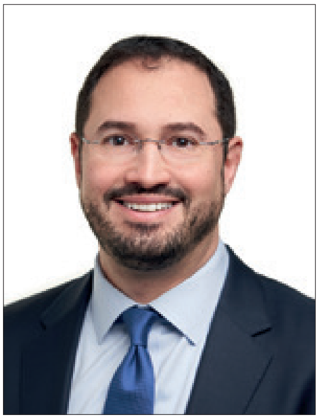
KEYNOTE INTERVIEW

The growing tailwinds behind GP-leds



A greater understanding of the benefits of GP-led deals among both GPs and LPs may drive continued market expansion, say Neuberger Berman's Ben Perl, Ethan Falkove and Peter Bock

Secondaries players may be busiest during periods of economic uncertainty with activity centred around buying up LP fund positions. But this time around it has been very different. Having gained ground in the years leading up to the pandemic, GP-led deals have dominated the post-covid secondaries market.

In early 2021, we spoke to Neuberger Berman managing directors Ben Perl, Ethan Falkove and Peter Bock to get their take on what has been driving GP-led deal volumes both pre- and post-pandemic, how to spot the best opportunities and how the market may evolve further.

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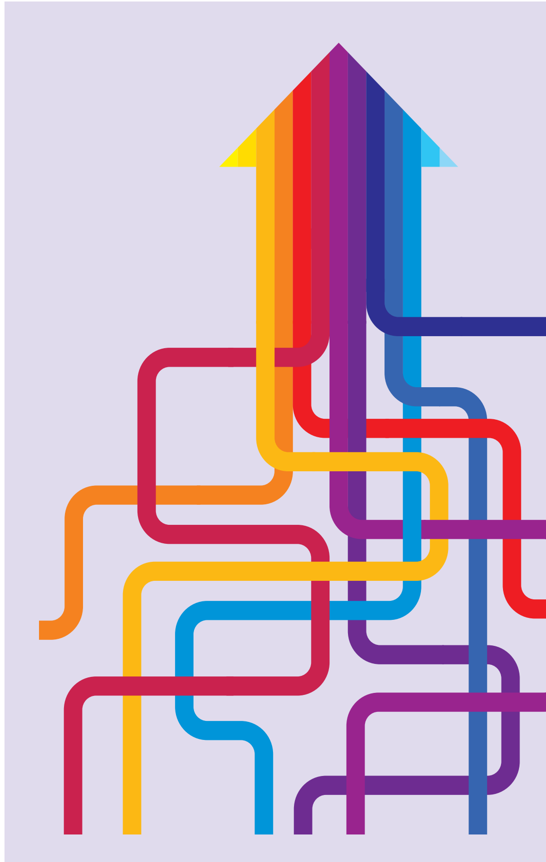
Q GP-led deal activity was growing fast in the lead-up to the pandemic. What was driving that?

Ben Perl: At their core, GP-led secondary solutions offer private equity fund managers another constructive way to address some of the structural challenges that can be present with a closed-end fund structure. Namely that certain assets may benefit from additional time and certain assets may benefit from additional access to capital, both of which may be unavailable or constrained in the existing fund structure.

Part of the market's more recent growth stems from the continued evolution of these solutions, in particular the adoption of single-asset continuation fund solutions in which a single company is rolled into a new fund. These transactions were gaining traction through 2019 and that was accelerating as we entered 2020.

We believe many GPs are embracing single asset solutions as they enable fund managers, and, of equal or more importance, their LPs who do not want liquidity, to own valued assets for longer and continue to invest in them. Prior to these solutions, GPs were often faced with primarily two, arguably sub-optimal paths – either sell to someone else and forego future potential value appreciation or extend duration for all LPs and reduce the liquidity available to LPs who may not be as patient.

> *"The motivation must be about creating further value rather than monetising or exiting the investment today"*
>
> **Ethan Falkove**



Q How has the pandemic affected GP-led activity?

Ethan Falkove: Before the pandemic, we were getting to the point where GP-led technology for the best assets in older funds was becoming more widely accepted and understood. When covid-19 struck, there was a concern among many GPs and LPs that liquidity could abate as traditional monetisation paths might become more challenged. Against this backdrop, many recognised the elegance of GP-led secondary solutions whereby GPs can create attractive liquidity options while continuing to own their best assets for longer, and often in a better capitalised manner, in a volatile and uncertain market.

As buyers, we have been focused on well-performing assets, particularly in a more challenging economic environment. And while we have always focused on asset selection, the uneven effect of lockdowns on different sectors has underscored this focus and reinforced the challenges that we think can present when buying traditional portfolios of multiple fund interests and hundreds of companies in a single transaction, especially if access to underlying company financial information is limited.

With GP-led deals, buyers can really dig inside a portfolio or asset, talk to the management teams and understand how the business has been positioned during the pandemic. It is much easier to choose the companies to invest in when you have access to the right information.

Our existing portfolio of GP-led deals has performed well through the pandemic which we attribute to our thorough due diligence and deal structuring.

Q Do single-asset deals currently predominate in the market?

Peter Bock: We are seeing a surge of single-asset continuation fund deals in the market and, in fact, we have heard that some advisors have concerns that there may not be enough secondary capital to address the full demand for these GP-led solutions. As it relates to single asset transactions, they can be particularly appealing to both GPs and buyers when the company is performing well and the secondary creates a path for continued growth, for example by providing additional capital and time to complete substantial M&A.

That having been said, while there has been a surge in these transactions, and certainly the headlines tend to focus on these transactions, the overall GP-led market is still a mix between single asset and portfolio opportunities.

Q To what extent might we see a reduction in asset quality as more single-asset transactions come on to the market?

EF: Generally, we are seeing higher quality assets come on to the market, although we do see some that fall below the bar. That is also true of multi-asset GP-led transactions. However, GPs often view single-asset deals as a route to further value creation for well performing companies and for them it is arguably less risky to hold these existing, known assets and compound for longer than invest in new companies.

From a buyer standpoint, single-asset deals can offer access to attractive assets of high-quality sponsors. However, as a buyer, you typically need to conduct a great deal of due diligence and that is not easy for many. Beyond

Q How do you think the GP-led secondaries market will develop moving forward?

PB: We expect the market to continue to expand. We saw a lot of growth in 2020, even versus 2019, which was already a strong year. Many firms have now completed their first GP-led secondary and with a successful playbook, they have the confidence to move on to subsequent transactions. A growing list of GPs have accepted these types of deals as an important tool to meet their portfolio management needs.

On the LP side, we spent a lot of time educating investors two to three years ago about the benefits of these transactions and we are now seeing them ask much more informed and focused questions around what is happening in the market. These factors are translating into a lot of interest and driving capital towards this area.

BP: We have already seen significant evolution in the market. Remember that GP-led deals started out with whole funds, then came partial portfolios and now you have single-asset deals. While it may be hard to predict exactly how the market evolves and what new technologies are developed, as Peter said, we have confidence that these solutions are creating attractive liquidity options and value for all stakeholders and this should drive their continued growth and adoption. And I do not think we are alone in recognising this. Major investment banks, for example, have made recent pushes to enter the secondary advisory business because of GP-led deals – that would have been inconceivable for many of these banks as little as two years ago.

the work we do with the sponsor and the underlying management teams, we also leverage our access to proprietary private company information, a large database of private equity transactions, dedicated buyside research analysts and other differentiated diligence resources available to us, in order to help us figure out the right companies to invest in at the right valuations. These resources help us distinguish between transactions that may be designed to find an exit versus those focused on growing the real gems in their portfolio.

Q What about new secondaries entrants to this part of the market – is that increasing competition for deals?

BP: It is a great question. We have completed over 30 GP-led investments and have been speaking about the merits of these secondary opportunities for many years now. When we first started preaching about this attractive, nascent and growing part of the market many years ago, there was a lot of education. Many investors and secondary market participants did not see the development and opportunity as we did. However, as the market has matured and earlier investments have demonstrated why these can be attractive, there has been growing interest in the GP-led sector, especially as the supply of these opportunities continues to outpace the demand or the capital available to support the growth. Q4 2020 looks to have been a record period for GP-led transactions even as more traditional secondaries were down year-on-year.

That having been said, we have not seen many new entrants or a dramatic change in the competitive dynamic. In fact, there is an argument that we can be more selective today than ever before given the growth of the overall opportunity set. Part of what continues to be a barrier to entry is that GP-led deals are not easy transactions to underwrite. You really need the right underwriting processes, investment teams, diligence resources and industry expertise. There are also a lot of legal and structural complexities, and one should also understand GP motivations and create the right options for LPs. The skillset required is different from other types of secondary deals.

Q One concern some might have about GP-led deals is the potential for misalignment between parties. How do you mitigate this risk?

EF: We believe there must be a clear rationale for the deal – that there are strong growth prospects for the assets – and existing LPs need to be treated fairly. We endeavour to structure our transactions to have a strong alignment with the GPs we are backing and to provide the right liquidity options for existing investors. Every situation is bespoke – there is no cookie-cutter approach to this. But we want GPs who have great conviction and are more buyers than sellers in these deals.

The motivation must be about creating further value rather than monetising or exiting the investment today. Most GPs pursue these deals for the right reasons and advisors are doing a good job, but we do sometimes see situations we are not comfortable with and in these cases, we simply pass on them.

Q What trends are you expecting to see through 2021?

EF: We may well start seeing younger portfolios of assets coming to market. The market started out with older portfolios, but with the emergence of single-asset and multi-asset deals there is scope to do deals at an earlier point in the fund lifecycle. This would offer LPs more optionality around liquidity and is likely to be well received by investors. ■