial crisis had depreciated in value, LPs wanted liquidity and a solution was needed. "We thought we would get through a tough spot and then put the tool back in the toolbox, but we were completely wrong," says Landa. "The secondaries market has grown through the downcycle in M&A and IPOs, and through the upcycles in M&A and IPOs. It has proven to be a consistently growing market that is not context dependent."

"We are finding the right pools of capital in our market that can help GPs"

COLLIN ZYCH
PJT Park Hill

Diversification in the use of secondaries capital

While demand for single-asset continuation vehicles is in the spotlight, the use cases for secondaries capital in GP portfolio companies continues to expand. Collin Zych, managing director in the PJT Park Hill Private Capital Solutions group, says: "The range of problems that we are looking to solve continues to evolve. Last quarter we closed a deal involving a GP that wanted to consolidate control in a blue-chip asset with co-sponsorship. Via a continuation vehicle, our client was able to acquire incremental ownership in the portfolio company while providing liquidity to the existing third-party investors.

"We also worked with a group who closed on a structured continuation vehicle. The preferred equity structure allowed for a scaled liquidity solution that the traditional fund continuation vehicle market may have been stretched to capitalize, while giving existing LPs up-front liquidity along with participation in future upside.

"We are continuing to find ways to take situations that don't neatly fit into a box and use secondary capital as a solution. We are finding the right pools of capital in our market that can help GPs further their objectives as asset managers."

The secondaries market has also been growing fast in areas like infrastructure and credit secondaries, and in the lower mid-market.

Brett Hickey, founder and CEO of Star Mountain Capital, says: "Private credit is just a very big market that has grown to around $2 trillion of assets today and is expected to continue to grow. There are lots of reasons for secondaries to be valuable to both GPs and LPs as a result and some of the complexities of credit – like different types of leverage facilities – create both barriers to entry and opportunities."

Landa adds: "We've been saying for some time that credit secondaries would be the next big thing given the size of the private credit market. We are certainly seeing more take-up now and more focus on the buy-side with people willing to look at credit portfolios. We're expecting more steady growth."

Hickey argues the lower mid-market secondaries space is also ripe for expansion. "That lower part of the market represents about half of US GDP and is hyper-fragmented with over a thousand smaller GPs. Many of those are part of an aging demographic cohort that is challenged to raise new funds and challenged to retain talent, which means you have a lot of motivated sellers, both on the GP side and among LPs.

"We spend a lot of time educating the market around the opportunity because, on average, that is a structurally less sophisticated audience. These aren't large managers that are constantly looking to optimize their portfolios, working with large law firms and advisers. But we see great continuation vehicle opportunities and demand growing enormously. The lower mid-market will continue to offer attractive alpha and motivated sellers, but it will not become a huge market because of the labor intensity required on the part of buyers."

> *"Secondaries are providing a great outlet for liquidity"*
>
> **LEOR LANDA**
> **Davis Polk & Wardwell**

> *"We believe GP-led solutions are here to stay"*
>
> **BORIANA KARASTOYANOVA**
> **Neuberger Berman**

Expanding the investor base

One challenge that has long stood in the way of secondaries market growth is a mismatch in the scale of the inventory versus the volume of capital available to deal with it.

"If there is any kind of lull in the market right now, in our view it is because the market is so under-capitalized," says Robard. "Getting buyers' attention in order to execute on a transaction is really the challenge."

He talks about three eras of secondaries: the decade of institutionalization, from 2001 to 2011, when the market grew from $5 billion to $25 billion; the decade of innovation, from 2011 to 2021, which saw the market grow from $25 billion to $130 billion, driven by a huge expansion out of straight LP portfolio deals into continuation vehicles, credit, infrastructure and real estate secondaries, structured solutions, GP stakes and more; and we have entered the decade of capitalization.

"Through that period of innovation the market has ended up vastly under-capitalized, and now that capitalization needs to catch up," says Robard. "We saw $425 billion get deployed from 2021 to mid-2024, while roughly $275 billion got raised. So 65 cents got raised for every dollar deployed over the past three and a half years. Right now, assuming no additional fundraising, there is essentially just one year's dry powder in the market with significant pent-up liquidity in the system."

One trend that has really accelerated through 2024 has been the rise in the number of 40 Act funds emerging as potential buyers of secondaries deals. These heavily regulated vehicles offer the potential to tap retail investor capital using semi-permanent structures that operate very differently from traditional private funds.

Landa says: "This is a logical extension of what we have seen over the past decade in private equity, private credit and hedge funds, and it is starting to accelerate because some of the benefits of secondaries work well for that investor base. Secondary funds seek to mitigate the J-curve by being able to deploy capital faster, generating a higher velocity of returns and more visibility into liquidity and timing of distributions. Those strategies line up well with a more retail investor base, and we are expecting that market to continue to grow."

Buyers look for alignment

Given the tough fundraising climate, a number of GPs have been coming to market with GP-led transactions motivated by current or future fundraising needs, which some LPs have pushed back against.

Karastoyanova says there must be a clear rationale for continuation vehicles. "Generating liquidity to potentially help with a manager's fundraising process could be a component of a GP's motivation and objectives when pursuing a continuation vehicle," she says.

> *"We see great continuation vehicle opportunities and demand growing enormously"*
>
> **BRETT HICKEY**
> **Star Mountain Capital**

"We are also cognizant of the current tougher fundraising and liquidity environment and LP demands for DPI. As LPs are evaluating a GP's performance, they want to see realizations as part of the track record. We appreciate that sometimes means a manager selling one of their best-performing assets early to convert a paper return into a realization and demonstrate a win.

"Liquidity could often be part of the equation, but as a new secondary investor, we want to gain conviction that the business plan for the asset, or assets if a multi-asset transaction, makes sense for the next hold period, that there is a clear line of sight to generate EBITDA improvement, cashflow generation and compound value, and that there is compelling optionality around exit path and valuation."

Alignment is also important in GP-led transactions, argues Karastoyanova. "We very much want to see full roll of the GP's carried interest as well as fresh capital contributed at the new valuation established by the secondary investor. Every deal is bespoke but ultimately, we want to ensure the active members of a GP who drive the assets' value going forward are the ones rolling over."

Pricing and public markets

What we see is that the average pricing on LP portfolios has moved upwards over the course of 2024, starting the year in the low-90s before trending to mid-90s and close to par by year end. Robard says: "That makes sense to us when you start seeing public markets going up 40 percent and private equity only going up 15 percent in the same period. Private markets have generally lagged public market increases and, as such, we believe there is embedded value building in private equity portfolios reducing the optical discounts at which LP portfolios are trading.

"When you combine that with more clarity in terms of where the economy is heading, the bid-ask spread narrowing and liquidity starting to return, our perspective is that we may be entering a private equity super cycle over the next 24 months for assets that are in the ground today. That higher pricing allows sellers to come to market without having to absorb a wide discount, which is bringing more assets to sale."

On GP-leds, pricing tends to be more variable, with some strong single-asset continuation vehicles trading at or close to par. Hickey says: "The pricing trends in the GP market are very asset-specific – you need to zone in on the industry, sector, valuation and performance of the company. For something that has been conservatively held, with a lot of embedded value and optionality at exit, you can get those par values, whereas in other cases you might be far away from that."

When it comes to price discovery, there are clear advantages to bringing in advisers to help navigate some of the complexities of the GP-led process. While the SEC's proposed Private Fund Adviser Rules are dead, the policy concerns behind the proposals to regulate continuation fund deals remain.

Landa says: "An important mitigant of those regulatory concerns is a properly intermediated market process for real price discovery with a sophisticated third-party adviser on board to help position the transaction."

Looking forward to 2025

We wrapped up our roundtable discussion by asking each of our participants to share something that had surprised them about the secondaries market in 2024, and what they were looking forward to in 2025.

Hickey says: "In general, we are surprised to see people holding onto assets longer, seeming to wait for better days and better valuations. We continue to see that among both GPs and LPs, partly because they are looking at public markets reaching all-time highs. My guess is that as you translate that into the future, that is going to create a lot of opportunity as people finally get to the point where public markets won't stay where they are from a valuations perspective forever and people decide they need to do something.

"LPs continue to want liquidity so my expectation is that we will continue to see increased transaction volume and value as we move through 2025."

Karastoyanova shares an optimistic outlook: "Given the record amounts of private equity dry powder sitting on the sidelines, and the well-functioning markets across both private debt and broadly syndicated loan market, it is a surprise to me that we haven't seen a lot more transactions of private equity assets. Coming off a period of dislocation can often be a good time to invest capital, though on the flipside it may not be a good time to sell, and that creates a bid-ask spread around valuation.

"LPs have been experiencing two-plus years of negative cashflows and as a result there is a huge pent-up demand for liquidity. That will take time to clear, even when M&A activity picks up. As such, there is pressure in the system that, we believe, will likely translate into a conducive backdrop for secondary transactions in 2025. GPs hold some great assets, yet need to generate liquidity, so rather than sell them in a less than ideal environment, there is a compelling reason to explore continuation vehicles to allow them to compound further value while providing a liquidity option to investors that would benefit from it."

Robard says it was no surprise that 2024 could turn out to be another record-breaker for the secondaries universe: "My prediction for next year is that the market is going to break $200 billion," he says. "Back in 2019, we said the market would hit $200 billion by 2025 and that was met with a lot of skepticism, but I still believe we are on track."

> *"My prediction for next year is that the market is going to break $200 billion"*
>
> **YANN ROBARD**
> **Dawson Partners**

Zych says it is the ingenuity of the secondaries market that continues to drive growth: "We continue to find ways to solve issues in the private capital ecosystem, which requires asset-appropriate cost of capital and product and team specialization. The sources of new capital continue to evolve as well – the pace of fundraising from retail capital and the number of buyers accessing that channel surprised us in 2024, and we think more and more capital will come in from non-traditional sources and from buyers that don't yet have institutionalized teams.

"You have traditional LPs that for a long time have thought about GP-led opportunities as something they have to deal with versus something they should be investing in. They are now getting their acts together, either with secondary fund partners or by building their own institutional teams to evaluate opportunities. More participation from traditional LPs, along with the continued proliferation of retail capital and new scaled entrants, will hopefully expand the amount of capital available for an ever-growing pipeline of secondary transactions in 2025."

Landa says secondaries will continue to represent a relative bright spot in the fundraising market as people are drawn to the attractions of the asset class.

"We expect fundraising generally in private markets to improve in 2025, and I think secondaries will outperform as people try to allocate more capital to it," he adds. "Even with a rebound in M&A activity and the return of IPOs, we still expect the volume in secondaries to increase meaningfully."

Those that predicted the scaling back of secondaries once liquidity returned could well stand corrected – all indications are that the market is just at first innings and set to scale in line with the exponential growth of private capital. ■