KEYNOTE INTERVIEW

Pondering performance

A lack of full exits means it is too soon to say how well this latest generation of GP-led secondaries will fare, but the ingredients for success are all in place, says Jochen Mende at UBS Asset Management

Q How would you describe the supply/demand dynamics that you are seeing in the GP-led secondaries market today?

We are seeing strong demand for liquidity from the fund investor community, which is driving GPs to use the secondaries market more and more to generate liquidity options, in part also to facilitate new fundraising activity. What is particularly interesting in the current environment is that the quality of deals that we see is – on average – a lot higher than was the case two or three years ago.

Meanwhile, my perception is that only the highest quality opportunities are getting across the line. There seems to be a real bifurcation in the market. Those high-quality transactions are attracting a great deal of attention and capital, while transactions where either the GP or the underlying asset(s) have an issue, are a lot harder to get done.

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Q What makes a high-quality GP-led secondaries deal?

Regardless of whether it is a single- or multi-asset GP-led secondaries transaction or a co-investment deal, we want to see a credible path to long-term operational value creation, along with good alignment of interest between ourselves, the fund manager and the management team of the underlying portfolio companies, at a reasonable entry valuation.

As far as the underlying assets are concerned, we have an affinity for certain sectors and business models. For example, a company in an industry that is very capex intensive is probably not for us, whereas tech-enabled business models with recurring revenues in certain sectors are going to be of interest.

In addition, we are looking for a focus on operational value creation that is a good fit with the GP's track record and for the underlying companies and sectors. Finally, and maybe most importantly, we want to see strong alignment of interest between all parties.

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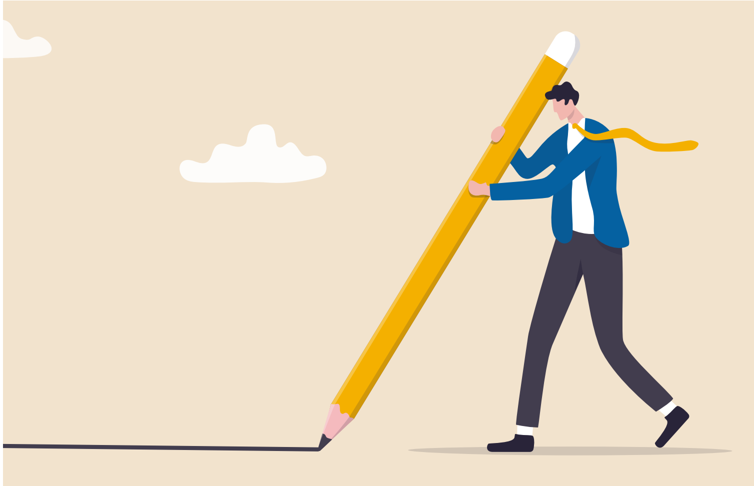

Q Where do you see the line between GP-leds and co-investment? Is there an argument that GP-leds are really just co-investment with fees attached?

When we set up our transactions business, we had a discussion about what types of investment opportunities we would define as co-investment and what we consider to be a secondaries transaction. We took the view that any deal where a GP is adding a new asset to its portfolio and then offering a piece of that to their LP base is a co-investment. If you take that approach, it is pretty clear where the line is.

In answer to your second question, I do not buy into the argument that a GP-led is really just a co-investment with fees and carry attached because the dynamics are so different. In many cases, with a GP-led secondaries deal, the GP has spent a significant period of time working with the underlying portfolio company, identifying and resolving any problems that may have been the reason to invest in the first place and laying the foundations for growth. You do not get that dynamic with a typical co-investment.

Furthermore, I would argue that the alignment is greater in the GP-led space because of the significant investment that sponsors typically make. The amount of their own capital that GPs put into a deal alongside co-investors is simply not as great as those at risk in a continuation vehicle.

Q What represents strong alignment of interest for you and what would be an immediate red flag that would cause you to walk away from a deal?

For us, the more of their own money a fund manager puts at risk alongside us, the stronger the positive signal that is sending us. At the moment, we are seeing fund managers contribute significant amounts of their own capital – often 5 percent or more – to GP-led transactions, which we view as a strong indicator of conviction and alignment of incentives.

For example, we invested in one GP-led secondaries transaction recently where the GP rolled over all proceeds, injected significant new money out-of-pocket into the deal alongside us, with successor funds also coming into the deal. Ultimately, the GP accounted for more than 10 percent of the continuation vehicle. It is that type of conviction that we really like to see.

Q What changes have you seen in the way that LPs view GP-led secondaries?

I think the sentiment has turned from being very critical to being appreciative of the liquidity that these GP-led secondaries provide. Consider what took place in the broader exit environment last year: M&A activity has slowed down a lot and IPO markets have largely been shut. LPs have therefore come to recognise that GP-led secondaries represent one of the few avenues to liquidity available and, according to the broker community, these deals have contributed between $50 billion and $60 billion of liquidity that LPs would otherwise not have received.

Q What do you consider to be best practice when it comes to a GP's communication with its LP base in the run up to one of these deals?

What works well in our view is to get LP input into a process early on. It is also important to provide a clear rationale to investors as to why a certain asset has been selected for a GP-led secondaries deal and why the process is being run.

In terms of best practice, we think it is important to give LPs a decent amount of time to come to their own conclusion and to provide information in a fair and transparent way. These things are certainly helping to manage some of the negative perceptions that historically existed around these GP-led secondaries transactions.

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Q How would you say this latest generation of GP-led deals is performing, or is it too soon to say?

Having had this conversation with a number of my peers, I think it is too early to know. As of early 2024, we haven't really seen many large-scale studies or survey results published – yet. We think all the ingredients are in place for this latest cohort of GP-led secondaries to ultimately perform very well, but we haven't seen many full exits take place.

From our own experience, we have participated in more than 20 GP-led transactions and have only seen one full exit to date that was announced at the end of last year. It hasn't closed yet but it looks promising, with a money multiple of 2.5 times and an IRR in excess of 30 percent. Hopefully we will see more of these, but for now it's just too soon to tell how this sub-asset class performs and compares to other private equity styles.

I would add that trying to benchmark GP-led secondaries transactions against other parts of the secondaries industry, or other areas of private equity more generally, is complicated. For example, comparing a single-asset GP-led secondaries deal with a multi-asset deal with 30 underlying companies, simply makes little sense.

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Q What advice would you give a GP thinking of executing on a GP-led deal for the first time? What does it take to get a deal across the line, as seamlessly as possible?

First and foremost, I would say that if you are considering embarking on one of these deals you need to study the market and find yourself a broker that has a great deal of experience orchestrating these types of transactions.

Also, I think you need to be transparent with LPs about the rationale behind the transaction, the asset selections and the go-forward value-creation plan. Transparency is paramount, in our view.

Q How do you see the GP-led secondaries market evolving?

I think we will see more of the same over the next 18-24 months. I do not expect the broader exit malaise to dramatically change any time soon. Even if exit markets are more accommodative, there is just a large backlog that needs to be worked through. Certainly, I do not believe we will be returning to the situation we had in 2021, when you could sell just about anything. As a result, I think every GP will be trying to avail themselves of this tool that provides liquidity options to their LP base.

Meanwhile, what is particularly interesting to me, is the fact that a lot of GPs are now also trying to launch dedicated continuation vehicle strategies. Furthermore, it will be interesting to see the extent to which GP-led secondaries penetrate the venture market and, of course, I am curious to see what the performance of the GP-led secondaries segment will be. ■

Jochen Mende is an executive director and head of secondaries, Real Estate & Private Markets, at UBS Asset Management