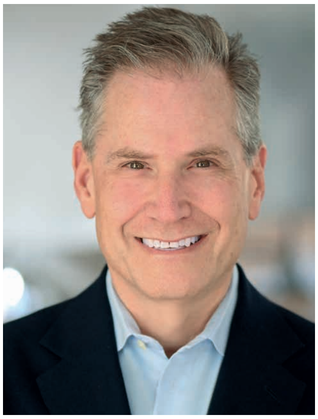
KEYNOTE INTERVIEW

More than continuation vehicles



The compelling benefits of the GP-led market have fueled a 5x growth in depth and breadth, and that growth is only accelerating, say W Capital Partners' David Wachter and Todd Miller

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Q How have you seen the GP-led market evolve over the past two decades?

David Wachter: GP-leds have gone from a bespoke industry worth just a few billion dollars to the over $50 billion market it is today, and including minority recaps and direct secondaries we believe it's well over $100 billion.

There have been two main drivers of that growth. The first is an acceptance by GPs that secondaries offer a viable, strategic tool for sponsors to better manage cashflow, keep their best assets longer and generate liquidity for their LPs. The second is that there are so many GP-led structures available today that provide true solutions to the specific objectives of both GPs and secondaries investors. At W Capital, GP partners have always represented the majority of our dealflow, so we are well-versed in collaborating with GPs and crafting the right solution for the situation.

Q What do you see driving the dealflow today?

Todd Miller: The remarkable growth in dealflow is a function of multiple structural and market drivers converging. First, there has been a significant increase in private equity AUM over the past five to seven years, which has created a large inventory of private equity-backed portfolio companies.

Second, GPs want to hold their best assets longer but also recognize they need to balance that with interim distributions to their LPs. Addressing that healthy tension is where the emergence of creative secondaries solutions has found a real home. These solutions enable there to be interim liquidity at the asset level, just like traditional LP secondaries created that liquidity option for limited partners decades ago.

Meanwhile, there are also market drivers accelerating secondaries demand even further. M&A exits are down, IPO volumes are down, debt has become much more expensive and the fundraising market has become more difficult. The demand for liquidity is severe.

It really is a confluence of all these elements that has led to the explosion in secondaries dealflow. We don't think that growth is abating anytime soon.

Q How broad is the range of liquidity solutions available to GPs today?

DW: There's an infinite number of ways for GPs to receive secondary liquidity, including through GP-led continuation vehicles, minority recaps, co-investment liquidity and monetizing rollover equity positions for those control-sponsors who hold minority stakes in assets they previously owned. The way we see our market is twofold – we offer GPs capital to refinance the equity in an existing investment or direct liquidity to exit all or part of an existing investment.

Q Can you explain the minority recap solution and why a GP might choose that rather than a continuation fund?

TM: Continuation vehicles have widely been embraced by sponsors for their highest conviction assets, but minority recaps should certainly be a part of the same conversation, particularly in today's market where exits are down, debt is expensive and there is a higher bar for continuation vehicles.

Minority recaps entail purchasing a minority stake in a portfolio company from a control sponsor, while enabling that sponsor to maintain control over the asset including control over the ultimate duration of the investment. It's a great way for a buyout sponsor to generate liquidity for their fund, validate a mark on a well-performing portfolio company, and perhaps raise capital for add-on acquisitions, especially if the sponsor is low on reserves.

Minority recaps are straightforward to complete and, unlike continuation vehicles, don't require a fairness opinion or lengthy LP tender process. It's a direct negotiation between the control sponsor and the secondaries buyer. Overall, secondaries funds have become great partners for buyout sponsors because of the lighter touch and more flexible mandates than traditional buyout firms.

Q What does a GP need to consider before entering one of these transactions?

DW: First and foremost, GPs need to consider the rationale for the transaction. Why is the fund choosing to keep the investment rather than selling the company in a change of control transaction?

Other key underlying questions that need to be asked include the duration of the investment to date and the timeframe to exit. Is the sponsor looking to bridge for two to three years to an exit, or re-underwrite the company for a five-year hold? Another question: is the sponsor looking for more equity as part of the transaction? Lastly, where is the sponsor in terms of the fund that holds the asset? Is it early or late stage? Does the fund need to generate distributions or require capital for recycling?

All of these things are key to consider on a strategic basis. Then, with regards to deal attributes, the GP should consider the quality of the asset and the logic for the transaction, both for the fund and new investors. Is there alignment between the new money and the sponsor in terms of an organized path to medium-term liquidity? All of these factors will determine whether there is a reasonable and fair solution for all sides.

Q Have you seen the supply side evolve over the years?

TM: As David mentioned, this is no longer a bespoke market. Most GPs have embraced secondaries, have become more sophisticated with the benefits of these structures, and are now proactively seeking some type of solution for their best assets. There is also a large and growing ecosystem of advisers bringing secondaries deals to the market. Most investment banks have ramped up their secondaries efforts and have integrated these teams with the bank's more traditional M&A and sponsor coverage groups, who are all now collectively pitching secondaries solutions as part of the menu of options for sponsors and companies to consider. Overall, there is no shortage of deals being surfaced and, in fact, we believe the market is currently undercapitalized for the supply-side demand.

Q What does it take to be successful in this market?

TM: It's important to be flexible and creative in developing the right solution for a sponsor, in addition to having the background to properly underwrite and the expertise to be a collaborative partner post-investment. I came from a direct private equity background, and I think that, combined with a secondaries toolkit, is the ultimate combination for these transactions. With our capabilities in providing a broad range of alternative structures, combined with a direct experience, we believe we can provide compelling solutions for GPs looking beyond just continuation funds.

Q How big can this market get?

DW: There is around \$500 billion to \$600 billion of current buyout exit value per year, in addition to \$300 billion of exit value in growth equity and venture capital. We believe that the GP-led market could justify being 20 percent of total exit value per year as GP-leds and minority recaps grow and take share from M&A deals and IPOs. That would result in a \$150 billion to \$200 billion annual market, substantially larger than today. We have always believed PE-backed company shareholders should have multiple liquidity options. With market acceptance and new GP-led deal structures, the flywheel of growth has accelerated. It's exciting times in secondaries. ■

David Wachter is co-founder and managing partner and Todd Miller is partner at W Capital Partners