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Secondary Direct Volume Climbs 21% in 1H to $5.5B

By Laura Kreutzer

Buyers are plowing full steam ahead into the direct secondary market this year, although large fund portfolio stakes continue to dominate the market, according to the latest secondary deal volume survey published by Toronto-based intermediary firm Setter Capital.

The volume of direct secondary deals increased to $5.5 billion during the first half of the year, a 21% increase over the first half of 2014, according to Setter's survey of 116 active secondary buyers.

However, survey respondents anticipate that direct secondary deals, which include general partner restructurings, the purchase of a single portfolio company stake or even co-investments, could reach more than one quarter of deal volume in three years.

"We're swimming in deals right now," said Simren Desai, a vice president at Setter. "The tough part is every situation is unique, and it really requires some trouble shooting. In the direct [secondary] world, it's a bit of the Wild West right now with all kinds of novel transactions and structures."

Overall, Setter estimated secondary deal volume for the first half reached $20.6 billion, of which private equity secondary deals accounted for $16.5 billion. Setter bases its data on a combination of survey results from secondary buyers and extrapolation based on the firm's statistical analysis. Buyers of large portfolios dominated the first half data, accounting for 49% of total volume this year, compared with 44% during the first half of last year.

Several forces are driving direct secondary deal volume, including an increasing supply of assets lingering in older funds that face rising pressure to wrap up. Among the survey respondents, nearly 45% said they felt that more general partners attempted to liquidate or restructure older funds in the first half of 2015 compared with the first half of 2014.

Irving Place Capital is one such firm that sought to restructure older funds this year, according to media reports and people familiar with the deal.

The supply of more typical direct secondary deals involving equity stakes in individual companies, including growth equity deals or venture-backed startups has been robust, according to several secondary buyers.

W Capital Partners , one of the oldest and largest direct secondary buyers, did eight deals in the last trailing 12 months, one of the busiest years that the firm has ever had, according to co-founder David Wachter . W Capital typically focuses on the purchase of growth equity stakes in companies where early shareholders want to de-risk and sell all or part of their investments or the purchase of control stakes that allow a minority equity holder to cash out.

Rich pricing for fund stakes, particularly for what some buyers refer to as "flow funds," interest in the largest brand name megafunds, may be pushing more buyers toward the direct secondary space. One-third of buyers surveyed by Setter felt that buyer competition was significantly higher in the first half of 2015 than in the first half of 2014, while another 64% felt that competition was about the same as the prior year. Only about 3% felt that competition for deals was lower during the first half.

"There are better return opportunities available for directs, but there are some issues with directs that make it more complicated," said Mr. Desai of Setter.

Mr. Wachter of W Capital added that sellers aren't giving assets away that cheaply even in the direct market.

"You have to be competitive in the current market," he said. "You have to understand where market conditions are and pay fair value or it won't sell."

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