Q&A

EVERYTHING YOU NEED TO KNOW ABOUT GP-LED SECONDARIES

Amyn Hassanally discusses the role that GP-led transactions are playing in an evolving private equity landscape

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The private equity landscape has undergone a significant transformation over the past decade, and especially over the past several years, with secondaries becoming an ever-more mainstream liquidity solution and accounting for $100bn+ in transactions every year since 2021[1]. GP-led secondaries transactions in particular have emerged as a pivotal development, with these deals making up around half of all secondaries completions by value since 2020, up from around a third previously.

To understand this segment of the market better, we sat down with Amyn Hassanally, Partner and Global Head of Private Equity Secondaries at Pantheon, to explore the drivers behind the rapid and sustained growth in this segment of the market, and the implications of this evolving phenomenon for investors.

Among other things, the discussion covered the role of GP-led secondaries in solving for limitations of the private market fund model, uncovered insights into deal flow, pricing, and performance, and examined the delicate balance of supply and demand in this burgeoning segment. It also covered what investors should seek in a GP-led secondaries manager, and how these transactions fit within a broader private equity portfolio.

Q **What exactly are GP-led secondaries, and why have they become so prominent in the private equity market?**

AH: GP-led secondaries are a form of transaction in the private equity market where the general partner (GP) of a fund initiates the sale of one or more assets, typically bringing in new investors in the process and providing a liquidity option to existing limited partners (LPs). Unlike traditional secondaries transactions, where LPs sell their stake in a fund to other investors, GP-led secondaries allow the manager to retain control over key assets by rolling them into a new vehicle, backed by new capital.

[1] Source: Evercore H1 2024 Secondary Market Review, July 2024.

These transactions have gained prominence because they address some of the structural limitations of the traditional private equity model. Private equity funds usually operate within a fixed lifespan, often around 10 years. This can pressure GPs to exit assets prematurely when they are still executing on a growth plan, potentially leaving value on the table. GP-led secondaries offer a way to extend the hold period for high-potential assets, ensuring that GPs have the opportunity to maximize their value while still providing LPs with liquidity.

Q How do GP-led secondaries work – and what are the opportunities for new investors?

AH: GP-led secondaries are particularly effective in extending the hold period for high-quality assets that have not yet reached their full potential. The most common type of deal involves the creation of a continuation fund for either a single asset, or a small selection of assets. These companies are transferred from an existing fund, or funds, into a new vehicle, which is backed by new money from the manager, existing LPs who opt to roll over their interest, and new secondary investors.

This process allows GPs to avoid a premature exit and continue managing high-quality assets with additional time and capital. Crucially, the process crystallizes returns and generates liquidity for existing investors, who typically have the option to roll their existing exposure to the assets into the new fund to capitalize on potential further upside, or to exit their investment in exchange for cash.

For new secondaries investors, the deals present a unique opportunity to gain exposure to top-performing assets, with the additional benefits secondaries bring in the form of visibility on the underlying companies, continuity of management and shorter-duration hold periods.

Q Do you have any insights into deal flow, pricing, exits, and performance across the market and among dedicated GP-led secondaries funds?

The flexibility offered by GP-led deals is increasingly attractive in a market where high-quality assets are in demand, but in which traditional exit avenues may be challenged or not offer the best value.

AH: One undeniable trend we're seeing is the sheer growth in deal flow within the GP-led secondaries market. Over the past few years, these transactions have gone from being relatively niche to becoming a significant portion of the overall secondary market, accounting for around half of all deals[1]. This increase is driven by both the growing acceptance of GP-led secondaries among GPs and investors, as well as the innovative deal structures that GPs are developing.

In terms of pricing, GP-led secondaries often command higher valuations than traditional secondary transactions. This is largely because the assets being transferred are typically high-quality, and there is strong competition among buyers for these opportunities. However, this also means that investors need to be more diligent in assessing the true value of these assets and ensuring that they are not overpaying in a competitive process.

Realizations from GP-led secondaries across the market have generally been favorable, with many continuation funds and single-asset secondaries delivering strong performance that is in line with direct buyout funds[2]. This is partly due to positive selection bias – the assets selected for these transactions are often those with established growth plans and demonstrable continuing upside potential at the time of investment. The additional time and capital provided by the new vehicle can allow them to reach their full potential.

[1] Source: Evercore H1 2024 Secondary Market Review, July 2024.

[2] Source: Lazard Interim Secondary Market Report 2023, Lazard Estimates. Past performance is not indicative of future results. Future results are not guaranteed, and a loss of principal may occur.

Q How do you examine supply and demand in this evolving segment of the private equity secondaries market?

AH: The supply and demand dynamics in the GP-led secondaries market are quite fascinating. On the supply side, we're seeing an increasing number of GPs looking to utilize these transactions as a portfolio management tool. The desire to extend hold periods for top-performing assets, coupled with the need to offer liquidity to LPs, has led to the establishment of these transactions as a viable exit route for managers and, as a result, a steady flow of GP-led secondaries opportunities.

Demand, on the other hand, has been driven by the attractiveness of these high-quality assets and the innovative structures that offer tailored investment opportunities. Investors are drawn to the potential for strong returns, but they are also increasingly discerning about which GP-led secondaries to back. The challenge for GPs is to manage this demand without oversaturating the market, which could lead to diminished returns.

Overall, the balance between supply and demand in this market is delicate. As more GPs enter the space, and as investor interest continues to grow, maintaining discipline and focusing on quality will be crucial to sustaining healthy market dynamics.

Q What should investors look for in a GP-led secondaries manager?

AH: When selecting a GP-led secondaries manager, investors should focus on a few key factors. First and foremost, the manager's track record is critical. Investors should seek out managers who have demonstrated success in navigating complex secondaries transactions in relevant sectors and delivering strong returns.

Experience in structuring and executing these deals is also essential. GP-led secondaries are often intricate and require a deep understanding of both the assets involved and the broader market context. A manager with a strong background in secondaries markets and a network of relationships with GPs and LPs will be better positioned to identify and capitalize on the best opportunities.

Transparency and alignment of interests are other important considerations. Investors should look for managers who prioritize clear communication, use independent valuations, and involve LP advisory committees early in the decision-making process. This ensures that the interests of all parties are aligned and that potential conflicts are addressed appropriately and early on.

Finally, investors should assess the manager's ability to add value post-transaction. This includes their strategy for managing the assets in the continuation vehicle and their plan for eventual exits. A manager with a well-thought-out approach to value creation will be better equipped to generate strong returns over the extended investment period.

Q How does GP-led exposure sit in a private equity portfolio, and what are the benefits?

AH: GP-led exposure can play a strategic role in a private equity portfolio. These transactions often involve high-quality assets with proven track records of outperformance, which can provide a level of stability and potential upside that complements other, potentially higher-risk investments in the portfolio. Often target returns are in line with those of direct buyouts, but with the additional downside protection afforded by secondaries in that you are buying into known assets and existing management relationships, with established growth plans and enhanced alignment of interests.

Additionally, the flexibility and customization offered by GP-led secondaries allow investors to tailor their exposure to specific assets or sectors that align with their investment thesis. This level of control can be particularly valuable in a volatile market, where the ability to selectively increase or decrease exposure to certain investments can make a significant difference in overall portfolio performance.

Q What does the future hold for GP-led secondaries?

AH: The future of GP-led secondaries looks promising, but it's not without its challenges. The market is expected to continue growing, driven by the increasing size and complexity of private equity portfolios as investors move away from the traditional 60/40 portfolio, the ongoing demand for liquidity, and the continued evolution of secondary market structures.

Innovation will be a key driver of this growth. We're likely to see more creative deal structures and the use of technology to enhance transparency and efficiency in these transactions. As the market matures, we can also expect to see a greater standardization of best practices, which will help mitigate some of the complexities and risks associated with these deals.

However, the sustainability of this movement will depend on the discipline of market participants. With the growing popularity of GP-led secondaries, there's a risk of market saturation and increased competition, which could lead to lower returns. GPs and investors will need to be selective and focus on high-quality assets to ensure that the market remains healthy.

Q Any final thoughts on the significance of GP-led secondaries in the broader private equity landscape?

AH: GP-led secondaries have quickly become a crucial component of the private equity toolkit, offering a unique blend of flexibility, liquidity, and value-creation opportunities. These transactions are not just a passing trend; they represent a fundamental shift in how private equity operates.

For GPs, the ability to manage their portfolios with greater control and flexibility is a significant advantage in a competitive market. For LPs, the options for liquidity and reinvestment add a new dimension to their investment strategy. As the private equity industry continues to evolve, GP-led secondaries will likely play an increasingly important role in shaping the future of the market.

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