Buyouts

Secondaries

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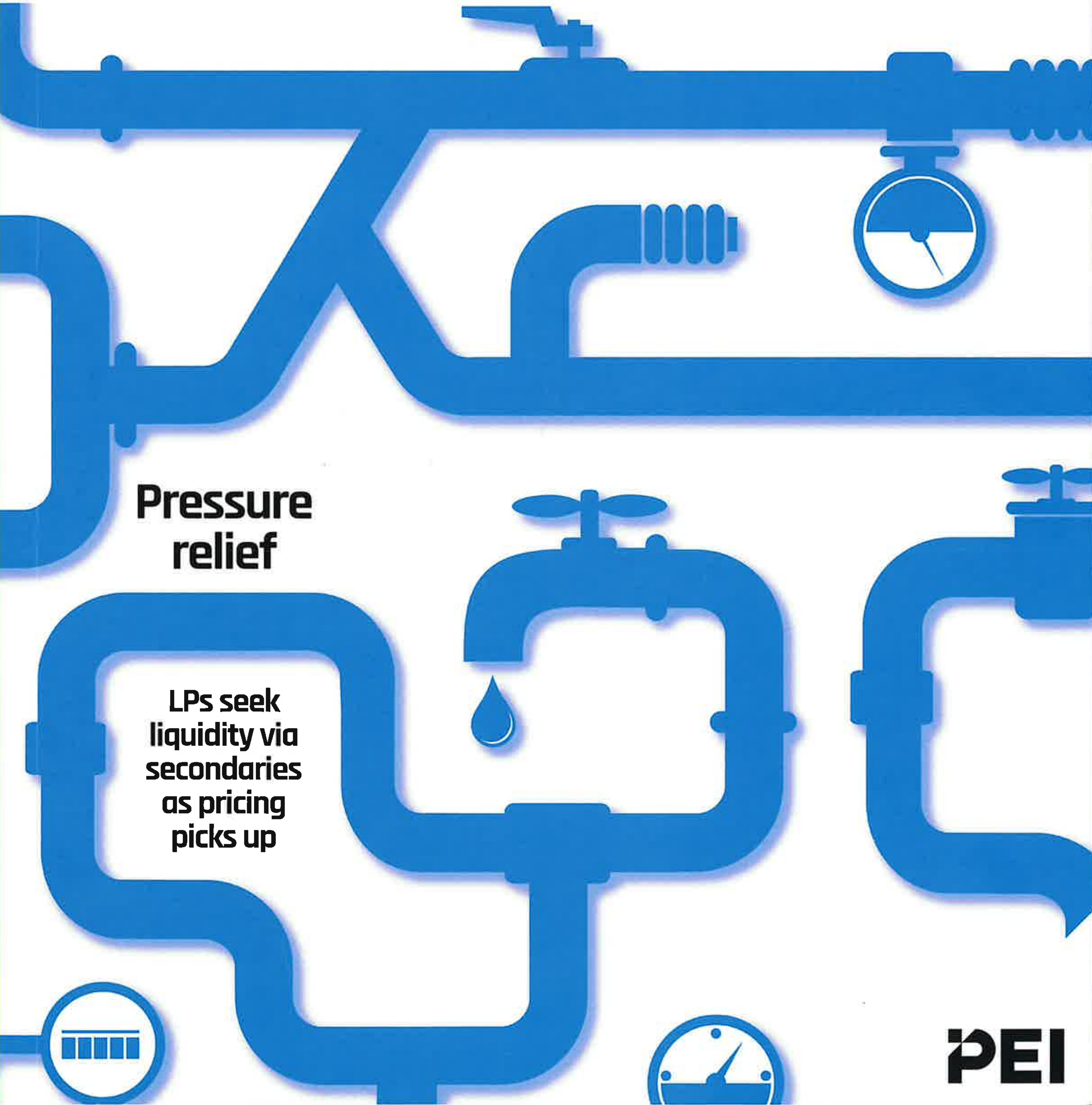

Pressure relief

LPs seek liquidity via secondaries as pricing picks up

PEI

KEYNOTE INTERVIEW

Secondaries 3.0: Beyond continuation funds

The next phase of secondaries will see GPs embracing a broader range of interim liquidity solutions, say David Wachter and Todd Miller at W Capital Partners

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Q W Capital defines its strategy as providing 'GP solutions.' Is this just another term for GP-led secondaries?

David Wachter: The term 'GP solutions' captures a broader range of liquidity options, each designed to help GPs better manage their portfolio exposure and fund performance. In addition to GP-led secondaries – or continuation vehicles – these solutions include minority recapitalizations, direct share purchases and GP customized solutions.

The term 'GP-led' was coined by secondaries managers to differentiate those transactions from LP-led secondaries, but we don't believe it adequately conveys the full range of liquidity-driving structures and opportunities that are now available to GPs.

GPs are now comfortable pursuing a number of different types of transactions that generate partial liquidity during the holding period of high-quality assets. If done constructively, and with the right companies, these deals result in a win for the GP, which gains more control over its exit strategy, allowing it to both grow and exit its best companies at the same time. Meanwhile, LPs win by getting steadier distributions and secondaries investors like us win by gaining access to great portfolio companies, mid-way through their growth story and path to eventual exit.

Q What trends are creating the need for these GP solutions?

Todd Miller: Demand is being driven by both short-term and long-term trends. In the short term, exits are down considerably. There is a pronounced lack of liquidity in the market through traditional M&A, IPOs, and dividend recaps. That is forcing sponsors to contemplate secondaries solutions to achieve their annual liquidity targets.

Meanwhile, even beyond the immediacy of the current macro environment, exits haven't kept pace with the explosive growth the private equity market has experienced over the past few decades. At the same time, sponsors are increasingly embracing secondaries transactions as a way to retain their best assets. This trend is unlikely to reverse. In fact, most top sponsors have already completed some type of secondaries transaction, and these secondaries solutions have become a strategic tool, rather than a one-off option.

As David says, these creative liquidity solutions have created a win-win dynamic for all parties – sponsors, LPs, portfolio companies and secondaries investors such as us. These solutions are not one-size-fits-all. They can be customized to meet specific needs.

Finally, secondary transactions are becoming a core offering at investment banks, presented alongside M&A and IPOs. Secondaries groups used to be siloed, but now they are fully integrated with other teams within the banks, which means secondaries solutions are routinely being presented as a viable option. The pitch is now sell, go public or explore interim liquidity solutions, which means secondaries options are now very much in the mainstream. It is a combination of all these trends that is fueling the tremendous demand we are seeing for GP solutions today.

Q Beyond the continuation vehicle, what other options exist for GPs?

TM: The exploding continuation vehicle market has served as a wake-up call for sponsors. It has drawn their attention to the wider range of options available in the secondary market, which may provide a better fit for their specific needs. These solutions include minority recapitalizations, where a minority stake is purchased directly from the controlling sponsor. We can also address liquidity needs of minority stakeholders seeking an earlier exit compared to other investors with longer horizons, such as those holding rollover equity or co-investment positions.

Furthermore, we collaborate with sponsors to consolidate the shareholder bases of their portfolio companies through broad-based tender offerings. This approach improves alignment with the institutional investors and management aiming to grow the business before exiting. In essence, all these solutions offer various forms of interim liquidity or other strategic options to sponsors at different stages during their investment period.

Q When does a continuation fund make sense and when is a minority recap a better option?

TM: Continuation vehicles offer multiple benefits. Sponsors can maintain AUM while generating liquidity for LPs and continuing to work with high conviction portfolio companies. However, continuation vehicle deals are complex, requiring LPAC approval, third-party valuations, tender offers and often syndication. They can be lengthy to complete.

Minority recaps, by contrast, offer a more straightforward and streamlined alternative while still providing partial liquidity and locking in a partial gain for the sponsor. The GP enters into a partnership with a secondaries firm that's comfortable underwriting to a shorter duration, allowing the GP to retain its control position. Generally speaking, minority recaps are great for investments that are two to four years old, whereas continuation vehicles may be a better fit for older investments where the sponsor is running into fund duration issues.

Q W Capital recently announced a strategic relationship with AXA Investment Managers. How will that support plans for the GP solutions business going forward?

DW: AXA shares our vision about where the private equity industry is heading and the opportunity that being a solutions provider represents. AXA formed a private markets division called Prime two years ago, covering private fund investing, co-investing, direct lending and NAV lending. But they also see GP solutions as a key component of that overall strategy and share our views that the solutions that can be offered are far broader than just continuation vehicles. Both businesses have over 20 years of GP, banker and LP relationships to leverage and by cross-marketing and collaborating, we believe we can be a meaningful contributor to the private equity liquidity landscape.

Q How do you see the GP solutions market developing in the future?

DW: There are currently around 28,000 private equity-backed companies representing some $3.2 trillion in unrealized global buyout AUM, according to Bain & Company data. However, only around 1,400 exits are taking place each year. The private equity industry has exploded in size, but the exit market has not kept pace, leaving 20 years of overhang today.

With GP distribution pacing continuing to decline, GPs must embrace GP solutions for the private equity industry to continue to thrive. Given the win-win nature of GP solutions, we believe that 20 percent of the more than $3 trillion out there will come from the GP solutions industry in the future.

TM: The secondary market began with LP-driven trades. That was version 1.0. The emergence of continuation vehicles represents version 2.0. We believe the next phase will involve the offering of a wider range of GP solutions. That is version 3.0, and it is clearly where the secondaries industry is heading. ■

David Wachter is founder and managing partner at W Capital Partners and Todd Miller is a partner at the firm

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GP Solutions Secondaries provider to the Private Equity Market

AXA IM Prime and W Capital Partners believe GP Solutions Secondaries are now a significant and permanent component of the private equity industry.

We believe our combination creates a key participant in this new market by bringing together one of the leading global asset managers with a pioneer and early thought leader in providing GP Solutions Secondaries for over two decades.

AXA IM Prime and W Capital Partners look forward to providing capital and creative solutions to GPs seeking investment liquidity and enhanced portfolio management.

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