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NEUBERGER | BERMAN

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Navigating Secondary Growth: Opportunities Beyond the Horizon

Secondaries has been one of the fastest growing segments of the private equity market for well over a decade. We see continued support for its long-term growth, which we expect to be expedited by renewed macroeconomic uncertainty and recent market volatility.[1]

For both limited partners ("LPs") and general partners ("GPs"), secondaries are a solution for the private equity market's constrained liquidity, which we expect to remain lower for longer than many market participants had been anticipating toward the end of 2024. Nonetheless, despite strong secondaries fundraising, the market remains undercapitalized, resulting in relatively attractive pricing even after the deeper discounts of 2022 – 23 have narrowed.

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Executive Summary

Historically, increased volatility and heightened uncertainty have resulted in periods of tight liquidity and created a more compelling opportunity for secondary buyers. Given the size of the market, the sophistication of LPs, and the established GP-led market, we expect the positive impact from the current uncertainty and volatility to be much larger than in prior cycles.

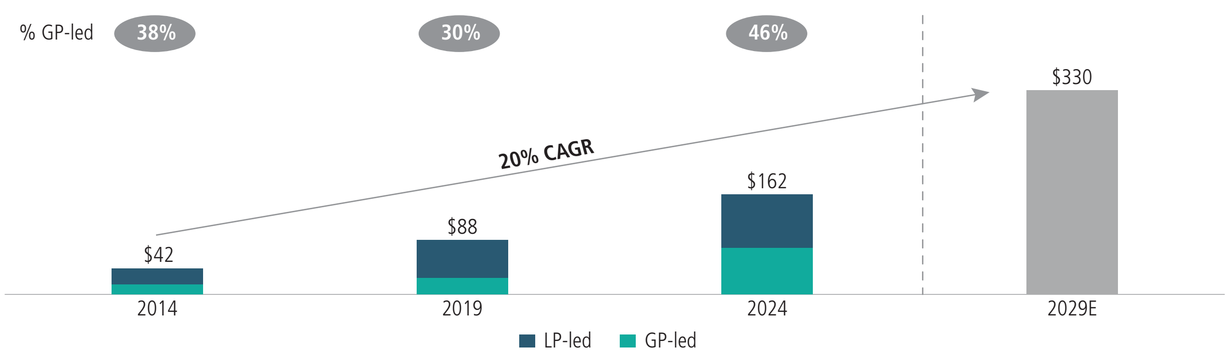
- **Record secondary volume:** New records were set in 2024, driven by both LP- and GP-led transactions.
- **Long-term and near-term growth support:** Secular support remains in place, while secondaries are seen as the potential solution to the industry's prolonged lack of exit liquidity.
- **Continuing growth in GP-led secondaries:** We see further adoption as GPs realize they can hold on to star assets while making much-needed distributions to investors, and LPs recognize the attractive return potential as supported by the latest data that appear to confirm that GP-led transactions can generate buyout returns with lower risk.
- **Undercapitalization relative to demand:** Secondary fundraising has been strong, but not strong enough to keep pace with the growth in transaction volumes, resulting in attractive supply-demand dynamics for buyers.
- **Attractive pricing:** The supply-demand balance keeps pricing attractive relative to long-term averages; we observe pockets of value in high-quality LP- and GP-led transactions.

Record Secondary Volume

At $162bn of transaction volume, according to Jefferies, the secondary market hit record levels in 2024.[2] Volumes were up nearly 45% versus 2023 and more than 20% versus the prior record year of 2021. Notably, it was a record year for both LP- and GP-led transactions. Consistent with prior tends, Jefferies anticipates a further doubling over the next five years.[3]

FIGURE 1. ROBUST, SECULAR GROWTH IS FORECAST TO CONTINUE

Private equity secondary market volume, 2019 – 2024, and estimated for 2029, $bn



Source: Jefferies. Data as of March 2025.

[2] For comparison, Lazard put the figure at $152bn (Secondary Market Report 2024, January 2025); Evercore estimated $160bn (FY 2024 Secondary Market Review, February 2025); and PJT Capital Solutions estimated $165bn (Full Year Secondary Market Update, January 2025).

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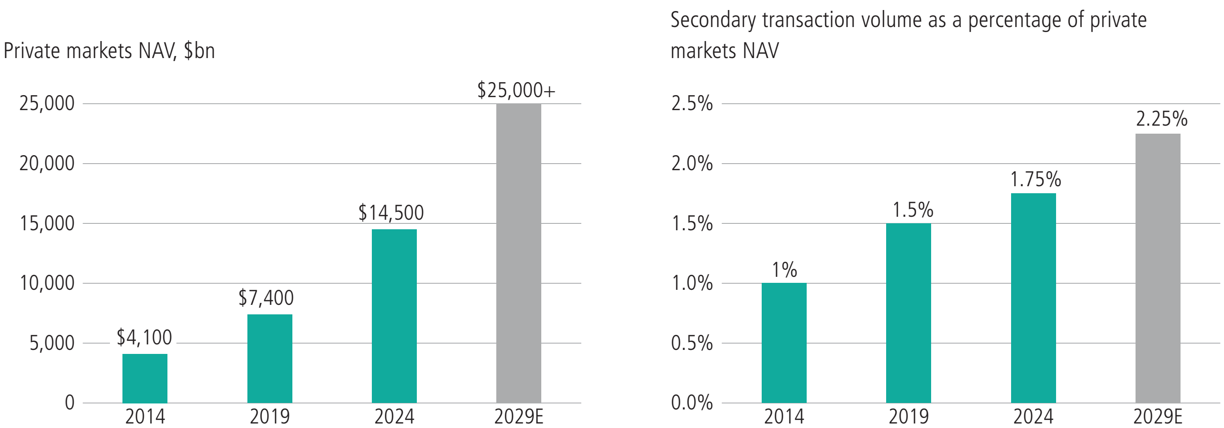
Long-Term and Near-Term Growth Support

We have documented the long-term drivers of the growth and evolution of this market in previous publications.[4]

- The most important is the sheer size and growth of the private equity industry. The combined NAV of private market funds was $14.5 trillion by the end of 2024, up by almost 100% from $7.4bn in 2019, creating a larger pool of assets with the potential to be offered into the secondary market. As this NAV of private market funds grows, so too does the supply of secondary investment opportunities.[5]
- Moreover, despite the secondary market growing by approximately four fold since 2014, the volume of secondaries trading remains low at between 1% and 2% of the total private markets NAV. Regardless of changes in the exit and liquidity environment, we believe this proportion will continue to rise as LPs become more active in managing their private markets holdings and GPs become more sophisticated in managing their investors' cash-flow needs. Even a small increase from the currently low turnover percentages would have a substantial impact on secondary market transaction volume.
- Finally, GP-led secondaries have been a key driver of growth: a segment of the secondary market that barely existed a decade ago now represents half of all transaction volume.

FIGURE 2. FAST-GROWING… WITH SIGNIFICANT POTENTIAL



Source: Jefferies. Data as of March 2025.

Furthermore, we have observed that these secular long-term growth drivers are expedited by near-term catalysts.

- During 2023 and 2024, secondaries got a boost as high and rising interest rates contributed to a significant decline in exit activity for private portfolio holdings. Many market participants anticipated a break in this logjam in 2025 as rates declined and the new U.S. administration was expected to create a more favorable regulatory environment for dealmaking. Contrary to expectations, M&A was lower in the first quarter of 2025 than it was the year before, and IPO markets have not reopened due to macroeconomic and geopolitical uncertainty. Market participants now expect exit activity to remain lower for longer than previously anticipated.
- Distributions as a percentage of NAV appear to have stabilized at 2023 levels, which was the worst year for buyout exits since the Global Financial Crisis of 2008. This lack of liquidity has led to many LPs having to contribute more capital to their private portfolios than they are receiving in distributions, and these persistent net capital outflows have begun to stress the self-funding nature of those investments.

[4] See "Opportunity in the Undercapitalized World of Private Equity Secondaries," November 2023, at https://www.nb.com/en/us/insights/insights_opportunity_in_the_undercapitalized_world_of_private_equity_secondaries; "Three Notable Trends in the World of Secondaries," November 2023, at https://www.nb.com/en/link?type=article&name=insights-three-notable-trends-in-the-world-of-secondaries; "GP-Led Secondaries: Private Equity's Most Underserved Market?" June 2023 at https://www.nb.com/en/us/insights/insights-gp-led-secondaries-private-equitys-most-underserved-market.

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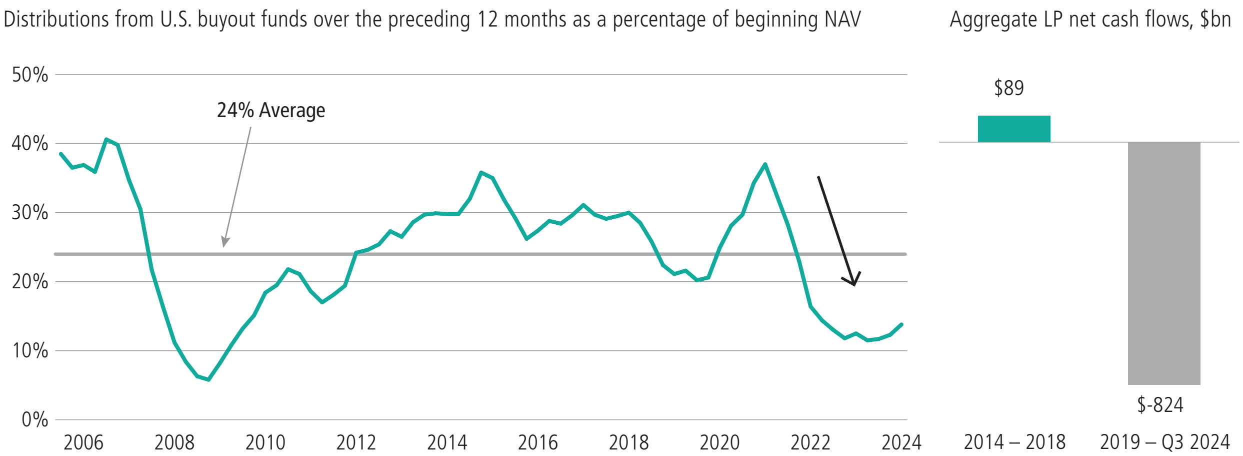
FIGURE 3. LACK OF EXITS CREATING CASHFLOW CHALLENGE



Source: Left-hand chart. Pitchbook as of 2024 Q4. Note: The data for the most recent two quarters was estimated based on exit deal value. Data depicted is the product of third-party sources and not the product of NB funds.
Source: Right-hand chart. Preqin. Data through 2024 Q3, which is the latest available. Data includes global private equity only. For illustrative purposes only. Statements made herein may represent opinions and beliefs of NBAA and are subject to change, and should not be relied upon as a promise or representation as to past or future performance. Historical market trends are not necessarily reliable indicators of actual future market behavior or future performance of any particular Neuberger Berman product and there can be no assurance such trends will continue. All information contained herein is to be read in conjunction with the endnotes.

Importantly, we expect the effect of a more active exit environment on LPs' net cash flows to be muted, as the same market dynamic that would drive exits would also likely spur GPs to draw down larger amounts of committed dry powder. We believe a broad reopening of the exit markets requires a more positive macroeconomic outlook and a decrease in the buyer-seller valuation gap dynamics, which would also drive increased investment activity by private equity funds. Once investment activity accelerates, it is our belief that GPs will be poised to deploy large amounts of dry powder, leaving LPs unable to control the pace of capital calls. We believe the pressure on LPs and GPs to generate liquidity via the secondary market will therefore persist for longer.[6]

Continuing Growth in GP-Led Secondaries

In a continuation fund transaction, a GP sells one or more portfolio companies from a typical 10+ year primary fund to a new investment vehicle—the continuation fund—managed by the same GP and structured at prices in negotiation with secondary investors.

We believe these GP-led secondary transactions can meet the liquidity needs of primary fund LPs and GPs while also generating potentially attractive long-term returns for GP-led investors. LPs in the primary fund can either cash out their current stakes or roll them into the new continuation fund to potentially generate additional value from select portfolio companies, allowing the individual LP to manage its specific duration and cash flow objectives. In these transactions, GPs are able to secure extra time and capital to create more value in some of their most successful portfolio companies. Rather than sell their best holdings to other PE sponsors, GPs can partner with secondary investors while still maintaining ownership and control of their high-conviction assets.

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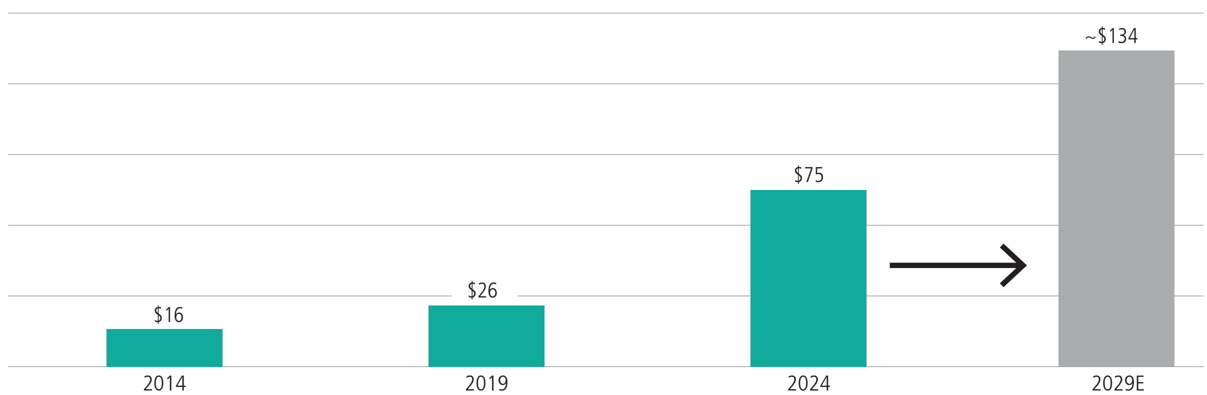
For investors—particularly value-oriented investors—GP-led transactions may be an opportunity to acquire best-in-class companies at valuations below a change-of-control transaction. In addition, by structuring the transaction as an investment rather than a liquidity event for the GP, meaning that GPs increase their financial investment in the assets at the transaction valuation, the secondary buyers may create strong alignment. Finally, GPs will have owned these companies for five to six years, on average, and built deep relationships with company management teams and have proven playbooks for value creation. We believe this can reduce operational and execution risks relative to new buyout transactions.[7]

Early market data supports the thesis that GP-led transactions outperform buyout transactions with lower risk. A recently updated market study by Morgan Stanley confirmed that "continuation funds generate a higher median net multiple on invested capital ("MOIC") compared to buyout funds, while achieving a lower principal loss ratio."[8] An earlier study by the HEC Paris Business School in partnership with Evercore showed similar results: comparing simulated baskets of 10 continuation funds picked between 2019 and 2023 with 2019 vintage buyout funds, they found that average performance was similar but with lower return dispersion among the continuation funds. As Evercore observed, "This is in line with the thesis underpinning the continuation vehicle ("CV") asset class—a positive selection bias of good performers that GPs wish to 'buy again' for another investment cycle".[9]

It is no surprise that "continuation funds have represented the fastest growing segment of the secondary market [since 2018] and today represent almost half of the secondary market," according to Morgan Stanley Private Capital Advisory.[10] They have become an important avenue through which GPs monetize assets, accounting for 9% of total private equity exits in 2023.[11] In 2024, the percentage of exits generated by GP-led transactions increased to 14% of all exits, estimates Morgan Stanley. As we saw above, GP-led secondaries accounted for half of secondary market volume in 2024, and we think the market is poised for continued growth. According to a survey published this year by PJT Private Capital Solutions, nearly 65% of GP respondents are or have been users of the secondary market, while 75% expect to use it opportunistically over the next 24 months.[12]

FIGURE 4. GROWTH IN THE GP-LED SECONDARIES MARKET

GP-led secondaries volume, $bn



Sources: Jefferies, data on realized volume as of January 2025; PJT Private Capital Solutions, estimate for 2029 as of February 2025.

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[8] Morgan Stanley Private Capital Advisory, *The Case for Continuation Funds: An Updated Review of Initial Performance* (March 2025).

[9] Oliver Gotschalg, "Continuation Funds: Performance and Determinants, 2018 – 2022 Vintages" (April 2024) at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4752652; Evercore, *H1 2024 Secondary Market Review* (July 2024) at https://www.evercore.com/wp-content/uploads/2024/07/Evercore-H1-2024-Secondary-Market-Survey-Results_vF.pdf.

[10] Morgan Stanley Private Capital Advisory: *The Case for Continuation Funds: An Updated Review of Initial Performance* (March 2025).

[11] "Percentage of GP-leds in PE distributions nearly doubled in 2023", *Secondaries Investor* (January 2024), citing data from mid-market investment bank Baird.

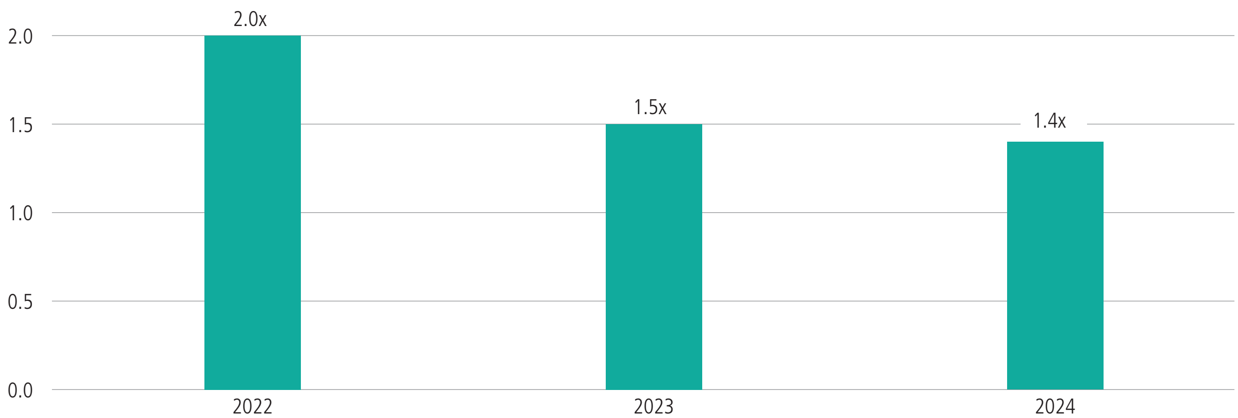
[12] PJT Private Capital Solutions, FY 2024 Secondary Market Update (January 2025).

Undercapitalization Relative to Demand

Reflecting strong demand for secondary market liquidity from both LPs and GPs, transaction volumes continue to outgrow fundraising and we believe that the market remains undercapitalized. Fundraising for secondaries funds has been strong, but has not kept pace with the growth in transaction volume. Dry powder is at record highs, but as a proportion of transaction volume, it has fallen from approximately 2.0 times transaction volume before the pandemic to 1.5 times in 2023 and just 1.4 times in 2024. For comparison, dry powder in the primary private equity market tends to hover consistently around three or four times transaction volume. We believe that this undercapitalization is one of the main factors holding back even stronger secondary market growth.

FIGURE 5. UNDERCAPITALIZATION MEANS ATTRACTIVE SUPPLY-DEMAND RATIO FOR SECONDARY BUYERS

Estimated unused secondary market commitments as a proportion of secondary market transaction volume



Source: Evercore Private Capital Advisory, PJT Park Hill. For illustrative and discussion purposes only.

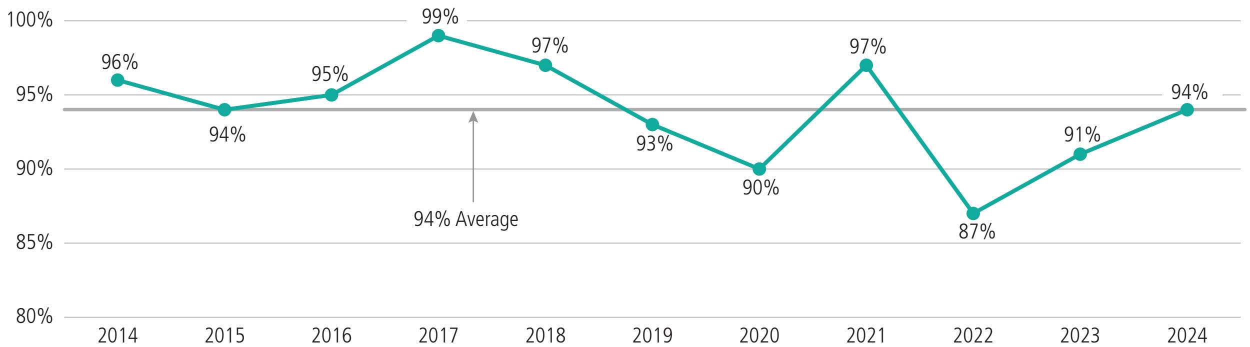
This undercapitalization is particularly acute in the GP-led market. We estimate that dry powder destined for GP-led transactions is *less than* current annual transaction volume. Consequently, we believe that approximately half of the GP-led transactions that GPs wanted to bring to market during 2023 and 2024, by value, did not launch due to capital and lead investor constraints. We do not anticipate a correction to this imbalance within the medium term, as we believe additional capital will merely unlock additional transaction opportunities. As such, we believe the current attractive supply-demand ratio for secondary buyers is likely to persist.

Attractive Pricing

As shown in the chart below, secondary pricing has been volatile over the past three to five years. In 2024, buyout LP positions priced on average at 94% of NAV, above the 10-20% discount range seen in 2022 and 2023. Despite this tightening, we believe that current pricing remains attractive relative to historic pricing which hovered around par for most of the past decade.

FIGURE 6. DISCOUNTS HAVE NARROWED, BUT REMAIN ATTRACTIVE ON A LONG-TERM VIEW

Secondary market in buyout funds, annual average high bid as a percentage of NAV



Source: Jefferies. Data as of January 2025.

While discounts narrowed in the LP secondaries market in 2024, we believe that the drivers warrant careful dissection to effectively assess the real attractiveness of the current market opportunity:

- As PJT Private Capital Solutions notes, the average discount has tightened "due to heightened competition for diversified portfolios,"[13] which Neuberger Berman sees as an indication that average pricing in this segment is being driven by less-discerning buyers who need to satisfy their required investment pace.
- We have also seen sellers actively trying to minimize the discounts they have to accept by:
  - Offering larger pools of assets with the intention to divest only a subset of these assets, those that minimize the headline discount. A large endowment or insurance company might offer $4 – 6bn of NAV to prospective buyers with the aim of creating "only" $1 – 2bn of liquidity from a sale.
  - Divesting funds of increasingly younger vintage years, which typically trade at higher valuations that reflect their greater value-creation potential.
  - Offering deferred payment options that typically allow buyers to pay higher headline prices.
- We believe GP-led pricing has remained fairly stable relative to the intrinsic value of the assets during 2023 and 2024, which would reflect the relative undercapitalization discussed above.[14]

Against that backdrop, we see attractive pockets of value:

- The targeted acquisitions of high-quality assets with conviction offer the opportunity to buy at attractive prices relative to intrinsic valuations, both in LP- and GP-led secondaries. Importantly, as we discussed in a prior paper, we believe this also to be a risk-minimizing strategy in uncertain times: "Whereas index buyers try to *mitigate* risk via diversification, targeted buyers try to reduce risk via selectivity and a focus on quality."[15]
- As a firm, we continue to see the value in actively sourced investment opportunities, which can avoid the broader, highly competitive intermediated auction market and which solve for specific sellers' needs such as speed, certainty of execution and confidentiality.

Historically, periods of tight liquidity, increased volatility and heightened uncertainty have created a more compelling opportunity for secondary buyers, and we expect current market conditions and the trends that are present in the market to benefit secondary buyers. Given the size of the market, increased portfolio management by LPs, and the established GP-led market, we expect the positive impact from the current uncertainty and volatility to be much larger than in prior cycles.

[13] PJT Private Capital Solutions, *FY 2024 Secondary Market Update* (January 2025).

[14] Based on NB market observations and analysis as of the date of this report.

[15] Peter Bock, Philipp Patschkowski and Ben Perl, "Three Notable Trends in the World of Secondaries" (November 2023) at https://www.nb.com/en/link?type=article&name=insights-three-notable-trends-in-the-world-of-secondaries.

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