KEYNOTE INTERVIEW

Tailwinds driving growth

As private markets adjust to a new normal, secondaries players are benefiting from an undercapitalised market and a sustained flow of opportunities, says Glendower Capital partner Rikesh Mohandoss

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Q What types of deals are you seeing in the secondaries market at present?
In the first half of this year, around 60 percent of deals were LP-led. That's up on some recent years, when the split between LP-led and GP-led deals was around 50/50. The LP-led side is pretty attractive currently – there are deals getting done in the market at some compelling discounts.

However, GP-leds will pick up over the second half of the year. The pipeline today is very robust and consists of very high-quality opportunities. There is a lot of pent-up demand from GPs looking for liquidity solutions for their LPs, particularly against backdrop of slower private equity distributions, so there are some great opportunities here.

Q What is motivating LP sellers right now?
We continue to see sellers come to market for the typical reasons: to rebalance their portfolios, to implement a change in their investment strategy, or because they want to consolidate exposure with certain GPs. And yet, over the past 12 months, we've clearly seen LPs come to market in an attempt to deal with the denominator effect. LPs have been hit by many variables – falls in equity markets in 2022, GPs taking a more balanced view of valuations, increasing capital calls and slower distributions, and so on – so we moved from a net cash in to a net cash out environment. All these were factors in driving LP portfolio activity.

This will normalise over time. Equity markets have partially recovered from 2022 and we are seeing some green shoots in the credit and IPO markets, although activity is lower than we saw in the past few years.

Q We've seen strong secondaries fundraising and new entrants. How is this affecting supply and demand for deals and capital?
It's an extremely exciting time to be a secondaries investor. The asset class and the opportunity set continue to outpace dry powder. We did see some strong fundraising last year and in the first half of 2023, but it's just not enough to meet the supply of LPs selling fund

commitments and GPs embarking on single and multi-asset deals.

The new entrants have not alleviated the supply-demand imbalance much either. It will take some time for the amount of capital raised to meet current transaction volumes, but NAVs are growing year on year, so it's hard to see when it will catch up.

The private capital market continues to grow – we saw $3 trillion of capital raised between 2019 and 2022 for private markets, and that won't slow down any time soon. Established GPs with strong track records will continue to raise funds and increase their fund sizes. Meanwhile, there is a host of GPs that got lost in the shuffle recently and didn't raise as much as they needed to – they will be back out to market sooner. All this feeds into future dealflow.

Q Where is LP-led pricing currently? How are mismatched price expectations affecting deals?

We saw quite a decline in pricing across all areas (buyouts, growth and real assets) in the second half of last year because of market uncertainty – buyers needed to ensure they were being compensated for the risk in the market. We entered a unique environment as inflation hit levels not seen for decades and interest rates rose quickly. That created questions around business valuations, and this continued through the first half of 2023.

Today, it's still to be determined where we will end up with rates and inflation, although inflation is generally starting to trend downwards and equity markets have improved. That has allowed pricing to rise marginally, though the market is still very attractive by historical standards.

There are still some gaps between buyers' and sellers' expectations, however. Deferred payments are one way to bridge this. Sellers are also being more creative: for example, they might have a target NAV of how much they want to sell, and then bring a larger portfolio to market so buyers can select from this. We're also seeing buyers pursue off-market approaches where the LP puts certain fund positions on the market, but the buyer wants exposure to other GPs in the portfolio and negotiates to bring those into the deal scope.

In addition, LPs are putting younger, largely unfunded positions on the market, along with fewer tail-ends. That's partly because buyers will pay more for exposure to greater value creation potential, but also to reduce capital calls they need to meet. More recently, we are seeing co-investments added alongside fund investments as well. This allows LPs to lock in attractive returns on assets for which exits will take some time to emerge. And finally, we are seeing some strip sales by larger LPs that don't want to sell their whole position.

Q What market developments are you seeing on the GP-led side?

We've seen some evolution here, as some buyers now focus on single-asset deals while others prefer multi-asset transactions. At Glendower, we're agnostic and just prefer to invest in the best opportunities.

However, the biggest challenge of the past 12 months has been on valuations. The bid-ask spread in the second half of 2022 was wide as GPs tried to set valuations at 2021 levels, despite the macro backdrop. Many deals, therefore, were not completed. However, we've seen many companies grow into their valuations as we've moved through 2023, reducing the bid-ask spread as new deals have come back to market.

> *"We saw quite a decline in pricing across all areas… in the second half of last year because of market uncertainty"*

Buyers are very focused on valuations in GP-led situations. They are looking at EBITDA multiples, but also free cashflow multiples and capital structures – how much runway does the company have, and do they have enough capital to continue with M&A plans? They are also focused on avoiding cyclical sectors, such as those reliant on consumer discretionary spend and, more recently, on the question of whether a business model will be displaced or replaced by AI.

A newer development in GP-led supply is the focus on management teams. Historically, people have tended to talk about making the deal work for the buyer, GP and seller. Today, we also need to consider management teams in this, because we are talking about continuation fund processes on buyouts originally executed in 2017 to 2019. These teams have done what was expected of them and they have also had to navigate through the covid-19 pandemic, but they haven't received liquidity – that's an important piece of the puzzle right now.

Q What's your approach to GP-led deals?

We tend to look at opportunities where there is more of the same. By that, I mean a continuation: the same management team, the same business model. We also look for strong alignment across the GP and portfolio company management team.

Having a say in that alignment and being a leader in GP-led transactions has always been of high importance for us. We generally seek situations where there is clear rationale for the transaction and a simple path to exit over a reasonable timescale, as well as opportunities where we are able to play a key role working closely with the GP and their adviser to form a solution that works for all parties. ■