ROUNDTABLE

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Growing pains

The return of the LP portfolio sale is poised to push private equity secondaries over $100bn this year. But does the industry have the human capital to keep up? By Amy Carroll and Chris Witkowsky

Despite a stubbornly persistent global pandemic, the explosive growth of the secondaries industry continues unabated. Indeed, participants at *Buyouts*' inaugural secondaries virtual roundtable discussion were unanimous in their belief that 2021 would see the market break the $100 billion barrier for the very first time.

"We are as busy as we have ever been," says Ben Perl, managing director at Neuberger Berman. "GP-led activity continues to be elevated and the LP trade is currently coming back as well, with pent-up demand from those sellers that delayed rebalancing their portfolios in the depths of covid."

"I am confident that this will be the year when we exceed $100 billion," adds Adrian Millan, partner at PJT Partners. "Whilst 2020 was heavily focused on concentrated deals, we now see the bounce back of LP portfolios and should end up somewhere around 50:50 for 2021."

Mike Suppappola, a partner at Proskauer, points out that while a massive amount of dry powder has been deployed since the market came back in Q3 2020, there has also been a huge amount of secondaries capital raised, with significant additional fundraising slated for next year.

"We all know the name-brand secondary funds that are hitting the market," he says. "Then there are the new entrants. From an opportunity standpoint, we are also seeing GP-led deals spread into the mid-market. That is opening up a whole new opportunity set. Add in the return of large LP portfolio sales and it is clear that there are no signs of a slowdown."

LP portfolio sale resurgence

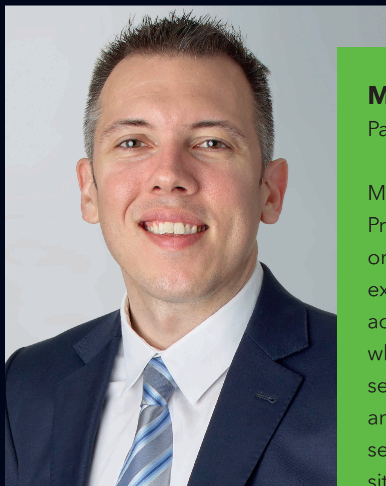
Indeed, the resurgence of limited partner portfolio sales seems to be the big story of the latter half of the year, following 18 months dominated by the meteoric rise of concentrated GP-led deals, and particularly single-asset transactions.

"The pipeline for GP-led deals continues to be strong," explains Andrew Gulotta, partner at Sixpoint Partners. "But because secondary buyers have been so active in this segment, the bar is getting higher and higher. Meanwhile, we have seen some tail-end LP portfolios that would have struggled to get two or three decent bids previously that are now getting 10.

"These aren't portfolios with a ton of upside. But with everyone having pursued single-asset deals over the past 12 months, the mindset for many buyers is that it is time to get back to the diversified LP portfolios that they originally pitched to their own LPs."

John Carter, managing partner at Hollyport Capital, which focuses on legacy portfolio transactions, agrees: "There was a brief lull while LP sellers held fire in the midst of the pandemic, but that LP portfolio dealflow is now coming back strongly. The idea of the 10-year fund life is an illusion. The value held in funds that are 10 years old or more is growing year by year and big institutional investors with longstanding private equity programs are increasingly bringing those older vintages to market on an annual or biannual basis. That is creating a regular flow of transactions."

That doesn't mean that GP-led deals have disappeared, Carter clarifies. "We have seen 10 new GP-led deals this week, a number of which involved single assets. I do wonder, however, how many of those deals will actually get done. Some will struggle on engagement and some will struggle on price. Whereas, if you are an



Mike Suppappola
Partner, Proskauer

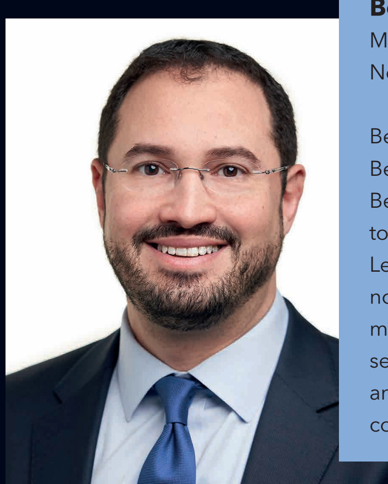
Mike Suppappola is a partner in Proskauer's Private Funds Group, with a particular focus on fund formation and the structuring and execution of secondary transactions. He advises a broad spectrum of fund sponsors who pursue a variety of strategies and sectors across North America, Europe and Asia, including buyout, private credit, secondaries, distressed and special situations, growth equity, venture capital, real estate and funds of funds.

John Carter
Managing partner, Hollyport Capital

John Carter has been a private equity investor since 1987, initially as a direct investor, before focusing on the secondary market from 2002 and co-founding Hollyport in 2006. Carter has overseen the growth of Hollyport through a focused strategy of acquiring private equity assets that are beyond their original term. The firm both acquires portfolios of tail-end fund interests and invests in GP-led restructurings of mature funds.

Andrew Gulotta
Partner, Sixpoint Partners

Andrew Gulotta is a partner in Sixpoint's Capital Solutions group. He focuses on GP-led secondary transactions, as well as the firm's broader origination activities. He sources and advises clients on structuring, marketing and negotiating secondary transactions and related equity placements. In addition, he maintains relationships with secondary investors on behalf of the firm. Prior to joining Sixpoint in 2009, Gulotta was an analyst in JPMorgan's energy and environmental group.



Ben Perl
Managing director,
Neuberger Berman

Benjamin Perl joined Neuberger Berman in 2001 and Neuberger Berman Private Equity in 2007. Prior to that, he worked as an associate at Lehman Brothers Venture Partners, now Tenaya Capital. He is now a member of Neuberger Berman's secondary, real estate secondary and strategic capital investment committees.

Adrian Millan
Partner, PJT Partners

Adrian Millan is a partner in PJT Park Hill's secondary advisory team. Prior to joining Park Hill in 2009, Millan was a director with Citigroup Alternative Investments where he led secondary transactions and business development initiatives. Previously, he was a member of the TMT investment banking practice at JPMorgan Chase.

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> **ANDREW GULOTTA**
> **Sixpoint Partners**

adviser or vendor bringing an LP portfolio to market, right now, I suspect those deals will go through pretty smoothly."

Exceptional GP-led deals will continue to fly out the door, of course. But the range of quality coming to market is undoubtedly widening. "A decade ago, the majority of GP-led deals focused on rescue capital for struggling sponsors, which gave them a negative connotation in the LP community," says Suppappola. "That perception has changed completely with the rise of blue-chip managers coming to market with quality portfolios that have attracted a lot of buyers. LPs have come to recognize that these deals can be a win for everyone involved. That said, we may see an uptick in sponsors trying to take advantage of the single-asset deal trend but who may have slightly less attractive assets to offer, which would naturally lead to a more mixed opportunity set overall."

Balancing act

The quality of the assets themselves is not the only consideration, however. Buyers are balancing the credentials of the individual portfolio company with the motivations and alignment of the GP.

"Ideally, buyers are looking for trophy assets where there may be some kind of catalyst event such as a duration misalignment or insufficient capital remaining in the fund to support future acquisitions," says Millan. "And they want the GP to be willing to recommit economics in order to remain owners. They don't want a situation where the GP is neutral on whether they are a buyer or a seller. That doesn't resonate. Once you start to lose any of those key points, buyers start to fade away."

Perl adds: "We typically want GPs to be doubling down on an investment alongside us and not viewing the transaction as a selling opportunity. You can have a quality company, but that doesn't necessarily mean it will be a quality investment if the alignment or going-forward thesis is off."

It is the job of the adviser, then, to educate GPs on what is achievable. "Every GP thinks they have a trophy asset, but while we don't exactly tell managers that their baby is ugly, we do sometimes have to say you have a good company, not a fantastic company," says Gulotta. "And in the absence of an asset that is truly spectacular, there has to be a genuine rationale. It can't feel like an economic grab by the GP. If it feels forced or contrived, it won't happen."

And as the quality of deals coming to market continues to expand, the definition of standard terms is naturally also broadening. "Certain managers can attract LPs at premium terms based on the outperformance of flagship funds over a sustained period of time," explains Millan. "It stands to reason then that a continuation vehicle created by the same manager, involving the same assets, would also attract premium terms. As the diversity of assets increases, tension around what terms are appropriate for individual assets has grown and that has created more of a marketplace."

"It all comes back to the quality of the assets at the end of the day," adds Suppappola. "We have seen plenty of situations where the sponsor has overstepped on terms, which can lead to prolonged negotiations. If you want a deal to get done in an efficient and cost-effective manner, all parties need to be commercial."

Suppappola also says that buyers can

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PJT Partners

sometimes be just as frustrated by pressured timelines as they are by terms. "Although it isn't uncommon for buyers to already be existing LPs with some familiarity with both the sponsor and the underlying portfolio, both buyers and existing LPs appreciate having enough time to look under the hood and figure out what is going on," he explains.

Carter agrees. "At the end of the day, the terms have to make sense to the LPAC, to the GP and to the new funders," he says. "The market will find its level. It is as simple as that. If you are too aggressive on terms, then the deal won't get done."

And it isn't only the lead buyer that has to agree to terms in many of these transactions. "As deals get bigger, the terms often have to pass through a syndication process as well," says Millan.

"Syndication is a real risk if the term sheet is too GP friendly," adds Gulotta. "Depending on the size of the deal, the lead may circle only 25 to 50 percent of the equity need, so it can be real hand-to-hand combat trying to get the backend of the syndication done."

According to Perl, this is why there has generally been more terms creep in the broadly syndicated market than for more complex deals attracting just one or two buyers. "In syndicated processes the message to LPs can sometimes be that the terms, and even the economics, are pre-ordained," he says. "The situation where we generally seek to play is very different."

In addition, terms don't simply refer to management fees and carry. There are a whole range of points that must be considered in the round. Something that can be viewed as a positive on that ledger, for example, is a cross-over investment from the GP's new fund. "That can demonstrate conviction," Perl adds. "It is not something we automatically look for or require. But [it] can be part of the overall calculation."

"We have had a few deals where a cross-fund investment has been part of the equation," says Millan. "The fact that the deal is good enough to meet the criteria for the new fund is a huge alignment statement."

Suppappola, meanwhile, says that buyers can sometimes be more frustrated by pressured timelines than terms. "They appreciate some time to look under the hood and figure out what is going on," he explains.

Gulotta adds: "The documentation for a GP-led tends to take 30 days, sometimes more, and even if you are sprinting, it rarely happens in under three weeks. Syndicating can work along a similar timeline. There is no excuse to jam syndicate investors. It does happen though. I have heard those frustrations in market calls with the buyers."

Pricing pressures

While terms and timelines are certainly important, few considerations trump price. And prices continue to be high. "Pricing is at or above pre-pandemic levels," says Millan. "Most of the dealflow that took place in the second half of 2020

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> **JOHN CARTER**
> **Hollyport Capital**

Talent shortages

Human capital bandwidth is among the bigger challenges facing the secondaries industry, according to our roundtable participants.

"You would be hard pressed to find any secondaries buyer, agent or lawyer that says they wouldn't love to have more hands on deck to service the volume of dealmaking going on right now," says Mike Suppappola of Proskauer. "We are also in an environment where new entrants are looking to either acquire or build teams, driving up that demand for talent."

Hollyport Capital's John Carter points to the sheer number of moves there have been around the industry over the past two years, particularly within the adviser community. "The sector is crying out for more talent," he says. "From our perspective, trying to recruit from within the secondaries industry is nigh on impossible. We address that by recruiting from outside the market. The good news is that private equity is a very attractive sector and so it is possible to bring in talented individuals. But the training process takes time."

Neuberger Berman's Ben Perl adds that the proliferation of complex GP-led deals has exacerbated the situation. "You need people trained as direct investors – who know how to do due diligence and structure a transaction," he explains. "But, at the same time, you need people who have been trained and understand how to act as an LP. They can be very different skillsets."

"These GP-led deals are also far more resource-intensive than traditional LP portfolio transactions," says Carter. "So, you have this double whammy of a growth in volume and then resource-intensive processes requiring a different skillset. These pressures are all compounding one another."

PJT Partners' Adrian Millan, meanwhile, points out that the fact many of the new entrants looking to establish a position in the secondaries market have chosen to buy rather than build goes to show that this is not an easy skillset to teach. "It is also a relationship-based business," he says. "You need a depth of pattern recognition across cycles, and you need expertise across different asset classes and myriad different innovative deal types that have evolved over the past five years. That experience is something that the market has put a premium on as it has continued to grow."

and first half of 2021 was buyout-centric and focused on companies in the technology and healthcare sectors – those industries not adversely affected by covid. Most LPs will not trade outside a 15 percent discount and so that has been the natural selection of the deals that have been done."

Pricing for LP portfolio sales is also robust, due to increased demand from the buyer base. "We have been pleasantly surprised by the pricing for a few tail-end portfolios recently," says Gulotta. "Deals we would have expected to fall in the 20 percent discount range have priced at a roughly 10 percent discount. While the remaining upside is small, the steady distributions are attractive. That demand profile is not going away. Add in the ability to back-lever diversified portfolios at extremely low rates, and that really moves the needle on IRRs."

And so, for now at least, it is hard to predict what could unsettle this relentlessly buoyant market. "There is lots of capital available to be deployed and lots of assets coming to market," says Carter. "M&A activity is high. You can raise debt at attractive rates. Something will eventually happen to make the cycle turn, which is why we focus on rigorous due diligence and maintaining price discipline. But for now, the market is in a healthy state of equilibrium."

Indeed, the private equity secondaries market is offering such an abundance of opportunity that, in some respects, it is thwarting the emergence of vibrant secondaries markets in other asset classes. Although the private credit secondaries industry appears to be on the cusp of significant growth, real estate, in particular, is still lagging.

"We worked on the largest LP real estate portfolio secondaries transaction for a large state pension in 2015 at $3 billion," says Millan. "At the time we thought that was a seminal event that would open up the market. But there have been headwinds. There is a smaller set of LPs in those funds so, by extension, the potential secondaries market is more limited. Real estate has also been hit hard by the pandemic across hospitality, retail and office space and it will take a long time for that equilibrium to be recovered. Private equity, by contrast, snapped back far more quickly."

Carter adds: "The fact that the private equity opportunity set has been doubling every few years has also hindered the growth of secondaries in these other asset classes. Credit is on the verge of real growth, but with $100 billion already in the bag for private equity secondaries this year and another record likely in 2022, there is limited reason for specialist firms such as ourselves to move outside the mainstream market." ■