KEYNOTE INTERVIEW

Growing sophistication in a maturing market

Supply and demand in the secondaries market is a key focus as LPs look to tap liquidity, according to Ed Ford and Sacha Gofton-Salmond, partners in the funds and secondaries team at Travers Smith

Q How are the current macroeconomic conditions impacting demand and supply in the secondaries market?

Ed Ford: It's a bit of a perfect storm at the moment. Exits are slowing down across the private markets, so distributions that come from this natural liquidity are decreasing. That's coupled with a tough fundraising environment in which there are a lot of GPs that have come back to market quicker than ever and are raising ever-larger funds, often without having returned as much cash back to LPs than has historically been the case. This places significant cashflow demand on LPs' balance sheets.

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Further, public market valuations have decreased far more than private market valuations, which means LPs can feel over-allocated to private markets (the so-called 'denominator effect').

All of these factors combine to make LPs likely to look to the secondaries market to access liquidity, rebalance their portfolios and take some cash off the table.

Sacha Gofton-Salmond: If LPs sell now, even at discounted prices, they are likely to be locking in very strong performance from their private market programmes. Ultimately, LPs are investing in private markets for very strategic reasons; a number of institutions are more than happy to crystallise paper gains from this cycle before looking at allocations for the next one.

In the UK in particular, we are seeing defined benefit pension schemes that have moved towards becoming fully funded looking to sell illiquid assets on the secondaries market. They need to generate cash in order to properly de-risk. Portfolio rebalancing ahead

Q What is the outlook for the market for the rest of this year, and into 2023?

Ed Ford: We have got some very big LP portfolio sales lined up, so we certainly expect that to be a busy part of the market.

On the GP-led side, we think the traditional drivers towards these transactions continue to apply, so we expect continued growth there. In particular, we expect M&A to be a bit dislocated or delayed in certain sectors, which will lead to fund terms being extended and GPs offering liquidity options to LPs as a result.

Sacha Gofton-Salmond: Our sense is that it is going to be much easier to do concentrated GP-leds than diversified GP-leds, because they are easier for the buy-side to diligence and underwrite. This will mean a lot of activity at either end of the spectrum, with big LP portfolio sales and concentrated GP-leds. We may see some GP-led processes involving four or five assets, but those will be the hardest deals to get away.

of a strategic de-risking transaction is behind a lot of activity in LP secondaries right now.

Q What are the drivers for LPs in this market?

EF: Ultimately, LPs are looking for cash to fund their strategic goals. For some LPs, they want to be able to re-up into their core GP relationships' next fund vintages. Others want to move away from private markets. Certainly, we've seen LPs look across their equity positions for cash: open-end funds have seen increased redemption requests, public equities have seen a sell off, and this trend is equally applicable to more illiquid private market positions.

SGS: LPs are increasingly familiar with the opportunities on offer in the secondaries market, and many will now look favourably on secondaries sales.

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> **ED FORD**

Most LPs have been accessing the secondaries market throughout the cycle; we have acted for numerous LPs selling one or a small handful of positions, perhaps wanting to exit one strategy or geography, or to step away from one particular GP. This means LPs are as comfortable as they ever have been to sell a larger portfolio, and this is why we've seen so much activity.

EF: It's worth noting that a portfolio sale is not the only way to generate liquidity: a significant number of LPs are looking to generate liquidity on a partially dilutive basis, either by raising debt secured against the net asset value of the portfolio or by structuring deals with elements of preferred or structured equity. This involves profit sharing between the 'selling' LP and the secondaries 'buyer'. We see advisers running dual-track processes to obtain

pricing from the secondaries market for full portfolio sales, as well as for more structured transactions.

SGS: Given the potential discounts in play in the current environment, the opportunity for an LP to maintain some upside may be attractive. Certainly, we expect more of these deals to come to market this year, which tracks what we saw during the covid lockdown – the most recent period of major dislocation.

Q How has LP behaviour changed in recent months?

SGS: We see ever more creativity around the processes being run for large portfolio deals. Ultimately, the simplest option is for an LP to sell its entire portfolio to a single buyer, because that reduces execution risk and means the process around pricing can be relatively simple. However, that rarely happens nowadays, and we routinely expect 'mosaic' sales, with multiple buyers for elements of the portfolio, often alongside the dual-track processes mentioned earlier.

EF: The buyside is a mature market, with different buyers having different strategies and focuses, so we have long moved away from the idea that one buyer is certainly the best buyer for an entire portfolio. Of course, LPs are focused on optimising the sale price, so they are receptive to selling, say, the private equity elements of their portfolio to one buyer and the credit elements to a different buyer.

Another feature of the market today is the prevalence of LPs receiving some of the purchase price on a deferred basis. Ultimately, a lot of the transactions are generated by LPs looking for certainty of cashflow, rather than immediate cash. Deferrals can therefore work pretty effectively in portfolio sales, as well as acting as a tool to bridge the gap between buyer and seller pricing expectations (as, all things being equal, buyers will pay a higher price for a portfolio if they are not required to fund the entire purchase price at closing).

> *"Portfolio rebalancing ahead of a strategic de-risking transaction is behind a lot of activity in LP secondaries right now"*
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> **SACHA GOFTON-SALMOND**

Q How are LPs approaching GP-led deals at the moment?

EF: Overall, we expect GP-leds to keep on growing. In a period of dislocation, you tend to see a flight to quality – that means if you are a high-quality GP with a high-quality asset, you can expect that to be highly attractive to secondaries buyers who can perform due diligence on that asset very closely and don't need to worry about getting to grips with multiple assets across multiple sectors or geographies as they would on a portfolio deal.

Equally, LPs are looking for liquidity, so when they are being offered a liquidity option, they are likely to take it. That means, broadly, if they are happy with the price, they will choose not to roll. LPs are also pragmatic about discounts and will now sell at less than NAV, which they wouldn't have been so happy with just last year. Of course, all of this can create issues for GPs if they are reliant on some LPs rolling over in order to build the book, but most of these deals are now fully underwritten by secondaries buyers, so that is not too much of a problem for the right deal.

SGS: Despite the desire for liquidity, LPs are increasingly well placed to scrutinise GP-led deal processes and expect to see rigour and transparency across the process, including symmetrical information provision at an early stage and a truly robust narrative for the transaction and the pricing process.

At the same time, GPs don't want to cause any issues with the investor base, so they are rising to that challenge. ■