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All About Secondaries (First of a Series)

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"The majority of GPs have observed some level of interest from their investors for continuation funds." – Private Equity International Private Fund Leaders Survey 2023.

Besides the above survey, an article last month in *Secondaries Investor* cited Jefferies data showing 80% of LPs sought liquidity by selling into continuation vehicles. This is an extraordinary shift from investors getting realizations the old-fashioned way, i.e. private equity owners selling businesses to new strategic or sponsor buyers.

Of course, current market conditions are weighing on M&A activity. Higher rates make it tougher for buyers to achieve their desired equity returns through financing leverage. Credit providers are hampered by tight interest coverage at those debt-to-ebitda levels. And until recently, everyone worried about a potential recession in late 2023 or early 2024.

Continuation vehicles are but one of many innovations designed to provide investors in equity (and credit) funds with liquidity as other sources dried up. A multi-billion dollar industry has developed around the notion that enterprise values embedded in sponsor portfolios can be financed within vehicles designed to make room to buy other companies.

Over the next several weeks, with the assistance of our head of secondaries, Nick Lawler, we will be exploring this fascinating so-called secondaries market. We'll review the reasons for its exponential growth, how it's evolved and expanded, and describe the types of deals being rolled out in the current environment.

Other questions we'll tackle: what's in it for the GP and what's in it for LPs? Why are investors looking to GP-led secondaries strategies for opportunities? What are the current market dynamics and why have they led to such a boom in this specialized arena?

Finally, what's the outlook for secondaries? Is it a creature of high interest rates, or as market conditions normalize will we return to traditional M&A solutions for LPs and GPs to find liquidity?

Think about headwinds affecting private equity right now. Fundraising has become (in the words of one partner) "challenged." Investors are more skeptical of returns and more sensitive to risk. Even the best sponsors say it's taking longer to raise the same sized fund. Sellers, whether founders or PE, are waiting for valuations to match expectations.

In the meantime, CLO formation is down, with higher liability costs hurting the equity arbitrage. Cash has exited from retail loan funds for other asset classes. Hence public credit issuance is off sharply as broadly syndicated loan arrangers have struggled to find clearing prices for deals.

With a narrower (or absent) path to value realization, GPs are forced to consider other approaches to give LPs liquidity. In this special series, we'll examine those approaches.