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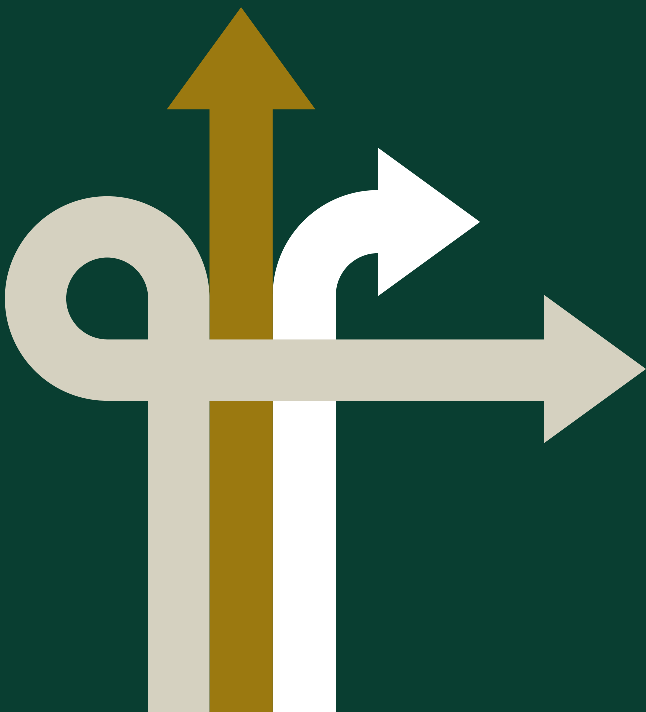
GP-led secondaries transactions



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What's in your liquidity toolkit?

In the context of continued LP scrutiny of all performance indices and management fee levels, GPs/managers continue to seek to differentiate themselves in terms of yield and broader 'value add' for investors. Increasingly they are looking to a range of sophisticated fund management and liquidity tools in order to maximise returns and distinguish their offering.

The emergence of these toolkits is taking managers far beyond the traditional private equity investment and divestment cycles and into constant and active portfolio and investor base management. With one of the largest teams in the UK dedicated to the whole spectrum of private equity activity, we leverage the depth of our M&A, funds, tax, regulatory and finance capabilities to help our clients evaluate, select, structure and execute the right transactions at strategic times in the life of each of their fund vehicles.

Identifying your transaction drivers

Identifying the GP's primary transaction drivers is key to designing the right GP-led solution. The most successful are by their nature highly bespoke and should draw on expertise and contacts across the primary and secondary equity and debt markets (as well as the adviser universe) to ensure the most efficient and cost-effective transaction structure.

Why are GPs focussing on liquidity options?

Value extraction

- Provide LPs with liquidity
- Enhanced IRR
- Locked-in returns
- Synthetic exits / dividends

Value creation

- Follow-on capital
- Maximise time to extract portfolio value
- Enhanced DPI
- Specific asset solution

Strategic and capital raising

- Stapled capital and liquidity ahead of a fundraise
- GP succession planning
- Carry liquidity and reset economics
- Retention of flagship asset(s)

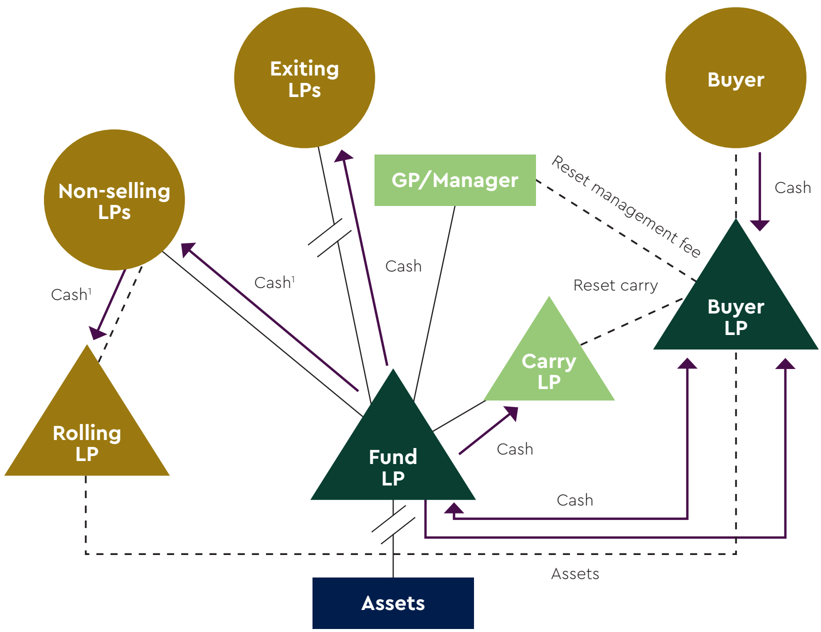
GP-led secondaries – the alternative exit?

GP-led secondaries have been heralded as a solution to two of the major structural challenges posed by the private equity model:

1. that a 10+1+1 fund life does not always track the growth trajectory of underlying portfolio investments
2. investors are increasingly seeking smoother and more regular liquidity during a 10+ year commitment cycle, favouring more active management of investments throughout their hold period over back-ended exits.

The secondaries market has well and truly thrown off any historic association with it being the sole domain of zombie funds or those with fundamentally misaligned GPs and investors and has instead emerged as an invaluable tool for efficient fund management. According to a report published by Campbell Lutyens, GP-led secondaries accounted for the majority of secondary transactions in 2020. In part, this was because LP-led deals suffered the brunt of the COVID-19 dislocation, but the dominance of GP-leds in 2020 followed several years of strong growth.

Liquidity offering via full asset sale



[1] Note that "roll" could be achieved via a distribution in specie if more tax efficient.

Key workstreams

Asset valuation & selecting a secondaries buyer

Sophisticated secondaries buyers will form their own views as to the value of assets, particularly as reference dates for the latest fund valuations may well lag behind the proposed sale. A clearly articulated story for the future growth of the relevant asset(s) is key. Sophisticated LPs also expect nothing less than robust market-tested pricing (and potentially fairness opinions) when evaluating whether to support transactions where the GP sits on both sides of the table. Regulatory considerations also favour equality of access to information.

Structuring & navigating the legal documentation

Expertise is required across structuring and documentation of the asset sale (including related change of control analysis), the rollover of existing LP and GP interests and the fund terms for the continuation vehicle – all of which may sit alongside a wider fundraising exercise for the GP for which this transaction may offer vital stapled capital. Strong market-knowledge, technical expertise and proven experience in running complex, multi-faceted processes are key skills required of advisers in this space.

Managing a positive & efficient dialogue with investors

Careful management of the interface with LPs and securing LPAC buy-in for these types of transactions is key to their deliverability. Conflict management is a fundamental part of running a successful GP-led process as there are a number of stakeholders to manage, including existing investors taking liquidity out, existing investors rolling into the new structure, new investors backing the continuation vehicle and the GP's own stake and fee package on both sides of the sale. Each of these interests needs to be carefully balanced in the context of agreeing bespoke economic terms for each component of the deal, including the price paid for the assets (set as a percentage of NAV), the terms of the new capital and carry and management fee arrangements, the terms of any stapled capital and the allocation of transaction fees amongst the various stakeholders.

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