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Private Market Talks:

Navigating Turbulence with Adams Street Partners' Bill Sacher

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With over $62 billion of AUM, Adams Street Partners is a global investor in private equity and private credit. It invests in over 450 global general partners in private equity and directly invests in private credit. As such, Adams Street has a unique window into these private markets. In this episode, we are joined by Bill Sacher, a member of Adams Street's Executive Committee and global head of Private Credit. During our conversation, Bill discusses how Adams Street is navigating today's rapidly changing market dynamics.

Peter Antoszyk: Welcome back to Private Market Talks. I'm your host, Peter Antoszyk. For over five decades, Adams Street Partners has been recognized as one of the most respected private market investment managers in the industry. A few data points: Adams manages over $62 billion in assets for more than 660 institutional investors. It is 100% employee-owned and has over five decades of private equity investing experience. It holds over 570 advisory board seats and investments with over 450 global general partners, and has a global footprint across U.S., Canada, Europe and Asia.

Bill Sacher is a member of Adams Street's Executive Committee, Global Chair of its Private Credit Investment Committee and global head of investment portfolio construction and fundraising for the Private Credit Team. During my conversation with Bill, we discuss trends in private equity and private credit, what it will take to navigate inflation and policy shifts under the current administration and how he thinks about risk and strategies for winning the future. As with all our episodes, you can get a full transcript of this episode and other helpful information at privatemarkettalks.com. And if you enjoyed this episode, drop us a note. We'd love to hear from you. And now, my conversation with Bill Sacher of Adams Street Partners. Bill, welcome to Private Market Talks, good to see you again.

Bill Sacher: Yes, you too, Peter. Thank you very much for having me.

Peter Antoszyk: Absolutely. Can you amplify on the overview I just gave about Adams Street Partners and maybe give a little more information about its strategies?

Bill Sacher: Of course, I thought you did a pretty thorough job there, but Adams Street, as you mentioned, has been around for a long time. We're over 50-years old as an organization. We're headquartered out of Chicago but have offices across the U.S. and around the world. The firm has five core strategies that are all very synergistic with one another. It starts with our primary fund-of-funds business, which has close to $40 billion of AUM. The fund-of-funds business is long-standing. We are actually a pioneer in that industry. We raised the very first private equity fund-of-funds back in the late '70s. We also have, not surprisingly, a secondary fund-of-funds business that is leveraging off the knowledge and advantage that we have on the primary side.

We have a long-standing equity co-invest arm that, like us, is investing alongside the private equity sponsors when they need supplemental capital. We have a growth equity arm – that is actually the original business that Adams Street had before the LBO industry even existed, and that is investing in growth-oriented businesses directly and late-stage venture capital.

And then, last but not least, is our private credit business. We formed that business back in 2017 from a literal standing start and today, we have over $10.5 billion of AUM. It is the second largest strategy at the firm. The synergies that exist between each of those vehicles is relatively obvious, but for private credit, we are able to leverage the relationships that we have that are in scale on the primary fund-of-funds side. Being an actual partner in the funds that you're sourcing deal flow from is a significant advantage that very few of the debt providers we compete with possess. And because of our standing with those private equity sponsors, we're also frequently invited to sit, as you mentioned, on the advisory boards. We have close to 600 of those positions and so, we have a sourcing advantage by being a limited partner in the funds we're sourcing deal flow from, but we also possess a really valuable knowledge advantage by sitting on those advisory boards, which help us make the right credit selections.

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Peter Antoszyk: So, you must have the ability to collect an incredible amount of data from these LP positions.

Bill Sacher: We do indeed, and we've been doing it for decades, and as I said, we do that in scale. Our perspective on the private equity business writ large is really quite extensive and almost proprietary in nature. So, our knowledge of those private equity firms and their track record and how they operate in different environments is valuable to us and having that key element to the underwrite extensively analyzed provides us again with a perspective on the broader private markets that enable us to position our portfolios in ways that produce what we think are superior returns.

Peter Antoszyk: Can you share some of those broad perspectives?

Bill Sacher: Trends on distributions, trends on industry selection, trends on fundraising, trends on dry powder…the list goes on and on. It's a hugely valuable insight.

Peter Antoszyk: And so, what are some of the trends that you're seeing in the private equity industry?

Bill Sacher: Well, especially as it relates to private credit, private equity sponsors continue to establish their private credit arms. That's pretty well evolved at this point, but even those that are still remaining without a private credit business, they're filling in those gaps. There's a natural synergy between private credit, obviously, and the private equity business. The other recent broad trend is a massive wave of refinancing and lowering the cost. Interest rates are likely to stay higher for longer, but competition in the market has compressed credit spreads, and private equity sponsors have been taking advantage of that in very large scale, and lowering their cost of leverage and helping preserve the health of the underlying portfolio companies themselves.

Peter Antoszyk: Some of the challenges we have spoken about on this podcast a fair amount, that the private equity industry has been experiencing runs the gamut from inability to make exits, which contribute to their inability to make the distributions that LPs have come to expect. There might be vintage problems, valuation problems, consolidation within the industry. I'm curious as to what you're seeing as an LP investor.

Bill Sacher: The level of deal flow, by implication, the level of exits is improving, but still remains below normal. What we are observing is the multiples being assumed in establishing the current valuation marks continue to slowly decline, which I think will eventually meet and bridge the bid-ask spread today. And so, we're encouraged about the prospect for a resumption of normal deal flow again. There are also a couple of other reasons to be optimistic about that. The pool of dry powder in U.S. private equity funds remain close to historic highs. They all reside in commingled funds with defined investment periods. That capital has another two plus years to go. And the likelihood of that money being deployed in that time frame remains relatively high and as a result, the demand side for companies is quite strong. There also is increasing motivation on the sell side. Due to the lack of M&A, distributions have been way below normal; LP's are starting to feel that pressure. It is creating headwinds on private equity firms' ability to raise new funds and so I think there's increasing motivation on the part of private equity firms to begin transacting. And then the last piece, as it relates to credit especially, the financing markets are wide open and relatively affordable and just ability to finance a deal today is about as strong as it gets. Those three pillars are exactly what you need to ensure a healthy deal environment, and I think those are all pretty firmly in place at the moment, and we're relatively encouraged by that.

Peter Antoszyk: I want to come back to that a little later on in our discussion, but just staying on the topic of exits, a couple of things you mentioned that I'd like to explore a little bit: One is, you mentioned that the bid-ask spread is narrowing multiples in part, because multiples have come down relative to the original underwriting. What does that mean for returns, and do you see this impacting particular vintages of private equity funds, more so than others?

Bill Sacher: We'll see when we see. I think the recent vintages are the ones likely to be impacted by this, and I think that we're still likely to see healthy returns but maybe a little bit lower IRRS and healthier multiples as private equity sponsors hang on to their assets a good bit longer.

Peter Antoszyk: Do you anticipate a consolidation within the private equity industry as they try to address some of the headwinds you just described?

Bill Sacher: Interesting question. I don't think we've seen a lot of that and we've been, the two of us, through a number of cycles.

Peter Antoszyk: Yes, more so than I care to admit.

Bill Sacher: Exactly, especially in the public.

Peter Antoszyk: You mentioned that the M&A market continues to be a little muted. The IPO market certainly is muted. What do you see as the timeline as to when there might be a "normalization of the M&A market," or is this our new normal?

Bill Sacher: I'm inclined to think that this is not the new normal, and I think that the likelihood of a resumption is high. The timing of it is uncertain, and I think a driver of the timing is going to be the deployment of that dry powder; the clock is ticking and it's likely to be deployed before that clock runs out, but it does have another couple of years to go.

Peter Antoszyk: What do you see as long-term trends over the next three to five years?

Bill Sacher: For private equity, I think private markets in general, private equity and private credit being on the top of the list, is still in secular ascent. And I think that it still has significant tailwinds, especially private credit, and is likely to continue to grow in popularity over a reasonable long term perspective, and part of the driver for that is the democratization of private markets and private equity and private credit in particular. And by that, I mean the ability to raise capital and access the wealth channel, then that is still, I would think, in the early stages of its evolution.

Peter Antoszyk: Do you see a shift from an appetite for debt over equity?

Bill Sacher: I do right now. I think that we are entering a very attractive vintage period for credit. Generally speaking, I think private credit in the particular and the interest rates have a lot to do with that. I think, short of a major recession, I think interest rates are likely to remain higher for longer and, even once they bottom, are going to remain high by post financial crisis period perspective. Even if we're lucky enough to get to that 2% target, which seems to be a bit of a challenge at the moment, the neutral rate of interest has to be higher than that. And so, I think even once we bottom, we're likely looking at underlying base rates of 3% or more, and that is historically high for the post-financial crisis period. And I think it creates attractive opportunities within credit, broadly speaking, and again, especially private credit, given its premium yields.

Peter Antoszyk: And, as you said, the private credit industry continues to expand. I'm curious as to how you think they're going to be, the capital that is flowing into the private credit industry will be deployed in a market where M&A volumes are muted, and there is a high degree of uncertainty, at least in the look forward 12 to 18 months.

Bill Sacher: In the near term, I do think the private credit market has a little bit of a supply demand imbalance. The demand for lending remains high. Capital continues to flow into the market from both institutional investors as well as individual investors, and the supply of deal flow, to quench that demand is below average, as we were saying. That has caused credit spreads to tighten, and I think we've seen that across the board. It varies a little bit depending on which end of the spectrum you're talking about. The upper mid-market is probably the most intensely competitive end of the spectrum at the moment. There is a supply demand imbalance there as well and there also is a source of competition that you won't find in the below upper mid-market and that is the broadly syndicated loan market, which is the borrower's alternative. That is as strong as we've seen. And most of the private deals are competing with each other, but also competing with that alternative. Their spreads might be as much as 50 to 100 basis points tighter than what you would find in the core mid-market. Core mid-market does have supply-demand imbalance. We have seen credit spreads tighten there. They've remained more stable and, as I just mentioned, higher, and it's being driven almost entirely by the supply-demand imbalance because these companies generally don't have sufficient scale to have broadly syndicated loans as a borrowing option.

Peter Antoszyk: You mentioned that one of the areas that is driving growth in the private credit area is the access to the private wealth channel. What is Adams Street doing to access that channel?

Bill Sacher: Peter, that is the one area that I know I'm not supposed to talk about. Sorry, I can't answer that.

Peter Antoszyk: Fair enough. But let's talk more broadly about the private wealth channel. What do you see as some of the challenges dealing with investors from the private wealth channel as opposed to institutional investors raises?

Bill Sacher: The areas that are different than potentially challenging is the nature of the vehicles that tend to access that channel. Unlike closed-end, commingled funds, which have defined investment periods and the capital is committed upfront and you draw it down as needed, most of the vehicles that are tapping into the wealth channel tend to be evergreen in nature. Money is flowing in all the time.

You also have cash redemption. So, you have the possibility of money flowing out as well. During periods where investor demand is high and feeling optimistic about the future, you can have significant inflows into those vehicles. Private credit is growing and evolving, but it's really hard to put that money to work immediately. And so, that creates a much different challenge for an investment manager than in traditional institutional commingled closed-end funds. At the same time, I do think you have the potential for a bit of a run on the bank when sentiment becomes much more bearish. Investors tend to pull money out of those vehicles in mass, and that too, given the illiquid nature of the underlying asset class, can be a challenge. The mechanisms for that are largely limits on how much can be withdrawn and gates, etc. But it does create challenges that are just, not in the nature of the traditional institutional fund business.

Peter Antoszyk: One of the things that we've seen in the market is a blending of the public and private debt in part to address that liquidity issue, public debt being more easily traded than private debt. What do you see as, does that create a challenge for allocators in terms of determining the returns and the risk profiles with those types of funds?

Bill Sacher: It does change the return profile. I think the liquid debt that generally comprises a portion of the portfolio as a measure of protection against the risk of withdrawals is one issue. I think the other issue is that, when you do get these periods where sentiment has really changed and investors start to withdraw capital in mass, that usually occurs when markets are also down. And that liquid debt could very well be trading below par or whatever the purchased cost was. And in that kind of environment to meet the redemptions, you're now turning unrealized losses into realized losses. And it can create a bit of a snowballing effect, because being left in the vehicle with now realized losses is obviously negatively impacting those that choose to stick around. And so, it tends to snowball and exaggerate the demand for withdrawals.

Peter Antoszyk: What industry trends are you seeing in terms of investments?

Bill Sacher: We try not to overconcentrate in any area of our portfolio construction, including sectors. I think the sector that still remains pretty popular at the moment are recurring revenue software deals. We honestly have been pretty picky about those. I think we are seeing some actual softness in the underlying businesses and not all recurring revenue deals are created equal. But from our perspective, it tends to be a little bit more about positioning, given where we think we are in the cycle than it is specific sector focused. And so right now, we think we're in an attractive vintage period again for the asset class generally speaking. But we also think there are some pretty formidable potential risks on the horizon, and we're not complacent about that risk. And so, our posture is a bit more defensive at the moment and that is causing us to lean a little bit more on cyclical businesses, sectors that are not particularly cycle-prone, aerospace and defense and some subsectors of healthcare, non-discretionary consumer products, etc. And we still try to stay diversified even within those sectors, but our bias is definitely more defensive in nature at the moment.

Peter Antoszyk: What about products or structures?

Bill Sacher: We have a very broad palette. We've designed our funds to be able to invest literally anywhere in the capital structure and to have a pretty broad palette in terms of the types of assets that we can put into those vehicles, including ABLs and NAV loans and even CLO equity. And so, we do think about relative value across the board. Given our defensive posture, again, our bias is a little bit more in playing it safe, and so we're largely focused on senior secured debt, top of the debt stack and the safest part of the debt capital structure. I also think that from a risk-return standpoint that senior debt, especially if you can tolerate some leverage, is one of the more compelling risk-return propositions that we have in the marketplace today, where you could produce returns that probably rival private equity returns without being at the bottom of a levered capital structure and backed by a diversified portfolio of senior secured loans. That proposition right now with equity-like returns is really hard to beat.

Peter Antoszyk: Well, perhaps that's why you're starting to see a shift from private equity to private credit allocation.

Bill Sacher: I think that is behind the popularity of private credit right now. It's not just the high returns, it's the relative safety of the underlying investments.

Peter Antoszyk: You mentioned earlier on that you're starting to see some stress in portfolios. Are you starting to see some cracks, anxiety among managers? What's the mood?

Bill Sacher: I haven't seen a lot of anxiety in most managers yet, but there are plenty of canaries in the coal mine at the moment. We are seeing a relatively steady increase in PIK as a percentage of the underlying interest rate.

Peter Antoszyk: That's payment in kind interest.

Bill Sacher: Yes. Payment in kind. We are seeing an increase in the percentage of outstanding loans that have less than one times interest coverage. That means the underlying business is not generating enough EBITDA to even pay the interest currently. That is probably what is causing, at least to some degree, the payment in kind to increase as well. We are seeing an increase in default rates and we have seen an increase in non-accruals. Not in the red zone yet, but they continue to rise. I think earlier vintages that were levered at six to seven times with highly adjusted pro forma numbers that don't look very realistic at the moment at current interest rate levels are putting real stress on those businesses. I think a lot of them have refinanced, as we were discussing earlier. That has taken some of the pressure off of those businesses that can refinance. But the ones that are still storied and unable to take advantage of that window are feeling some pressure.

Peter Antoszyk: Where do you see default rates going over the next say 12 to 18 months?

Bill Sacher: That's a really tough call. I do think we'll continue to see a rise to probably COVID-level defaults if interest rates stay high and these companies don't find an alternative. But the $1,000,000 question in that regard is are we going to have a recession or not?

Peter Antoszyk: There are some commentators that said that we're already in a recession. I'm curious as to whether you have an internal view as to where we're at and where we're going?

Bill Sacher: There are very few certainties in our business as you know. The one thing I am certain about is I'm really bad at predicting the future. So, we're not predicting a recession. But I do think the risk of one is higher than average and there are forces at play today that could very well create some economic softness, if not a recession itself.

Peter Antoszyk: Have you observed a dispersion among managers?

Bill Sacher: We are beginning to finally observe that. One of the challenges for investors, generally speaking in the post-financial crisis period, is that we had a very benign environment, usually low level of defaults over an unusually long period of time. Everybody was earning their coupon. It was very hard to distinguish the skill of the underlying manager. It's only in periods of disruption and defaults and economic softness that the skill of the manager tends to reveal itself. It's pretty early days, but in the lower quartiles we are starting to see some dispersion for the first time in many years.

Peter Antoszyk: One of the challenges being faced by asset managers today is navigating the risk of inflation, thought it was coming down, don't know, and policy shifts within the current administration. How is that impacting your thinking on risk?

Bill Sacher: It's a key element of the underwrite these days. Tariffs are the new top of the list issue as well, and we were pretty conservative about our inflation assumptions, going really all the way back to when people considered it transitory and partly—

Peter Antoszyk: We're starting to hear that word again by the way.

Bill Sacher: Yes, it's remarkable to me that has come back up, to be honest, but our particular approach to credit is that being optimistic about inflation when it's showing up or economic softness before it's happened is, the cost of that is too high to bear in a credit fund if you're wrong. If you're right, then I think that's just icing on the cake. But being optimistic and wrong is a dangerous place to be. And so, even though we're not very good at predicting the future, if we're starting to see inflation or we're starting to see the effects of tariffs, we're going to assume that that continues and try to build our portfolios in a way that weather those kinds of conditions.

Peter Antoszyk: You're a global player. How are geopolitical risks impacting your investment decisions as an LP?

Bill Sacher: I think the geopolitical risks apply everywhere at the moment, and regrettably and unfortunately, they seem to be intensifying, not diminishing. And the implications of disruption are quite high and very unpredictable, and that, too, is another reason we're trying to position the portfolios as defensively as we can.

Peter Antoszyk: What about AI? How is AI impacting your business both as a direct investor as well as an LP investor?

Bill Sacher: There, too. You could debate for a long time what the impact of AI is going to be. But there are certain sectors that could literally be shut down as a result of AI. And so, we're very careful about medical coding. We're very careful about call centers, and those businesses could not only be negatively impacted, but they could literally be obsoleted.

Peter Antoszyk: Final question. What advice would you give to a young professional looking to make their way in this industry today?

Bill Sacher: Not to be too old fashioned about this, but I think the traditional path is probably still the most viable one. And that traditional path is go to an investment bank, try to get into financial sponsor coverage group, M&A group, or maybe most importantly, if you're interested in private credit, leverage finance group. Get a couple solid years of good training with real deal flow on a quality platform and use that experience as a springboard into private credit. It's becoming more common, given how early firms like ours, private equity and private credit firms are now starting to recruit. And you don't have to make that stop anymore. But I do find most of the firms, the buy-side credit managers, really don't have the resources to do a great job in training and that deal training at an investment bank is really invaluable., and so I would encourage anybody who's really serious about the business to think about spending a couple of years at an investment bank before trying to join the industry.

Peter Antoszyk: Well, Bill, thank you for this conversation. I always enjoy our conversations, and I appreciate you joining us on Private Market Talks.

Bill Sacher: Well, I enjoyed it and thank you very much for having me. It's great to see you too, Peter.

Peter Antoszyk: And thank you, listeners, for listening to this episode of Private Market Talks.

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