Navigating Liquidity:
Proskauer's Secondaries
Pulse Check

New York – June 2023

Proskauer>

#### **Navigating Liquidity:**

#### Proskauer's Secondaries Pulse Check (New York)

# Agenda

1:00pm	Arrivals & Networking Coffee
1:30pm	Welcome Remarks Mike Suppappola, Partner, Proskauer
1:40pm	Panel Discussion: Traditional LP-led Deals and Direction of the Market Moderator: Bruno Bertrand-Delfau, Partner, Proskauer Vladimir Colas, Co-Head of Ardian US Dan Klima, Managing Director, Private Capital Advisory, Lazard Justin Pollack, Managing Director, Private Funds Group, Pinebridge Investments Taylor Robinson, Partner of Lexington Partners
2:25pm	Terms & Trends in LP Transactions Niamh Curry, Partner, Proskauer Jordan Hurwitz, Partner, Proskauer
2:45pm	Coffee Break
2:55pm	Panel Discussion: GP-led Transactions  Moderator: Chris Robinson, Partner, Proskauer  Gordon S. Appell, Managing Director of Secondary Advisory Group, PJT Partners  Steve Lessar, Partner and Co-Head of Sponsor & Secondary Solutions (S3), Apollo David Symons, Managing Director, Blackstone Strategic Partners  Jeremy Weisberg, Managing Director, Funds & Secondaries, CPPIB America
3:40pm	Terms and Trends in GP-led Transactions and Continuation Funds Niamh Curry, Partner, Proskauer Galen Lewis, Partner, Proskauer
4:00pm	Coffee Break
4:10pm	Panel Discussion: Emerging Secondaries Transactions in Credit, Infrastructure and Real Estate Moderator: Warren Allan, Partner, Proskauer Ed Goldstein, Partner, CIO of Credit Secondaries, Coller Capital Sara Huang, Managing Director, Ardian Richard Saltzman, Managing Director, Jefferies Luca Salvato, Partner of the Secondaries Group, Ares
4:40pm	Tax, Rules & Regulations: The Hot Buttons Jeremy Naylor, Partner, Proskauer Stephen Severo, Partner, Proskauer Rob Sutton, Partner, Proskauer
5:10pm	Closing Remarks Howard Beber, Partner, Proskauer
5:15 – 7:00pm	Cocktail Reception



#### **Executive Summary**

Proskauer's Secondaries Pulse Check data benchmarks a variety of secondaries transaction terms, including key legal, economic and governance provisions, across 55 traditional LP and 17 GP-led secondaries transactions. The data covers transactions closed between the third quarter of 2022 and the first quarter of 2023, and provides insight into how terms are changing over time and the market shifts we anticipate moving forward.

The analysis and related commentary reflects our experience from representing sponsor, buy-side, and sell-side clients, providing a unique insight into the market from all angles.

Built to serve asset managers, Proskauer's Private Funds Group will continue to monitor the evolution of the secondaries market, offering our clients insights to aid their transactional and fundraising needs.

**Proskauer** For Success. For Progress. For Good.

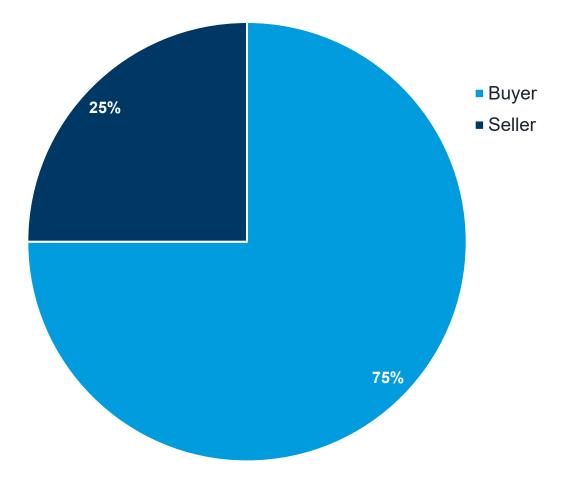
#### **Table of Contents**

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## **Party Represented**

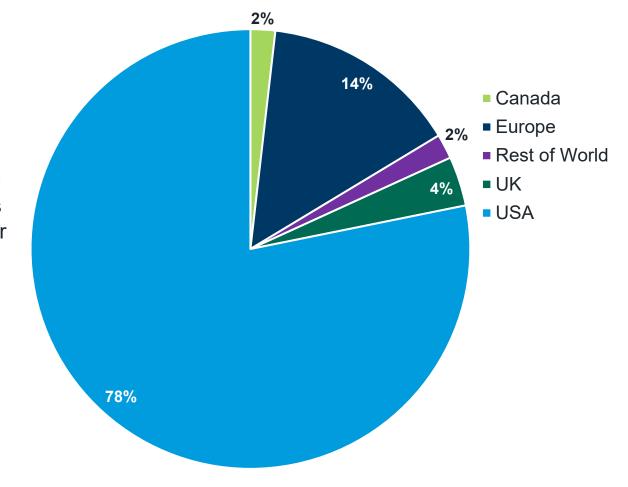
On the 55 traditional secondaries transactions we closed between September of 2022 and March of 2023, we acted on the buy-side on 75% of occasions and acted on the sell-side for the remaining 25% of deals.





#### **Buyer Legal Jurisdiction**

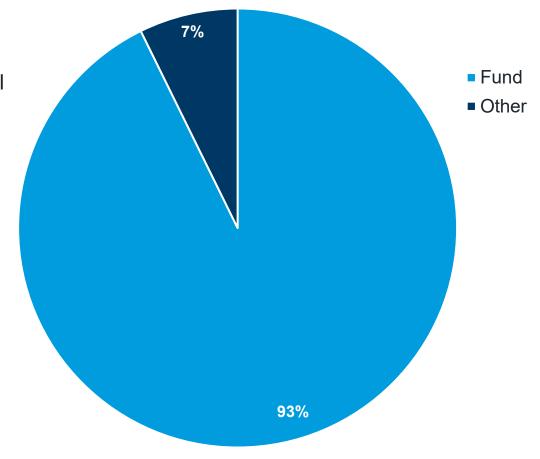
This chart highlights the principal jurisdiction of the buyers, with the largest representations being the USA (78%) and Europe (14%). We saw smaller percentages of buyers based in the UK, Canada and other parts of the world, including Asia.





# **Buyer Type**

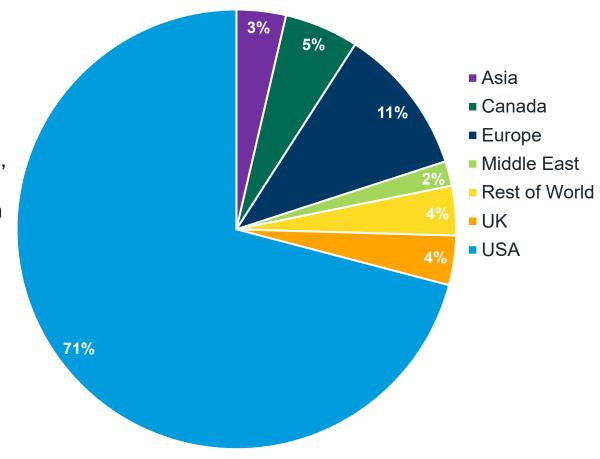
Unsurprisingly, 93% of the traditional deals we worked on involved a secondaries fund as the purchaser.





# **Seller Legal Jurisdiction**

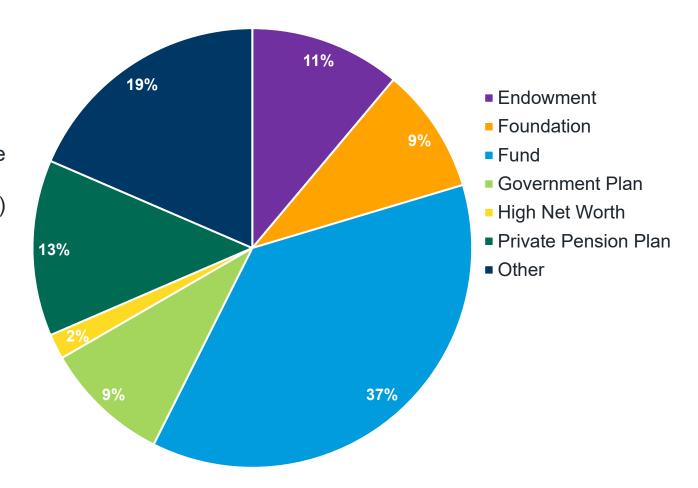
Consistent with prior years, a significant 71% of sellers were based in the USA, which was followed by 11% of sellers in Europe, 5% in Canada, and we also saw 4% of sellers based in the UK and 3% in Asia.





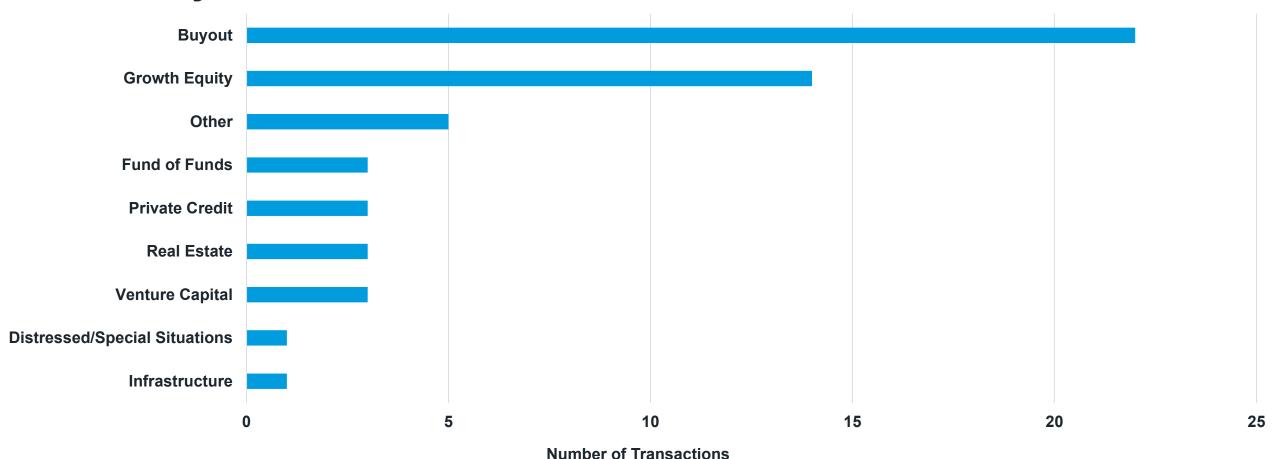
# **Seller Type**

This chart illustrates a relatively broad mix of sellers participating in traditional deals over the past three quarters with secondaries funds (37%), private pension plans (13%) and endowments (11%) being the principal players.



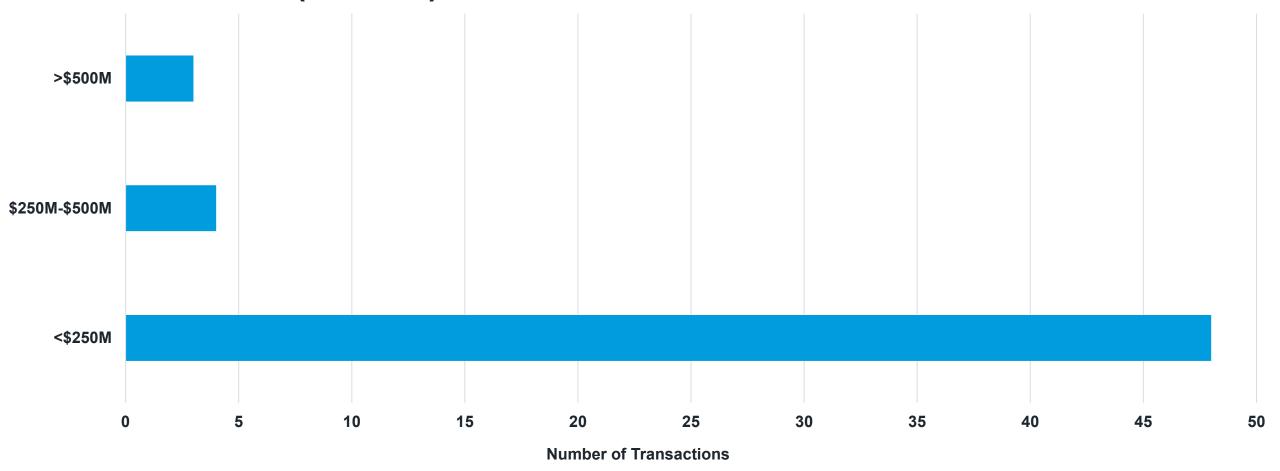


# **Primary Asset Class of Interests**



The main asset class we saw traded in the secondaries market over the past three quarters was traditional private equity buyout fund interests, which was followed by interests in growth equity funds. There was a noticeable drop in venture and real estate secondary volume given recent market volatility.

# Size of Deal (in USD)

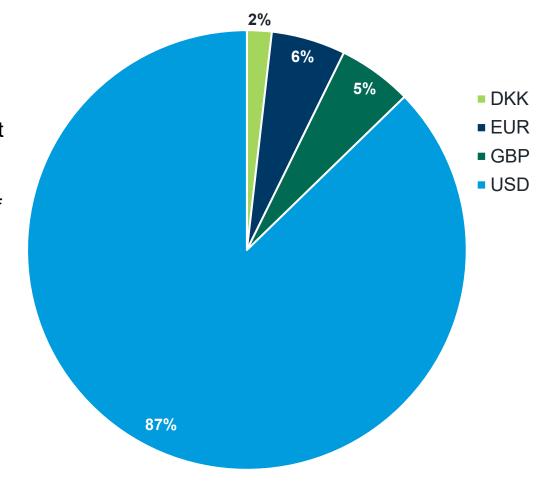


This slide shows that the vast majority of transactions we worked on had a deal value that was less than \$250m, which is reflective of the fact that most transactions over the applicable time period did not include particularly large portfolios.



# **Currency**

With regard to deal currency, the overwhelming majority of deals that we worked on over the relevant period were denominated in US Dollars (87%), which is reflective of the jurisdiction of the interests forming the subject of the portfolio.

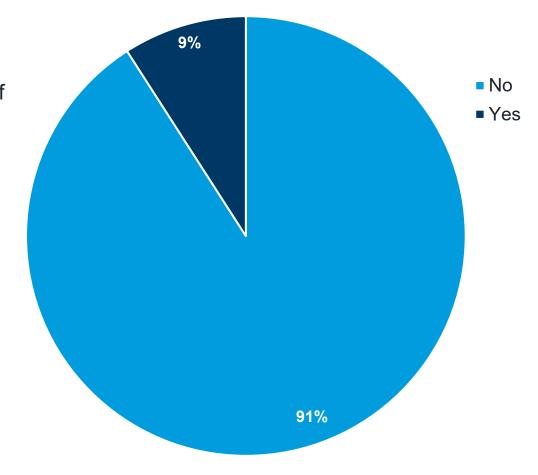




Are the Interests in the Portfolio Denominated in Multiple

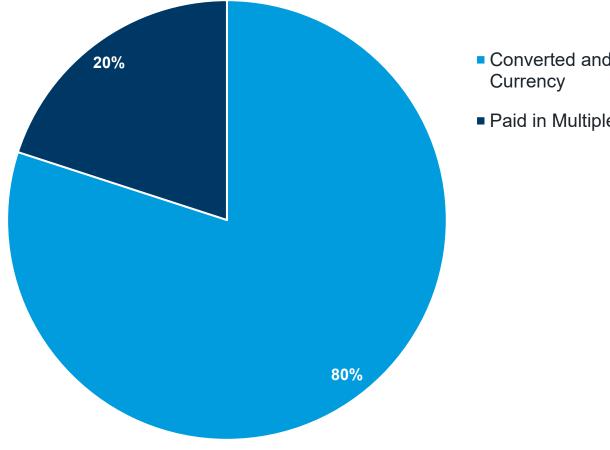
**Currencies?** 

This chart illustrates that only 9% of the 55 deals that were reviewed as part of the survey were multicurrency, which would be the deals that involved portfolios spanning across multiple jurisdictions.



If Interests in the Portfolio Are Denominated in Multiple **Currencies, How Is the Purchase Price Paid?** 

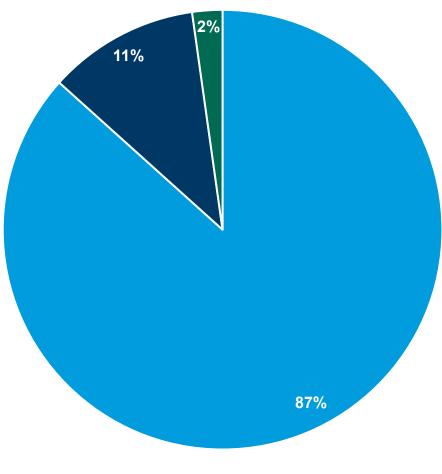
In deals where there were portfolios involving multiple currencies, 20% of such deals saw the purchase price for an interest calculated and paid in the applicable currency, whereas 80% of deals saw the parties agree upon a single currency for the purposes of payment. This would have involved agreeing upon a conversion method and setting out the relevant mechanics in the sale and purchase agreement, which tends to include agreeing on the appropriate date to apply when making the currency conversions.



- Converted and Paid in Single
- Paid in Multiple Currencies

#### Is Purchase Price Withholding Permitted?

This chart touches upon what is ordinarily a heavily negotiated topic: namely, whether a buyer is permitted to withhold from the payment of the purchase price. In 87% of cases, buyers successfully negotiated a broad right to withhold amounts as required by law. In practice, this will involve careful tax due diligence to determine whether withholding is applicable in respect of any of the interests forming the subject of the portfolio.

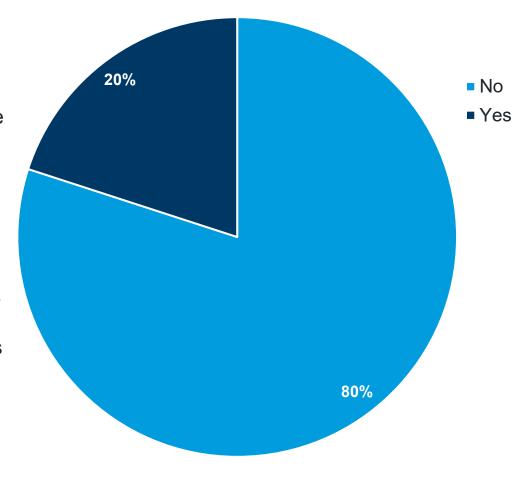


- Buyer has broad right to withhold as required by law
- Buyer has limited right to withhold if certain conditions are met
- Buyer has no explicit right to withhold or contract forbids Buyer from withholding



#### **Deferred Purchase Price?**

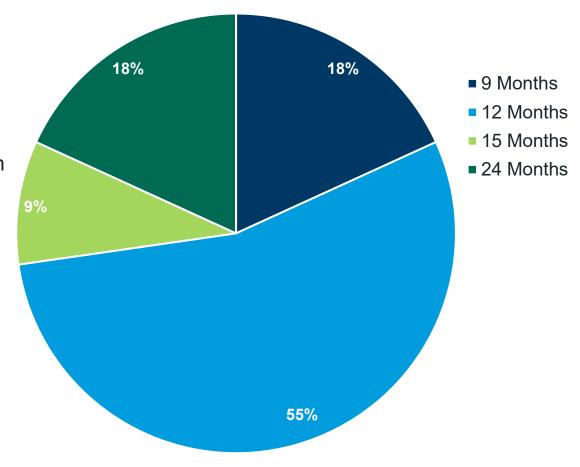
20% of our most recent deals involved a deferral of a portion of the purchase price, meaning the seller would not have received the full consideration at closing. It is worth noting that each of the three deals we worked on, with a value in excess of \$500 million, included such a deferral. This can be used as an effective tool deployed by certain buyers to bridge the bid-ask spreads seen in recent months





# If Deferred Purchase Price, What Is the Length of Deferral?

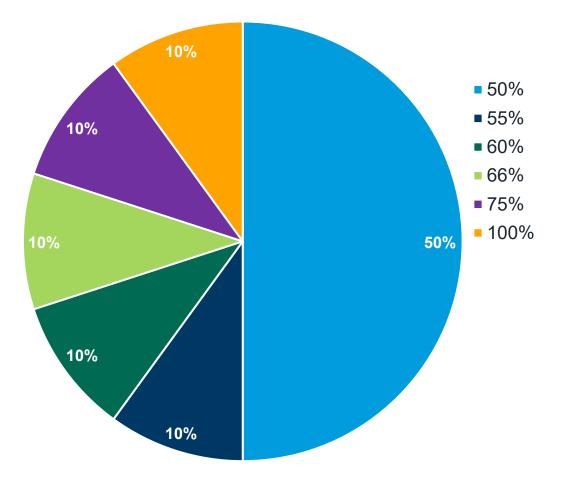
We see here that the most common time period for deferral of the purchase price was 12 months (55%), with a 9-month and 24-month deferral period being the secondmost common deferral periods (18%).





# If Deferred Purchase Price, What Is the Percentage Deferred?

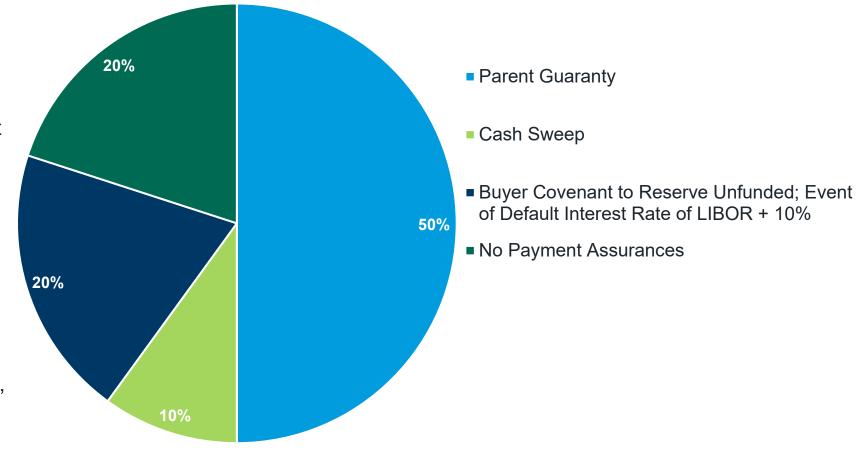
This chart considers the portion of the purchase price that has been deferred. Exactly 50% of our most recent deals featuring a deferral involved the deferral of 50% of the purchase price, whereas we saw deferrals of 55%, 60%, 66%, 75% and 100% each in 10% of deals.





# If Deferred Purchase Price, What Are the Payment Assurances?

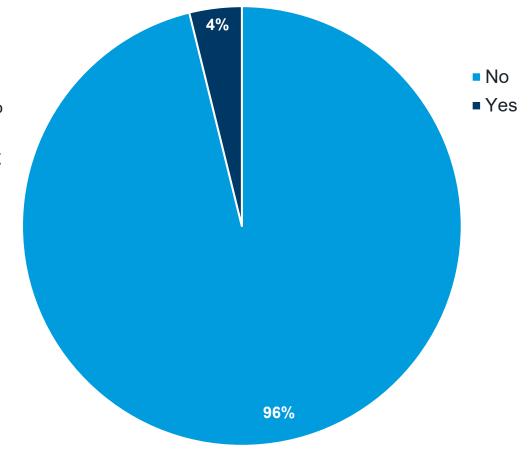
Where there is a deferral of the purchase price, sellers will often request a number of protections that will survive until the end of the deferral period. This slide highlights that a parent guaranty is the most common form of security granted to sellers (50%). In 20% of cases, the buyer was willing to give a covenant to reserve unfunded commitments sufficient to pay the deferral and agree to certain event of default provisions. In a further 20% of deals, there were in fact no additional protections offered at all.





# Is the Buyer Using Any Third-Party Finance?

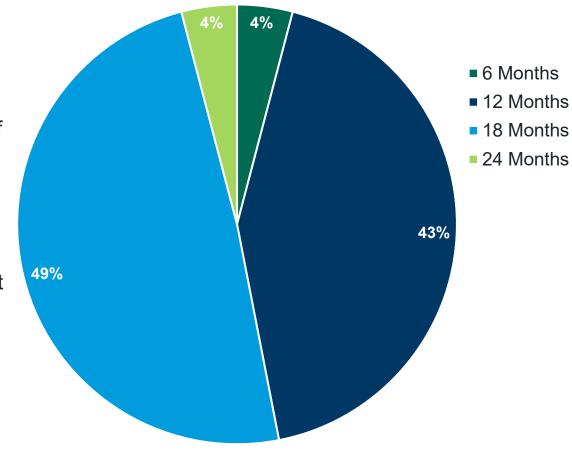
With regard to the buy-side transactions we worked on, only 4% of deals involved third-party leverage. This is likely to be a result of the increased cost of borrowing, as well as buyers negotiating a deferral of the purchase price.





## **Survival Period for General Reps**

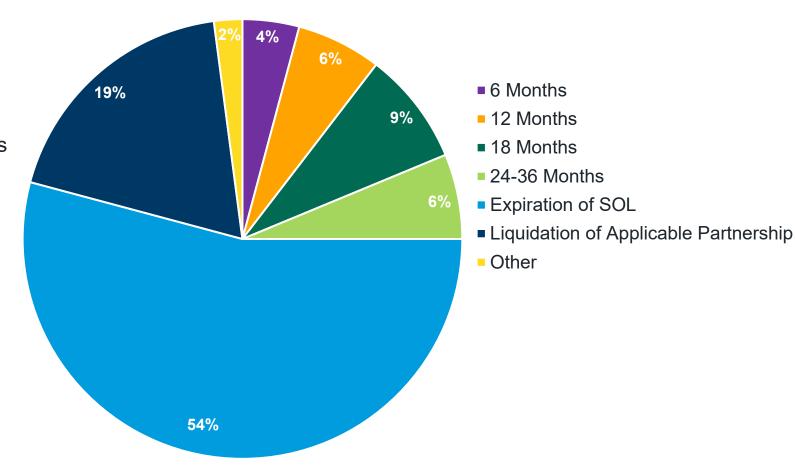
Regarding the survival period for bringing claims for breach of the non-fundamental warranties, 49% of deals saw an 18-month period following the closing date, and 43% of deals saw a 12-month survival period. Such percentages are relatively consistent with data from our prior transactions, indicating that an 18-month claims period for non-fundamental warranties remains the most common position.





#### **Survival Period for Fundamental Reps**

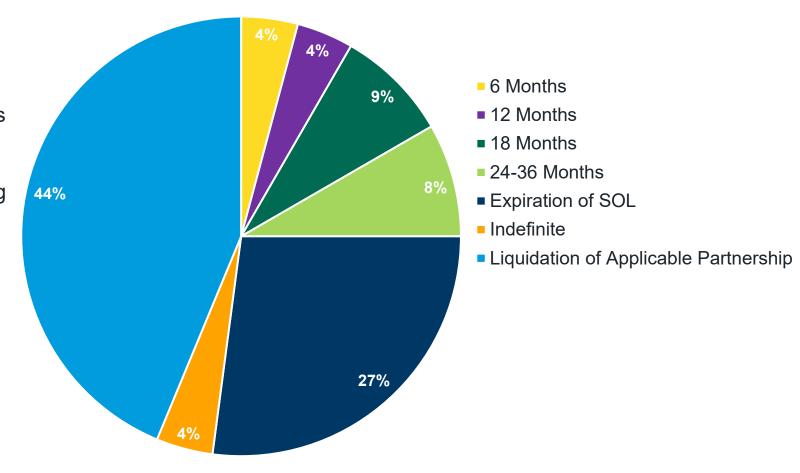
As for the fundamental warranties, which tend to be the warranties relating to title, authority, no conflicts and brokers, 54% of deals saw the survival period tied to the expiration of the applicable statute of limitations and 19% by reference to the liquidation of the applicable partnership.





## **Survival Period for Title Reps**

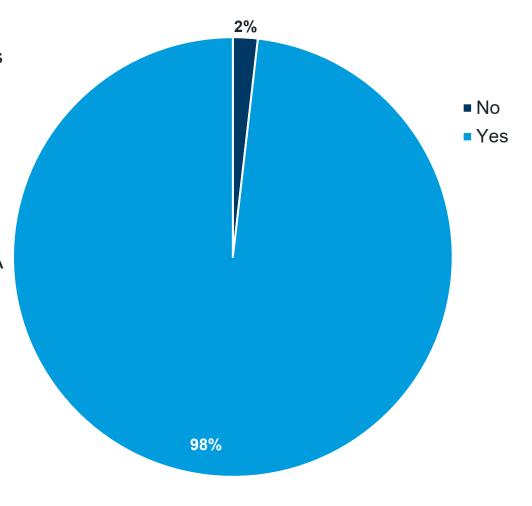
Looking more closely at the title warranty, which most would agree is the most important of the fundamental warranties, in 44% of deals the survival period for bringing claims for breach of such warranty was the liquidation of the applicable partnership. Second in line was the expiration of the statute of limitations, in 27% of deals.





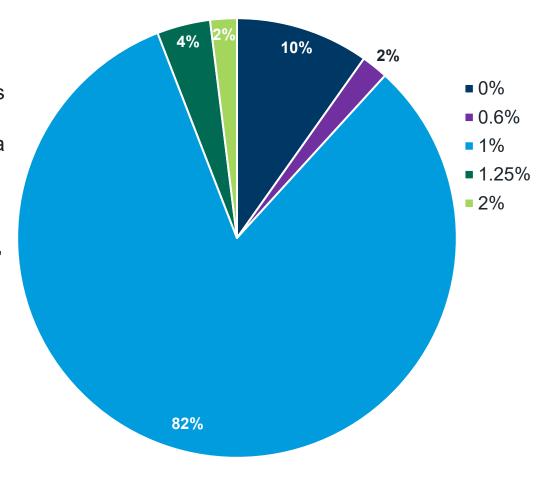
## **Indemnity?**

As is customary, 98% of secondaries sale and purchase agreements saw the parties granting one another an indemnity in respect of certain claims. The scope of the indemnity given by each party is subject to negotiation, but typically includes: (i) any inaccuracy in or breach of any rep or warranty contained in the PSA or the transfer documents; (ii) any failure to perform any covenant, agreement or obligation contained in the PSA or the transfer documents; (iii) any claim by any person for any finder's or broker's fees; and (iv) a seller indemnity for the excluded obligations.



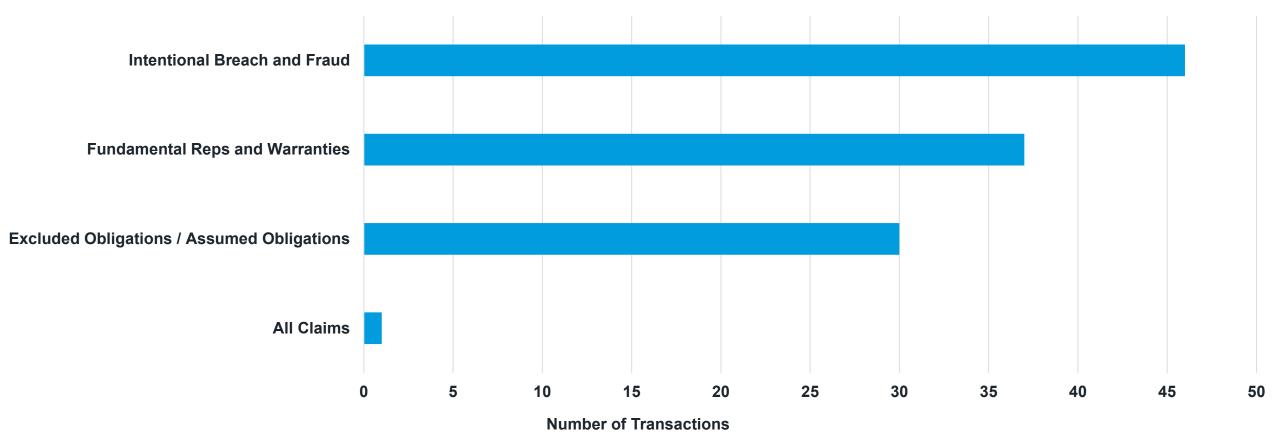
## **Indemnity Threshold**

The threshold for indemnity claims is typically pegged to a percentage of the purchase price and means that a party cannot bring an indemnity claim until the relevant threshold is hit. In 82% of deals, such threshold was set at 1% of the purchase price, which continues to be a relatively standard position.





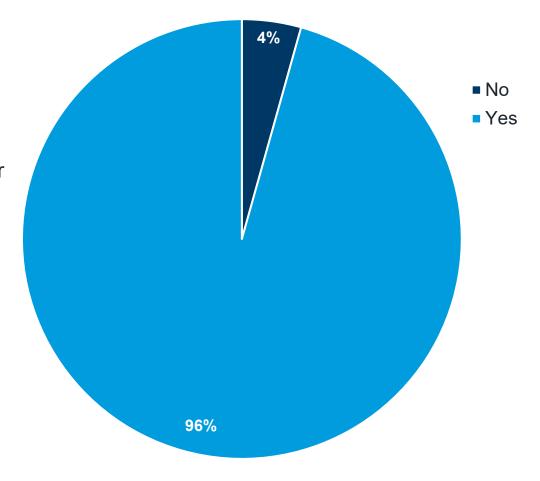
# Types of Claims Not Subject to the Threshold?



This slide shows the types of claims carved out of the financial limitations. Regarding the applicability of any financial limitations, the preferred buyer position is to apply the financial limitations to breach of the non-fundamental representations only, which would mean that all other types of indemnity claims would not be subject to any financial limitations whatsoever. Sellers, however, tend to push to apply the financial limitations to all indemnity claims. Proskauer>

#### After Threshold, Recover from Dollar-One?

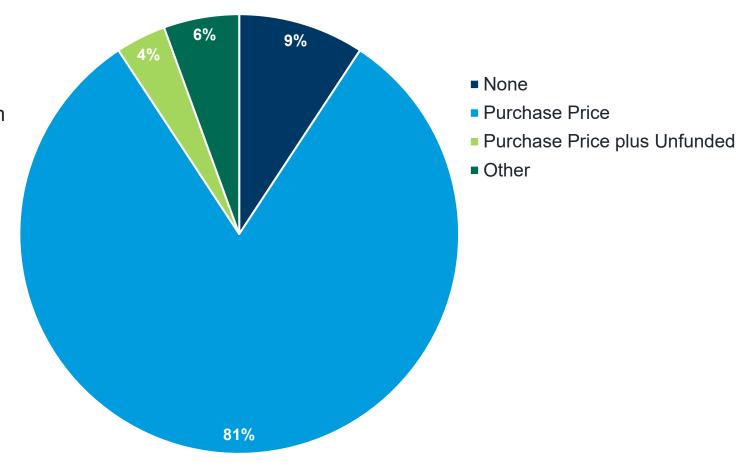
As shown in this chart, once the threshold is hit, the total amount of the indemnity claim is ordinarily recoverable from the very first dollar and without regard to the threshold. Only in 4% of cases did the parties agree to treat the threshold as a deductible so that only amounts above such threshold could be recovered.





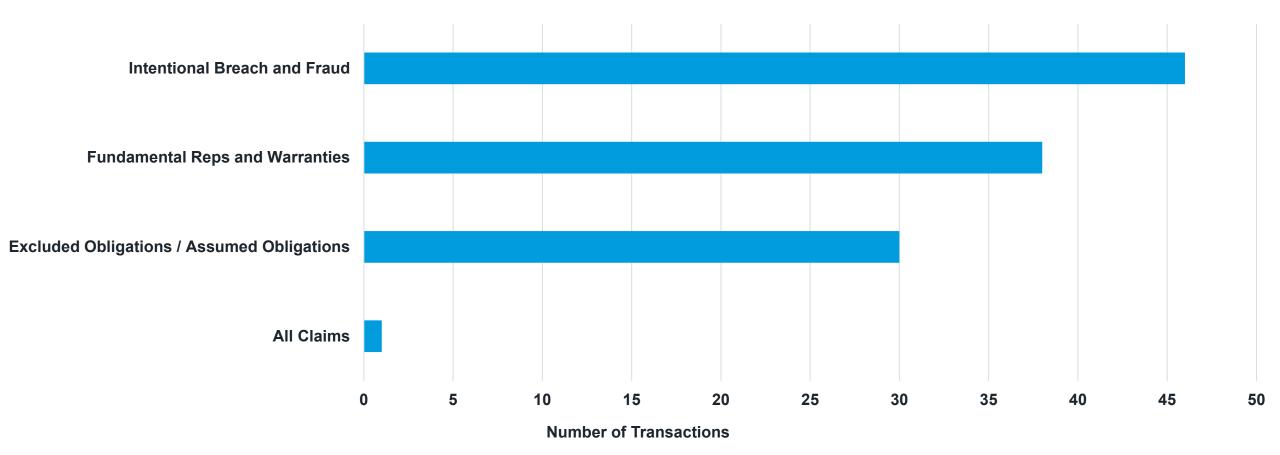
# **Indemnity Cap**

With regard to an overall cap for indemnity claims – i.e. the maximum amount payable by one party to another – this slide clearly shows that in the vast majority of cases (81%) this is set at the purchase price.





# Types of Claims Not Subject to the Cap?



The types of indemnity claims that the overall cap applies to more often than not mirror what the parties agree with in respect to the threshold, as is largely reflected on this chart.



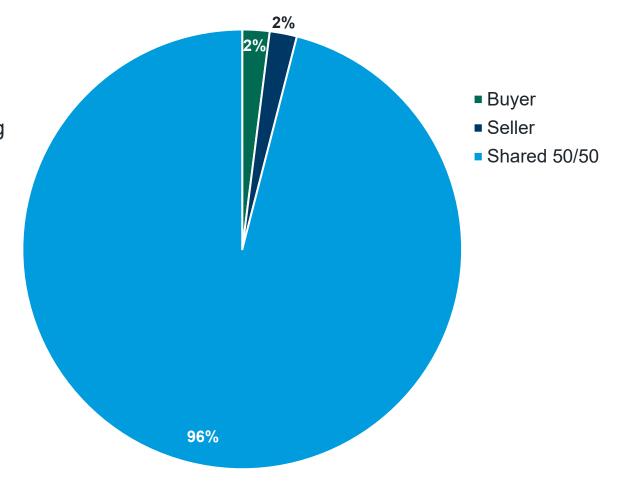
## **Excluded Obligations Include:**



This chart illustrates the various limbs of the excluded obligations being negotiated between buyers and sellers. It is worth noting certain relatively new limbs of the excluded obligations, covering any deferrals or waivers of pre-record date management fees and carried interest, which we have been successfully negotiating on behalf of our buy-side clients.

# **Transfer Expenses Borne by Which Party?**

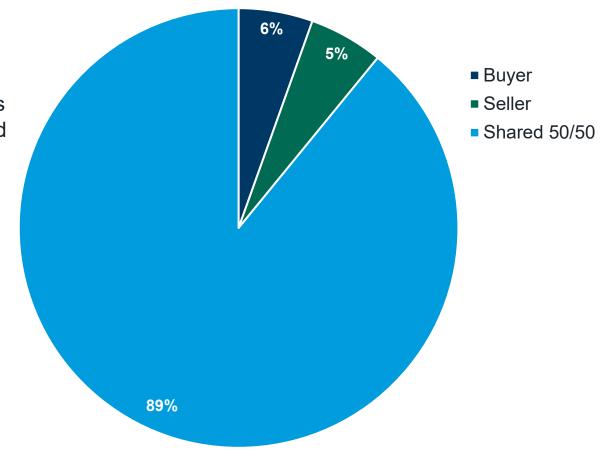
As is relatively market standard, the expenses incurred by the underlying GPs were shared equally between the buyer and seller in 96% of cases.





# **Transfer Taxes Borne by Which Party?**

In the event transfer taxes were to arise in connection with the interests being transferred, the parties agreed that they would be shared on a 50/50 basis between the buyer and seller in 89% of deals.

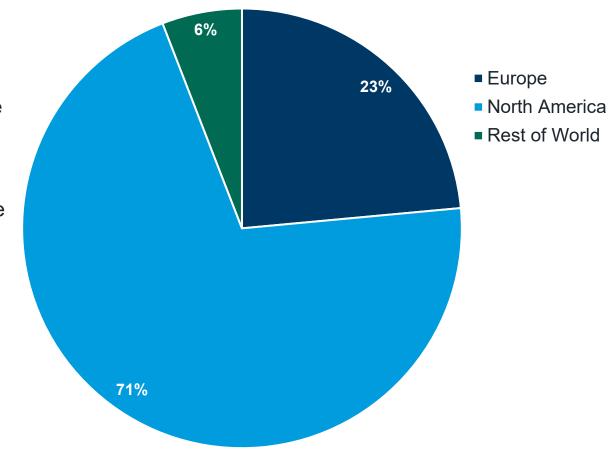






# **Sponsor Geography**

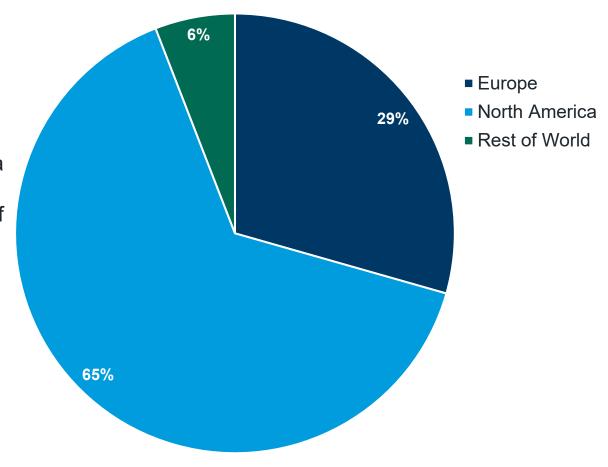
This chart highlights the principal jurisdiction of the sponsors, with the largest representations being the USA (71%) and Europe (23%). We saw smaller percentages of sponsors based in other parts of the world.





## **Portfolio Geography**

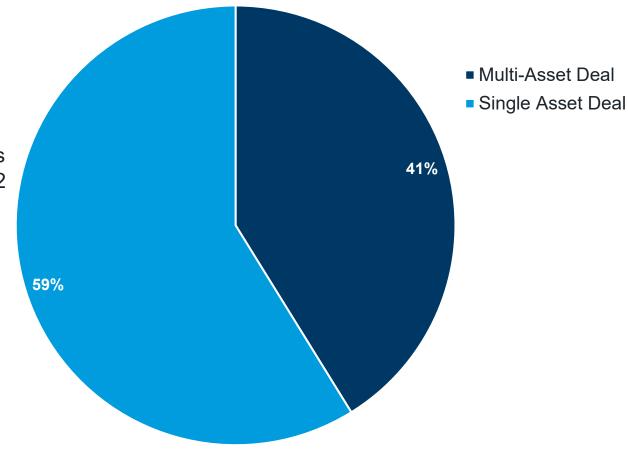
This chart highlights the principal jurisdiction of the subject portfolio companies, with the largest representations being North America (65%) and Europe (29%). We saw smaller percentages in other parts of the world.





# Single Asset Deal or Multi-Asset Deal?

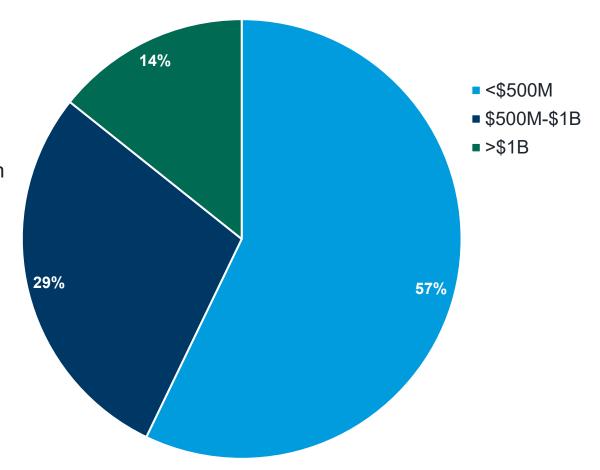
The last year has seen increased interest in single asset deals, with those transactions making up 59% of the GP-led transactions our teams worked on in the second half of 2022 and first quarter of 2023.





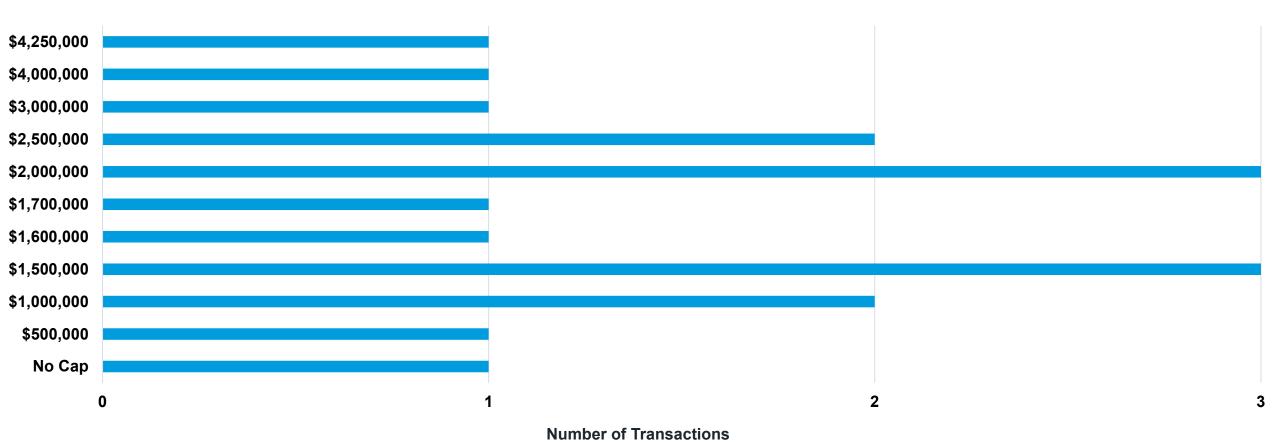
## Size of Deal

The majority of the GP-led deals worked on over the applicable time period were slightly smaller in size, with an overall deal size of less than \$500 million.





## **Organizational Expense Cap**



Recent transactions have seen increases in organizational expense caps for GP-led transactions.

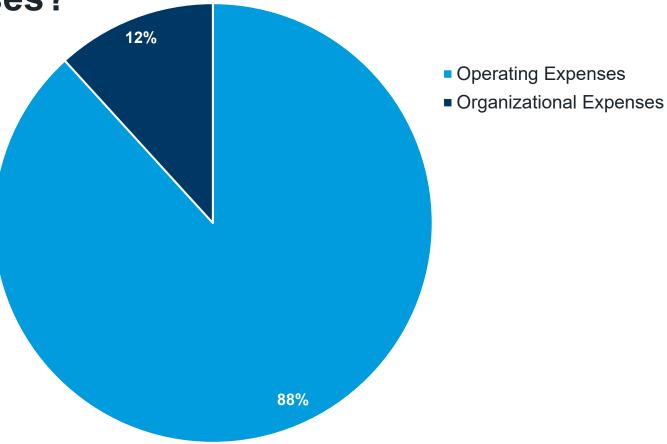


Are Lead Investor Expenses Treated as Organizational Expenses

or Operating Expenses?

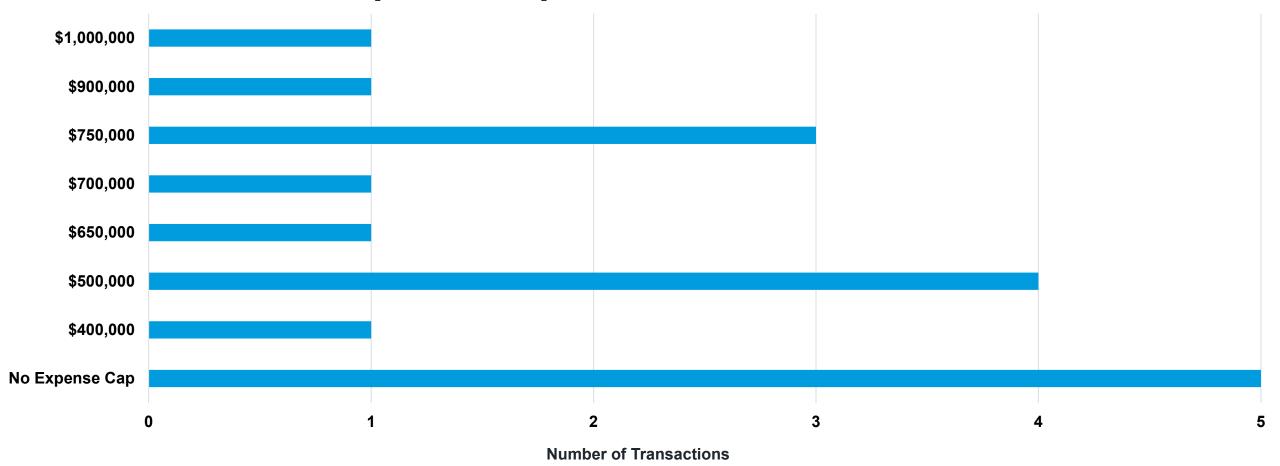
The vast majority of transactions do not include lead investor expenses in the applicable continuation fund's organizational expenses.

Transactions that do include lead investor expenses in the definition of organizational expenses will correspondingly increase the caps of organizational expenses, which could contribute to some of the higher caps we saw on the prior slide





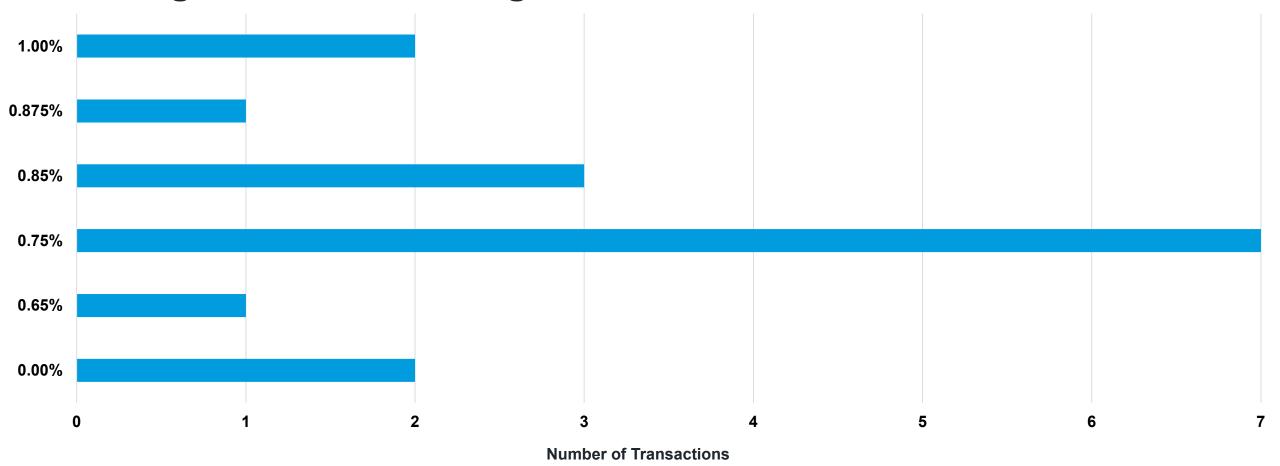
## **Lead Investor Expense Cap**



Lead investor expense caps are often marked at or around half of a continuation fund's organizational expense cap, so as organizational expense caps have increased, lead investor expense caps have unsurprisingly been on the rise as well.



## **Management Fees During Initial Term**



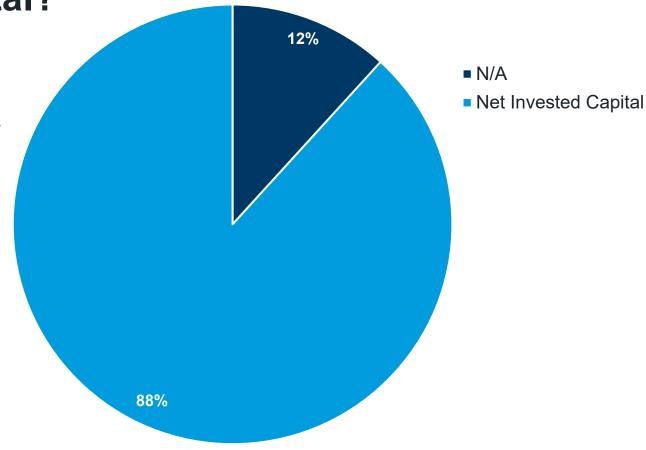
Nearly half of the deals reviewed had management fees at 75 bps during the continuation fund's initial term.



Is Initial Term Fee Amount a Percentage of Net Invested Capital

or Committed Capital?

In all of the deals that had a management fee, the rate was a percentage of invested capital rather than committed capital. This is the generally accepted formulation in GP-led transactions.





## **Management Fees for Remaining Term**

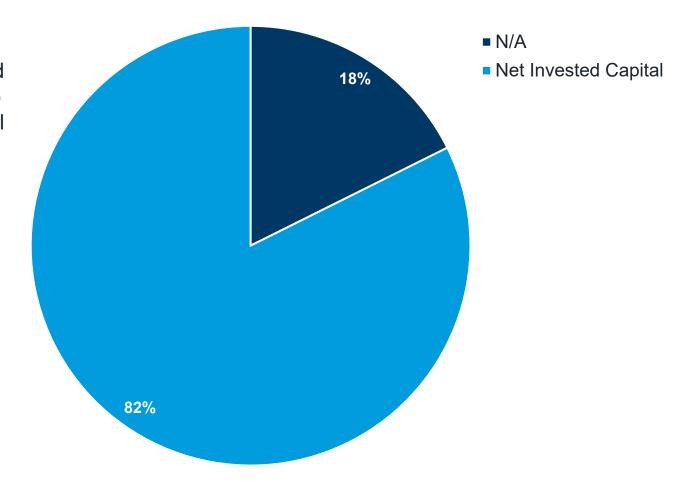


While not universal, it is common to see a management fee step-down during any term extensions.



## Is Remaining Term Fee Amount a Percentage of Net Invested Capital or Committed Capital?

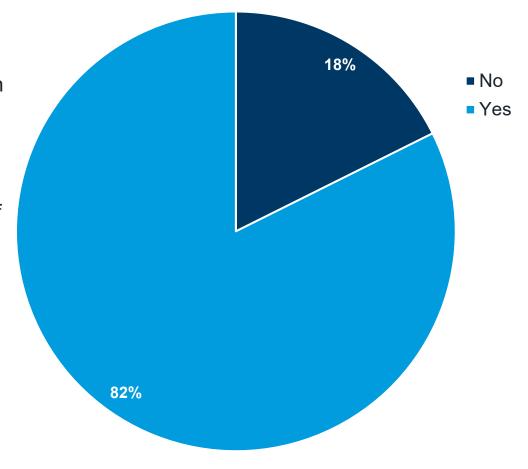
Like the management fee payable during the initial term, it is standard practice for any step-down rates to be a percentage of invested capital rather than committed capital.





## **Is There a Carry Ratchet?**

Almost all of the deals we worked on in the applicable time period provided for a carry ratchet whereby the carried interest to which the general partner is entitled increases based on generating multiple tiers of returns.

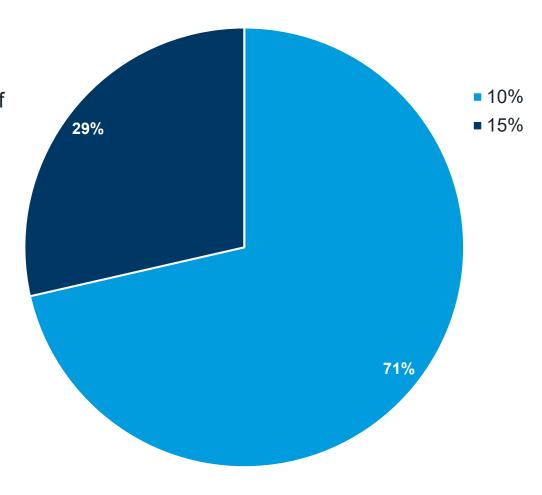




If There Is a Carry Ratchet, What Is the Lowest Attainable Carry

Percentage?

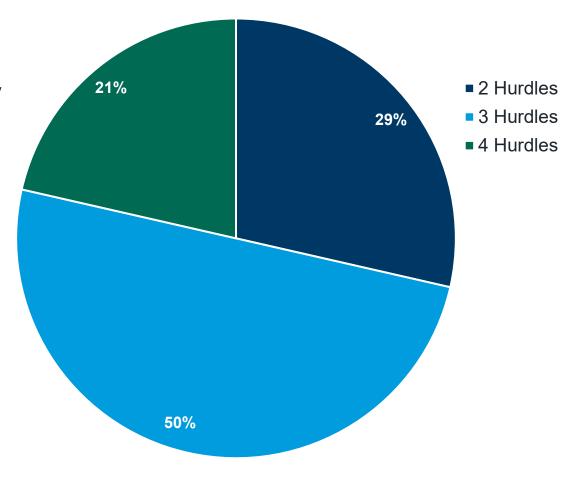
10% is the most common first tier of carried interest (71%), with 29% of the deals starting at 15%.



If There Is a Carry Ratchet, How Many Performance Hurdles Are

There?

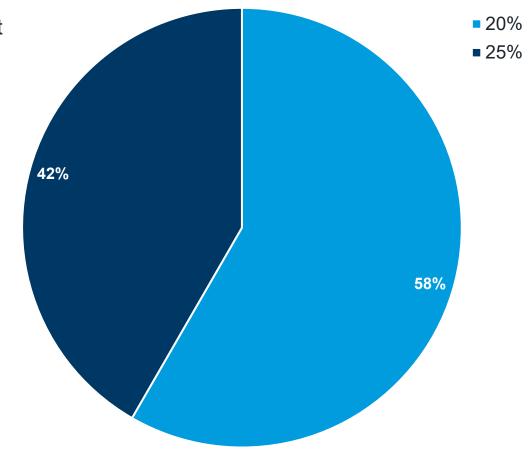
Three hurdles is the most commonly used formulation. We see two and four hurdles less frequently than three with nearly equal consistency.





## If There Is a Carry Ratchet, What Is the Highest Attainable Carry Percentage once All Hurdles Are Satisfied?

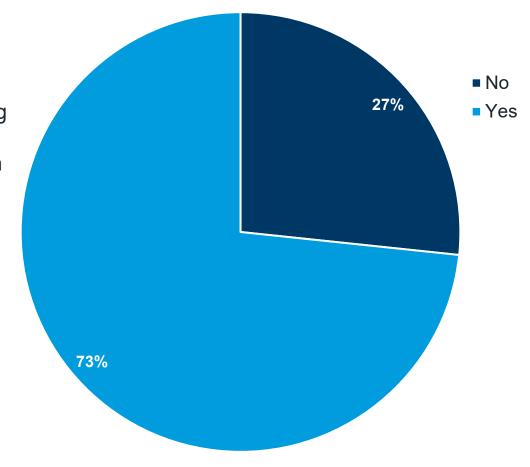
Recent deals have seen the highest attainable carry top out at 20 or 25 percent. This suggests fewer deals where there is a "super carry."





## Are Rolling Investors Required to Participate in Follow-Ons?

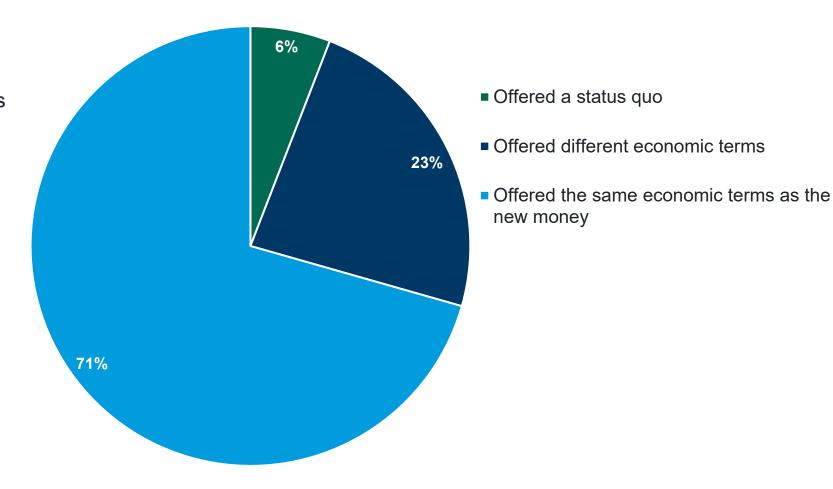
Recent deals have seen decreased optionality being provided to existing investors, including with respect to requiring rolling LPs to participate in follow-ons alongside new capital.





## Offerings to Rolling Investors

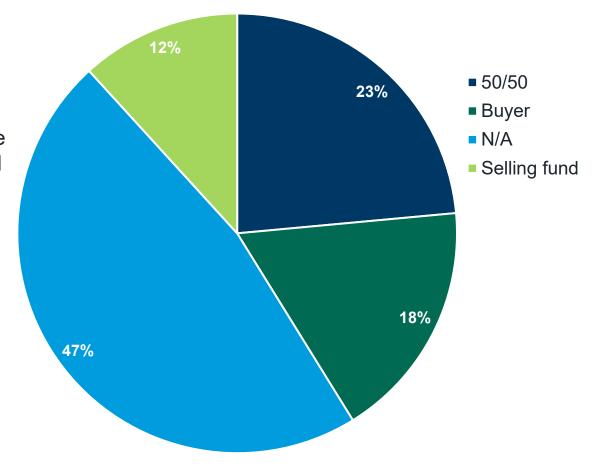
In line with the prior slide, sponsors have increasingly been requiring rolling LPs to roll on the same economic terms as new investors, with true status quo options being offered with less frequency than in prior years.





### **RWI Costs**

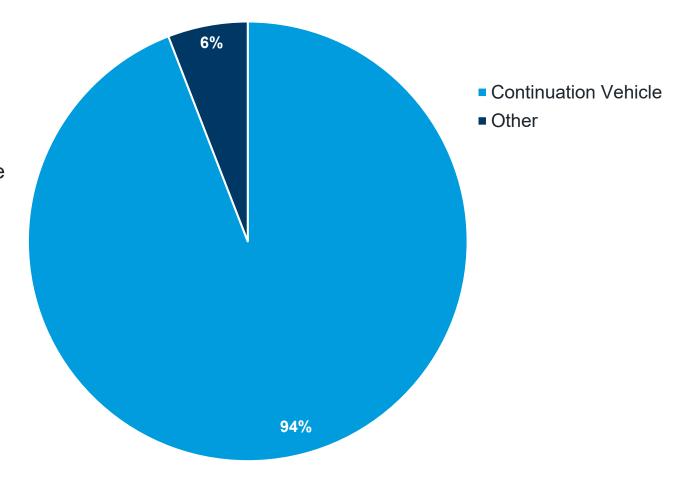
Almost half of the deals we closed during the relevant time period did not utilize RWI. In those that did, we saw those expenses being allocated in a variety of ways.





## **Continuation Fund Organizational Expenses – Who Pays?**

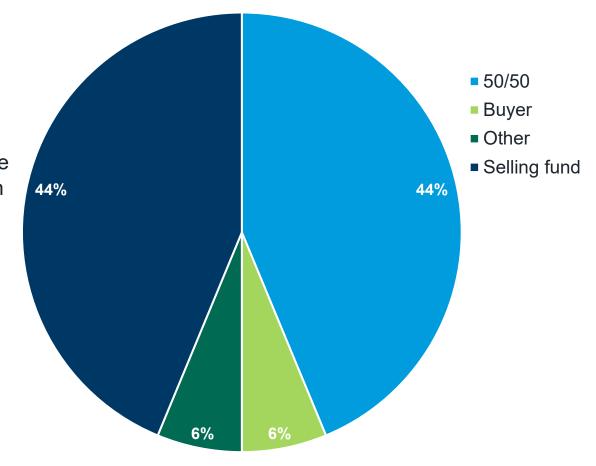
Unsurprisingly, the organizational expenses of the continuation fund are generally borne by the continuation fund, subject of course to the caps we saw in an earlier slide.





## **SPA/Contribution Agreement Costs**

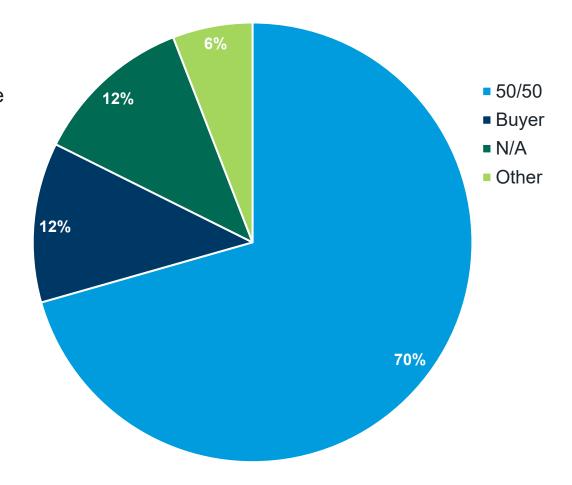
Recent deals have seen transaction agreement costs being borne either 50/50 between the selling fund and the continuation fund or 100% by the selling fund. This suggests a shift in the market with respect to the allocation of these expenses, which historically were most commonly split 50/50.





## **Transfer Taxes**

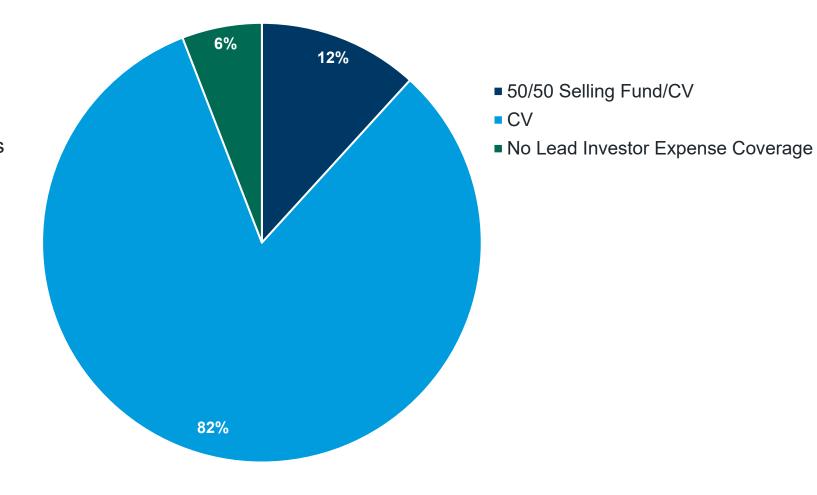
The vast majority of deals continue to split any transfer taxes 50/50 between the parties.





## **Lead Investor Expenses**

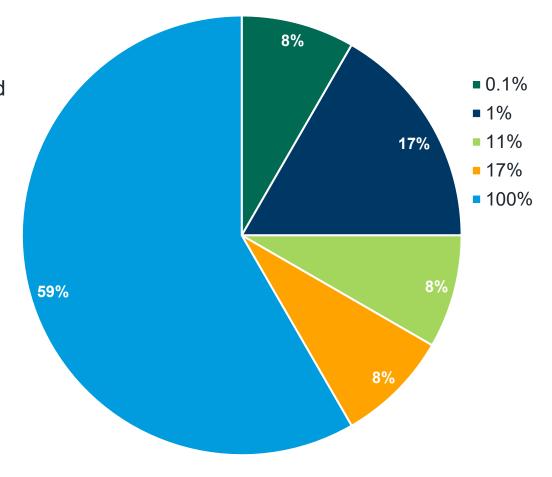
The continuation fund most commonly bears lead investor expenses, up to specified caps as seen in an earlier slide. A small minority of deals provide for alternate formulations – either splitting these expenses between the parties, or requiring lead investors to bear all of their own expenses.





## **Liability Caps for Fundamental Reps**

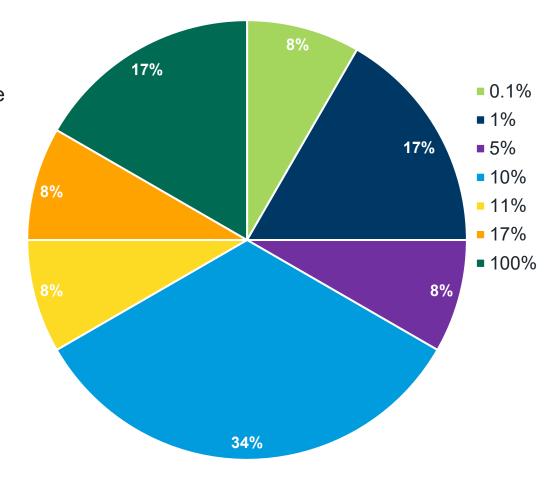
The majority of the deals we worked on during the relevant time period provided coverage for breaches of fundamental representations up to 100% of the purchase price. Some recent deals still relied on flat dollar amount caps, which account for the other varying percentages reflected on this chart.





## **Liability Caps for Non-Fundamental Reps**

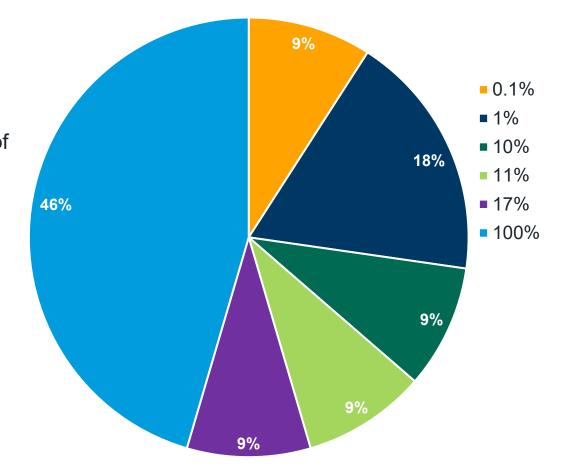
A wide variety of coverage caps are utilized for breaches of non-fundamental representations. As the use of RWI increases in GP-led deals, indemnity caps and baskets may standardize more.





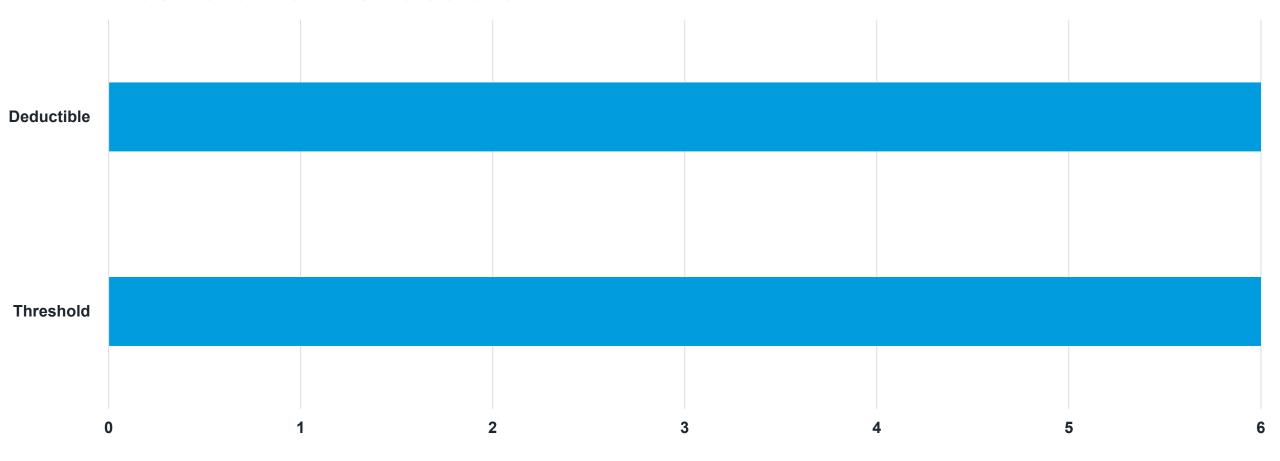
## **Liability Caps for Excluded Obligations**

Nearly half of the deals we closed during the relevant time period provided coverage of up to 100% of the purchase price for Excluded Obligations. This may increase as the use of RWI increases.





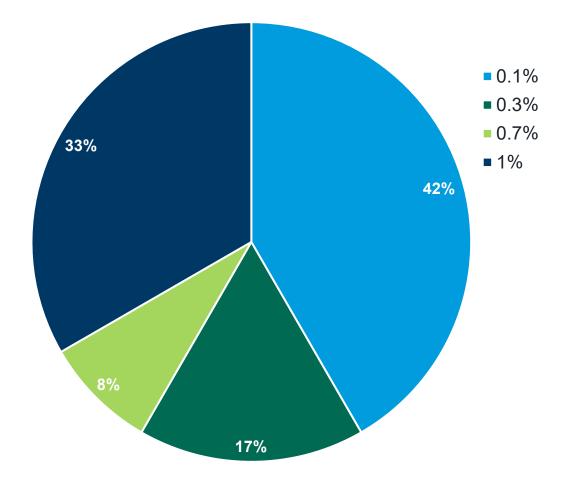
### Threshold vs. Deductible



In deals that employed the use of indemnity thresholds or deductibles, each were used with equal frequency. A threshold allows for recovery from dollar one once losses exceed a specified amount, while recovery is limited to amounts in excess of a deductible.

### Percent of Threshold/Deductible

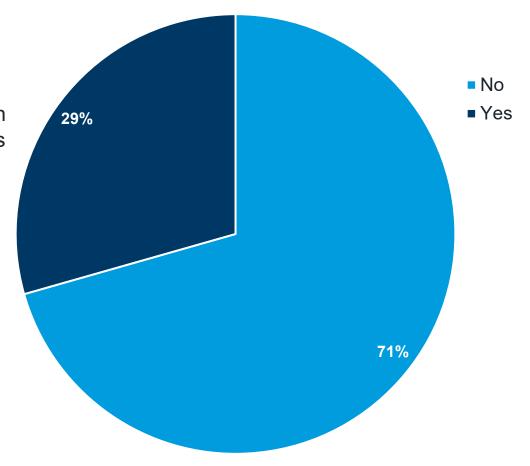
Thresholds and deductibles are generally a small dollar amount or percentage relative to overall deal value, with deductibles typically being the lower of the two.





## Does the GP/Manager Provide Reps/Warranties?

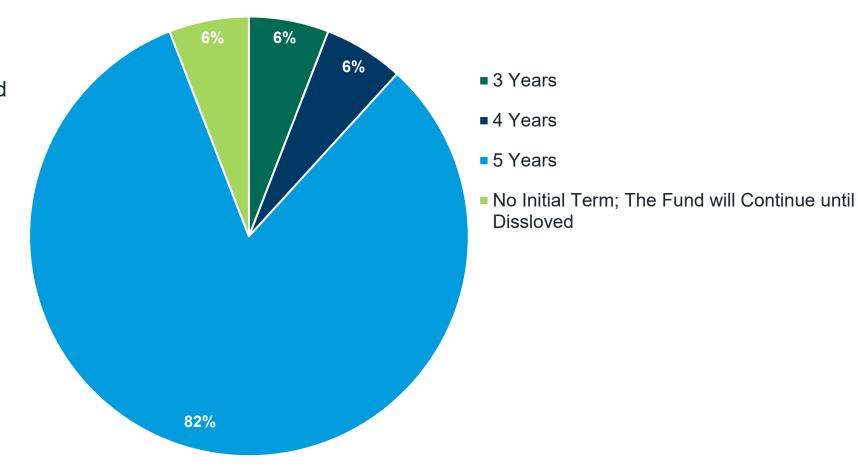
GP/Manager reps and warranties were made in 29% of deals closed in the relevant time period. These reps have become a less critical element of the deal.





## What Is the Initial Term of the Continuation Vehicle?

Nearly all continuation funds closed during the relevant period had an initial term of five years from the transaction closing date.

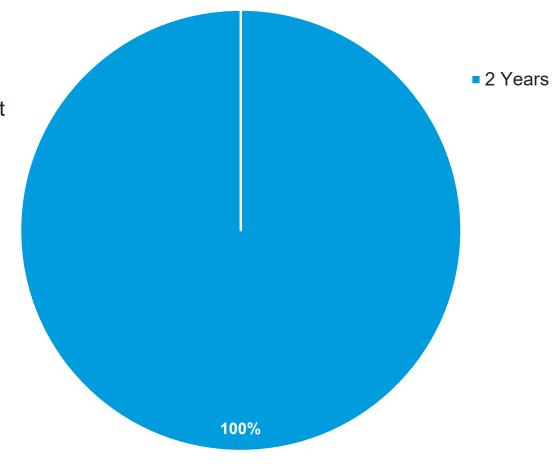




If Term Extensions Are Permitted, What Are the Lengths of Such

**Extensions?** 

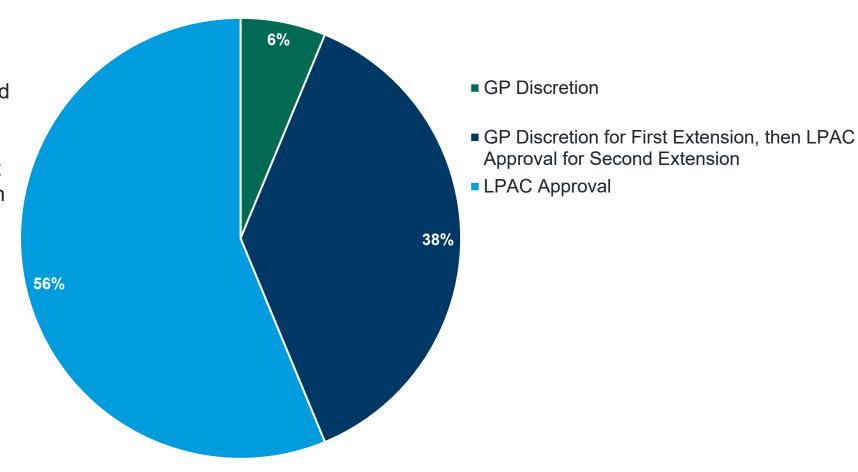
Two consecutive one-year extensions have become the market standard for continuation funds.



If Term Extensions Are Permitted, What Consent Is Required for

**Such Extensions?** 

These term extensions are permitted with some combination of GP discretion and LPAC approval, with LPAC approval being required for at least the second one-year extension in almost all instances.









#### The Sneak Peek:

#### Secondaries Pulse Check

May 9, 2023

Pent up dry powder? Biggest emerging secondaries sectors? Leverage still a viable means to finance deals? Below is a "sneak peek" into what our Proskauer panelists have to say on these big topics. They, along with our lineup of special guests, will deep dive these questions as well as many others throughout the day of the event

#### Secondaries has a lot of dry powder to spend. When will we see that big tsunami of deals expected?

Dedicated secondary programs continue to raise significant amounts of dry powder, but that doesn't necessarily result in deals being done unless the buyers and sellers can agree on pricing. The first quarter of 2023 was a "yellow light" environment, where secondary bids and asks came further into alignment in certain sectors such as buyout, but continued global market volatility still created some headwinds. For the second half of 2023, I think the general expectation is that we will continue to see buyer and seller spreads come closer together, which will cause sellers to jump back in from the sidelines and start clearing the pipeline in a meaningful way. The significant caveat is that continued macroeconomic disruption or other shocks to the system, similar to the bank defaults from earlier in the year, could inject additional uncertainty on pricing and push the anticipated "tsunami" further down the line.

Mike Suppappola, Private Funds, Boston

#### In a context of sharp interest rates increases is leverage still viable to finance secondary acquisitions?

Through 2022 and early 2023 we have observed a sharp increase of recourse to seller loans in LP portfolio secondaries in order to reduce the bid-ask gap. Many times this structuring has allowed portfolio sales to complete, if not entirely at least on sub-portions of LP portfolios. In a context of steady interest hikes by all major central banks around the world this structuring has provided secondary buyers access to "free interest rate" financings and therefore reduced their recourse to more costly third-party lender financings. But what we are now seeing is a significant shift back to third-party lender financings, and this in spite of interest rates being higher than what they used to. Those rates are still seen by major secondaries buyers as inferior to their cost of capital (and preferred returns to their LPs) and therefore useful to achieve greater returns to their LPs. There are large LP portoflio sales being shopped and third-party leverage, as well as syndication, are used to ensure their underwriting.

#### Bruno Bertrand-Delfau, Private Funds, London

We've seen several secondaries firms raise funds nearing or exceeding \$20 billion over the past few years – will secondary fundraising continue at this pace or are there any headwinds on the horizon?

Although the fundraising environment remains challenging, overall secondary fundraising should remain healthy. Secondaries remain an attractive strategy – we are seeing a rebound in LP-led volumes, with supply driven by investors' increasing need for liquidity, and GP-led transactions will continue to increase in popularity.

Sponsors raising secondary funds at or around the USD 20 billion mark are small in number, resulting in a concentration of dry powder. I expect we will see smaller secondary funds being raised by other sponsors, including new entrants to the market and sponsors raising capital dedicated to specific parts of the market, such as GP-led transactions, infrastructure, credit and real estate.

Warren Allan, Private Funds, London

We've seen a number of larger financial institutions acquire secondary teams in recent years – do you believe this trend will continue?

Yes. As the GP Led secondary market has expanded, financial institutions have recognized that continuation funds and other structured solutions are valuable tools for Fund sponsors looking to provide investors liquidity and provide valuable alternatives to traditionally exit opportunities so it is natural that financially institutions are looking to acquire and/or build experienced secondaries teams to provide these alternatives to their clients.

Howard Beber, Private Funds, Boston

#### Have you seen any recent shifts or trends in the GP-led secondary market over the past few months?

As the market for GP-led continuation funds continues to mature, there have been some notable key shifts and trends in recent months. We are seeing increased downward pressure on management fees as well as mounting scrutiny on rationale for the deal from existing LPs. This is coupled with a divergence between the U.S. and Europe on the basic framework for GP-led secondary transactions and given the current fundraising headwinds, increasing focus on stapled primary commitments to new funds. Lastly, the ILPA guidelines have recently been published. While the impact of the guidelines will have on GP-led secondary transactions remains to be seen, they will play a role in shaping transactions going forward.

Nigel van Zyl, Private Funds, London

#### Has the recent financial turmoil led to changes in the legal terms of secondaries?

A key issue seen in the secondaries market has been widening bid-ask spreads, largely triggered by the decline in public market valuations. This has resulted in an increasing number of buyers including a purchase price deferral and/or obtaining third party leverage, as a means to overcome such disparity, which has an impact on the legal terms being negotiated across a number of the transaction documents. In particular, a seller will seek a number of protections from the buyer during the deferral period and lenders will require certain consents from the underlying GPs with regard to its security package and ongoing reporting requirements.

Jordan Hurwitz, Private Funds, London

## How can buyers best position themselves as it relates to competitive processes where headline pricing is a material consideration of the seller?

When pricing is a material consideration there are a couple of things that a buyer can do to best position itself with a seller. We are seeing buyers offering better pricing if there is a purchase price deferral and are also seeing longer deferral on average. Limiting a bid to a subset of o portfolio can also allow a buyer to offer an optimised price on such subset. But fundamentals such as being able to assure the seller that the buyer is in a superior position to close efficiently and transfer the whole portfolio being sold in the desired time frame are always compelling. Here, being able to point to the buyer's experience, relationships with GPs and professional teams can emphasize that the buyer is the safest pair of hands without execution risk.

**Niamh Curry**, Private Funds, New York

#### What are the key tax considerations for limited partners in GP-led secondary deals?

Although price is usually top of mind, a deeper analysis of the proposed transaction may be worthwhile. For example, if there are "blockers" or other special structures, significant value could be eroded for investors in those structures. For cross-border matters, the tax laws of each relevant jurisdiction must be analyzed to identify any tax leakages (or potential credits available in respect of those leakages), and any potential tax withholding should be identified upfront to avoid surprises.

Stephen Severo, Tax, Boston

#### How have recent tax law changes affected GPs in the secondary market?

Beginning with transfers of interests effective January 1, 2023, GPs now are subject to a requirement to withhold on distributions to a transferee of a fund interest where the transferee did not properly withhold US tax on the transfer where it was required to do so. As a result, GPs would be prudent to ensure before approving any given transfer, that the transferring parties have complied with these obligations.

Jeremy Naylor, Tax, Boston

#### What is the biggest regulatory shift affecting secondaries that GPs need to be aware of?

Risks to GPs from the SEC's longstanding focus on conflicts of interest in GP-led secondaries transactions will likely be magnified by several recent converging developments. Recent amendments to Form PF will soon give the SEC regular notice of many transactions, thereby enabling targeted – and prompt – examination focus. The Marketing Rule amendments also create new tools for the SEC where they view CIMs and other materials as misleading. And with declining market prices driving SEC focus on valuation, GPs can expect more SEC scrutiny on any changes to valuation practices. All raising the stakes on getting it right when running a transaction.

Robert Sutton, Private Funds, New York

## Pulling in the same direction





As GP-led deals have evolved, so too have the terms designed to create alignment of interest between all parties, say Proskauer's Jordan Hurwitz and Natalie Scott

#### How can alignment be achieved in GP-led deals?

Jordan Hurwitz: We now have a relatively well-trodden path with regard to what elements are needed to achieve alignment in GP-led deals to ensure such transactions are viable. Creating alignment often involves early discussions and obtaining consent from the existing fund's limited partner advisory committee, independent price verification, the GP rolling over its crystallised carry, lower management fee charges, tiered waterfalls where the level of carried interest is linked to performance-based hurdles and providing appropriate optionality to existing investors. Achieving alignment among all

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parties has always been a key focus and will continue to be going forward.

Natalie Scott: Investors on the buy side of these transactions are looking for sponsors to roll 100 percent of the carry they have earned into the new deal as a means of encouraging economic alignment. Investors also seek heightened governance rights in the continuation fund or, in some cases, at the portfolio company level, which functions as an extra guardrail where perfect alignment is lacking.

#### How are participants gaining the disclosure they require?

NS: GPs will often provide a suite of due diligence information for new investors early in the process to aid them in evaluating the transaction. Ideally, sponsors also make this same information available to existing LPs. A more comprehensive disclosure document is also prepared for existing LPs to allow them to evaluate whether they want to sell their interest or continue to hold onto the asset.

JH: Providing a clear and comprehensive overview of all aspects of the transaction to the existing investor base is

#### **Analysis**

fundamental. A significant amount of time and effort will be spent by GPs on the preparation of the investor communication and election packs, and it is imperative to ensure the documentation is 100 percent accurate prior to circulation. If significant details are inadvertently omitted or certain aspects not made clear enough, such documentation may need to be reissued, which could negatively impact the deal timeline.

#### Clearly, setting a fair price for the asset or assets is vital. What developments are you seeing here?

JH: For any deal to take place, some form of third-party pricing verification is essential and has been a common feature in GP-led deals. One of the most common pricing verification methods involves the issue of fairness and valuation opinions. However, you may also see a minority position in the underlying asset sold to a third party ahead of the deal, with the applicable price then being used for the wider continuation fund transaction.

The US Securities and Exchange Commission recently proposed new rules, which if implemented would fall under the Investment Advisers Act of 1940 and would result in many GPs being required to obtain a fairness opinion from an independent third party in connection with any GP-led transaction. So, obtaining a fairness opinion may soon become a legal and regulatory obligation, notwithstanding the fact this is already common practice.

NS: Another way that GPs ensure fair pricing is by running competitive auction processes with a range of potential buyers. Arriving at the right valuation is, however, one of the most difficult aspects of getting these deals done. This is especially true at a time when there is a price expectations gap in the M&A market more generally and it has increasingly been



#### How does the GP's knowledge of the asset come into the alignment of interest equation?

JH: GP-led deals are often used to hold on to the GP's most attractive 'trophy assets', giving it more time to extract unrealised value and growth, which will hopefully lead to greater returns. Presuming there are existing positive relationships between the GP and management teams running the day-to-day operations of the underlying companies, the GP will have a significant head start due to its time already working with such companies. In comparison, 'new owners' in the context of a third-party sale would require more time to get up to speed with the businesses and make their mark.

**NS:** From a commercial perspective, these deals are very different to a primary investment in a blind-pool fund. There are targeted assets that have become part of the deal because of their performance history and so buyers have a higher vested interest in each specific asset's continued performance. But structurally, the terms are often quite similar to blindpool funds and so buyers are inherently reliant on a GP's knowledge of the specific assets involved in the deal in light of typically fairly limited governance rights.

a contributing factor for broken deals in recent months.

#### Natalie, you mentioned carry rollover. Has practice changed here?

NS: The vast majority of deals I see involve the GP rolling 90-100 percent of their carry, although there are some unique situations where buyers will accept less than this and it will depend very much on the quality of the asset and sponsor.

**IH:** We recently carried out a review of all GP-led transactions we worked on in the 18 months running to June 2022 and only one-third of deals required

the sponsor to roll 100 percent of the crystallised carry into the new fund. In other deals, we saw parties agreeing a set dollar amount to be invested by the GP, which was not necessarily reflective of proceeds allocated to the sponsor.

As transaction volumes proliferated when dealflow was still rife, with high quality assets and blue-chip sponsors accessing the market, we saw GPs successfully arguing for a lower proportion of crystallised carry being rolled into the deal. That said, bargaining power appears to be shifting back to the buyers and there is an expectation that a far greater proportion of deals will return to 100 percent rollover of crystallised carry.

#### What is happening with management fees in GPled deals?

IH: To create greater alignment, continuation funds typically charge lower management fees - in the range of 0.5 percent to 1.25 percent, which of course differs to the 2 percent seen in your typical primary funds. Certain continuation funds don't charge any management fee at all, but we have only seen that on European transactions. In the US, the most prevalent fee rate we have seen is 1 percent, whereas in Europe we saw more variation, with an even split between GPs charging 0.5 percent and 1.0 percent. Such percentage is typically applied to net invested capital - ie, the acquisition cost of unrealised assets net of write-offs.

NS: There are always some nuances with management fees to consider. If you have existing investors in a fund, that is relatively mature so there is no management fee; the GP needs to consider whether those rolling over should be charged management fees in the new vehicle. Early on, there was more of a presumption of offering existing investors the option to roll over while preserving their existing economics. The market is trending away from this practice though, so it's more common that LPs electing to roll will pay the same management fee as new investors.

#### This raises an interesting point about existing versus new investors. What's the state of play around status quo?

NS: We are seeing a move away from offering existing investors a true status quo option. It used to be considered the gold standard since it meant that GPs were not changing the position of existing investors who elected not to sell, other than perhaps by way of a term extension. This approach has the potential to cause misalignment between new and existing investors. If new and existing investors have differing fee and

"There is an expectation that a far greater proportion of deals will return to 100 percent rollover of crystallised carry"

JORDAN HURWITZ

"We are seeing a move away from offering existing investors a true status quo option"

**NATALIE SCOTT** 

carry structures, they may not be economically aligned with one another in respect of the disposition of the subject asset(s) on a go-forward basis.

While we do still see some transactions where GPs offer to preserve the existing fund economics for investors that roll, it is becoming much less prevalent.

Overall, the more optionality you offer to existing investors, the more complex the situation becomes. That doesn't mean existing investors aren't asking for this and even expecting to see it, but they are beginning to accept that they may not get a true status quo option.

#### How do you see fund terms shifting over the coming period to create greater alignment between all parties?

**JH:** We are continuing to experience a significant drop in dealflow, largely due to the ongoing valuation gap. It will be interesting to see whether there is a shift in fund terms as and when parties return to the negotiation table and deals start to get over the line.

There is now a relatively established set of criteria that all parties expect to be present on GP-led transactions to maximise alignment and reduce conflicts as far as possible. While the most reputable GPs may still seek to dictate terms for the most sought-after assets, the expectation is that the pendulum is swinging in favour of the buyers.

Buyers will be pushing harder than ever for greater alignment, which is likely to include requiring the GP to roll 100 percent of its crystallised carry generated by the transaction into the new fund so the GP is not taking any money off the table, as well as having the GP commit fresh capital. Enhanced information, governance and consent rights are also likely to be a common ask. ■

Jordan Hurwitz is a partner in the private funds group at Proskauer based in London. Natalie Scott is a senior counsel at the firm based in New York

## Mastering GP-led





A robust process is vital to any GP-led transaction, say Proskauer's Howard Beber and Warren Allan

While secondary buyers and LPs are becoming increasingly familiar with continuation funds, many sponsors are embarking on GP-led transactions for the first time and are not familiar with the process. Here, Howard Beber, co-head of private funds, and Warren Allan, partner in the private funds group at law firm Proskauer, set out what managers need to know about GP-led processes.

#### What are the biggest challenges around GP-led processes that sponsors may not be aware of?

Howard Beber: First, these are time consuming and complex transactions. Next, there needs to be a compelling **SPONSOR** 

#### **PROSKAUER**

reason why a manager has opted for this type of transaction, beyond economics for the manager. Typical reasons include a misalignment of the portfolio relative to the timeframe of the fund, an asset needing follow-on capital, or just creating a good liquidity opportunity for existing LPs in an older fund.

These transactions almost always require some level of approval from existing LPs or the LP advisory committee of the selling fund, as well as some level of due diligence on the underlying portfolio companies, including to assess change of control and other issues that may be triggered upon the sale of a portfolio company.

Meanwhile, from the buy-side perspective, any secondaries buyer is going to expect the GP to participate in the continuation vehicle by virtue of a rollover of some or all of its interest in the underlying portfolio. Beyond that, there are internal GP issues that could arise: who is going to roll over, who is going to get carry in the continuation vehicle, and how that differs from the initial fund.

Warren Allan: At the outset, sponsors should be aware that GP-led processes are not bilateral deals, and will involve engagement with a number of different groups that have disparate interests. Successful deals are those that best marry up those interests, and achieve a win-win-win outcome.

In terms of the groups, there are the existing investors in the selling fund; the advisory committee of the selling fund; one or more lead buyers that are generally selected following a competitive process; a number of syndicate investors; and, as Howard has mentioned, there can be a number of internal discussions at the sponsor itself as to the shape of the deal and economics going forward.

Looking at the underlying asset level, there will need to be engagement with the management team of each of the portfolio companies. Discussions with other security holders of, and lenders to, underlying companies may be necessary, and there may also be a need to engage with regulatory authorities, for example if the target company is regulated.

There are a lot of participants, and the sponsor will be at the centre of discussions with each group.

**HB:** Another issue that adds complexity is the tax structuring of the portfolio. If the portfolio is layered with blockers and/or intermediary vehicles, or if the buyer is requiring tax structuring, that can be another challenge.

#### You mentioned due diligence issues. What other challenges tend to arise in relation to deal preparation at the fund and asset level?

HB: For most of these transactions, buyers are going to want to do some level of due diligence at the portfolio company level. This is where it becomes important to have good relationships with management teams at portfolio companies. The sponsor needs to work closely with the management team to make sure they are aware of the transaction and are prepared for buyer due diligence. This can be time consuming for management teams and

"The sponsor needs to work closely with the management team to make sure they are aware of the transaction and are prepared for buyer due diligence"

HOWARD BEBER

particularly challenging if the sponsor doesn't control the portfolio company.

WA: It is important to get the portfolio composition right, and it helps if the portfolio composition is settled at the start of the transaction. From a transaction management perspective, it is better to get in front of diligence to flag any potential issues early on in the process. If a portfolio flexes during a process, it can lead to some process inefficiency, as the diligence workstream, on both the sell side and the buy side, will need to catch up in respect of the newly included assets.

#### What should sponsors focus on when it comes to choosing advisers?

**HB:** Choosing advisers with experience leading GP-led transactions is critical but experience is just table stakes. Sponsors should seek out advisers that have worked on similar types of GPled transactions before - for example, if your transaction is on the smaller side, you want advisers that have worked on similar sized deals. After experience, the key is finding a good cultural fit and an adviser that you can regard as an extension of your internal team.



WA: It is important for a sponsor to engage both a financial adviser and a legal adviser with experience of acting for sponsors on GP-led activities. Good advisers will have been through the process a number of times already, and will be able to issue-spot and feed into the transaction structure and process to give the best chance of success. Having advisers on board that are experts in the market will benefit all parties to the transaction.

HB: LPs are now used to these transactions and there is nowhere near the level of scepticism that there used to be - LPs have seen the value from a liquidity perspective and can often be convinced these transactions can be beneficial for all parties.

#### What are some of the key considerations for sponsors in regard to new fund terms and retained liabilities?

**HB:** Managers should think about terms the same way that they do about main fund terms. Terms can set the tone of the transaction - some managers in a strong position with attractive asset(s) may choose to be aggressive, while others in an equally strong position may seek middle of the road terms. It is important for managers to align with where they are in the market, but also where they want to be perceived to be.

Unique to continuation vehicles is the 'allocation waterfall' which is necessary if there is more than one buyer. Because selling volume is unknown when deals are negotiating, buyers typically agree on a 'waterfall' dictating buyer participation relative to the eventual selling volume. In addition, for continuation vehicles the 'distribution waterfall' is typically different than a typical main fund in that it is standard to include one or more performance-based hurdles with multiple levels of carried interest depending on performance.

WA: Recourse for the liabilities of the selling fund will be a key point of discussion and focus during the negotiation of deal terms between the sponsor and the lead buyer.

If the selling fund has a limited term remaining, or will have limited assets remaining after completion of a transaction, a buyer will often seek a holdback from the purchase price or escrow arrangement. In addition, a buyer will want to carefully review the ability of the GP of the selling fund to recall distributions previously made to investors in the selling fund.

The use of warranty and indemnity insurance products has become more prevalent in GP-led deals, both for single-asset deals and portfolio transactions. These policies limit the risk of contingent liabilities for the selling fund and, given recovery is against the policy, can result in the selling fund being willing to give a broader set of warranties.

#### What about concerns around transparency of process and conflicts of interest? How can sponsors address these?

WA: Transparency is key in these transactions. Given the potential conflicts involved, these transactions often require consent of the LP advisory committee and, potentially, the broader investor base.

Sponsors are encouraged to have early engagement with the LP advisory committee, in particular, to consult on plans for a proposed GP-led transaction.

At these meetings, sponsors and advisers will seek to discuss conflicts of interest, the proposed transaction structure, and the alternative exit

"Sponsors are encouraged to have early engagement with the LP advisory committee, in particular, to consult on plans for a proposed GP-led transaction"

WARREN ALLAN

options considered. There is value in pre-empting questions on these topics.

The feedback from these discussions can often shape a deal and flag any issues with a proposed transaction structure early on. It is better to deal with those at the start of the process, rather than finding out, later in the process, that the deal terms or structure needs to change in order to obtain the necessary consents to do the deal.

Communicating with the broader investor base is also important, and a lot of time is put into the preparation of investor communications and election packs.

These will commonly contain: a description of the transaction process, how the lead buyer was chosen, what alternative transactions were considered, a summary of the key terms of the transaction, a description of the actual or potential conflicts and how they have been mitigated, and information about the options available to the investors, to elect to receive a cash distribution or roll into the acquirer or a mix of the two.

#### Finally, what are the key factors that should be taken into consideration around portfolio composition?

HB: Around half of last year's GP-led deals were single-asset transactions. Single-asset deals are treated more like M&A transactions, with buyers engaging in fulsome due diligence on the asset.

On the sell side, if a sponsor is only selling one asset out of a fund that has other assets left, the transaction will likely be less attractive to LPs because it is not providing full liquidity, which could result in fewer LPs electing to sell.

Another important consideration for potential buyers is the relative unfunded commitment in the continuation vehicle. The more unfunded capital required in a transaction the less attractive the transaction will be to potential buyers.

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## Undercapitalization slows secondaries activity

While LPs and GPs cry out for liquidity, secondary funds are unable to recapitalize quickly, creating pent-up demand that bodes well for the future. By Claire Coe Smith

fter years of explosive growth, the global secondaries market hit a slowdown in the second half of 2022 that reflected challenges in the broader macroeconomic climate. Participants at the second annual Buyouts secondaries roundtable talked extensively of the challenges of undercapitalization but were unanimous in their belief that activity will soon rebound and today's slowdown bodes well for a strong uptick to address pent up demand.

"In January and February 2022, we still had a functioning secondary market," says Yann Robard, managing partner at Whitehorse Liquidity Partners. "In the first half of the year, \$53 billion was traded and most of that happened in the first quarter. Remember that

strong performance of private equity in 2021 left many LPs entering 2022 overallocated to private equity. Then public markets faltered in Q2 2022, compounding LPs' over-allocation to private equity, then distributions started declining and now capital call facilities are starting to get cleared, further compounding overallocation. If you wanted liquidity for your private equity portfolio, you had to start queueing in April of this year."



Because fundraising is difficult right now, secondaries funds have been unable to recapitalize quickly, creating undercapitalization and a backlog of demand.

"Reports suggest that the dry powder in the market stands at \$93 billion before any new fundraising," says Robard. "Last year, \$85 billion traded in the second half of the year. Assuming a similar deployment this year, this would suggest that most, if not all, dry powder will have been extinguished by the end of 2022. Said differently, we're entering 2023 with a lot of pent-up liquidity and little to no capital to absorb that supply."

An additional challenge is that there is a pretty meaningful bid/ask spread in the market, as the difference between what buyers are willing to pay for assets increasingly diverges from the



**Gordon Appell**Managing director, PJT Park Hill

Prior to joining PJT Park Hill in 2021, Gordon Appell was a director in the Client & Partner Group at Kohlberg Kravis Roberts, where he was a product specialist responsible for the firm's North American private equity and energy real assets platforms. Previously, Appell was a director in Credit Suisse's Private Fund Group.



**Ben Perl** Managing director, Neuberger Berman

Ben Perl is global co-head of NB Secondary Private Equity. He is a member of the secondary, real estate secondary and strategic capital investment committees. Perl joined the firm in 2001 and Neuberger Berman Private Equity in 2007. Prior to that, he worked as an associate at Lehman Brothers Venture Partners (now Tenaya Capital).



**Yann Robard**Founder, Whitehorse Liquidity
Partners

Yann Robard founded Whitehorse in 2015 and has over 20 years of private equity experience. Based in Toronto, Whitehorse has raised over \$12 billion in commitments, deployed over \$16 billion in over 185 transactions and consists of a team of over 125 individuals. Prior to Whitehorse, Robard spent a cumulative 13 years at CPPIB.



**Chris Robinson** Partner, Proskauer

Christopher Robinson primarily focuses his practice on representing buyers and sellers, as well as market intermediaries, in connection with complex secondary transactions, including traditional sales and purchases of fund interests, secondary direct transactions, captive fund spin-out arrangements, fund recapitalizations and restructurings, and "stapled" secondary transactions.



**Sola Adeleye**Director, Citi Private Funds Group

Sola Adeleye co-heads Citi's Private Funds group and advises private market sponsors and institutional investors on secondary market liquidity solutions, primary fundraising and LP portfolio financing. He has over 15 years of private market experience across secondary advisory, secondary investing and investor relations from KKR, Landmark Partners and UBS.

## "In this market, buyers are laser-focused on existing GP relationships"

**SOLA ADELEYE** Citi private funds group

lowest price that sellers are willing to accept.

"Private equity NAVs tend to be a little stickier and take a little more time to adjust to market sentiment," says Robard. "People who don't need to sell are not going to sell in this market and will hold out given higher optical discounts. This should self-correct over time. As markets settle and discounts to more recently marked books narrow, the need for liquidity will drive renewed activity in the market assuming the secondary market can recapitalize to absorb this demand."

#### **Market slowdown**

For sellers in the secondaries market, the route to exit a diversified portfolio sale to a buyer using significant leverage is challenged in this environment, both by the rising cost of leverage and a recognition by buyers of the uncertain conditions.

Ben Perl, managing director at Neuberger Berman and global co-head of NB Secondary Private Equity, says: "Each business has its own potential idiosyncratic issues right now, whether those relate to inflation, supply chains,

## "People who don't need to sell are not going to sell in this market"

YANN ROBARD **Whitehorse Liquidity Partners**  energy inputs, labor costs or regulatory change. It is not an easy environment in which to operate, and it is not an environment where people want to blindly buy diversification. Buyers are going to want to be more targeted, to understand what they own, to price risk accordingly and to steer away from using a lot of leverage to amplify returns."

He adds: "There is a need for liquidity that is structural and will not go away, but there is not a ton of dry powder and buyers really want to be careful around what they own and the prices they pay. We are going to see GPs understanding that pressure for their LPs and understanding that their LPs may not have great liquidity options, so they will be trying to help manufacture liquidity for their LPs as well. We did not see that through the last downturn, when there was really no such thing as a GP-led secondary solution to help drive liquidity."

Gordon Appell, managing director in PJT Park Hill's secondary advisory group, says: "The bid/ask spread that everyone is highlighting is a real issue. The Nasdaq is down around 30 per cent year-to-date, the S&P 500 is down around 20 per cent, but private equity NAV movements have been more muted so far. While this is not a surprise to see less volatility with private assets, a lot of buyers we talk to believe a downdraft is coming so they want to protect themselves from that, which is where some of the discounts come into play."

He says GPs are looking to do some really big deals in the single-asset space, because the IPO and traditional M&A markets are not there to the extent they have been in the past 12 months. "But getting a billion-dollar single-asset GP-led deal done now as opposed to 18 months ago is a very different proposition," says Appell. "You have to hit a bullseye across a select set of buyers, because the syndication market is not what it was, and then you have the pricing issue. It is going to take a lot of work

"You have to hit a bullseye across a select set of buyers"

GORDON APPELL
PJT Park Hill

to get deals done at scale. Advisers are a little more cautious and are guiding GPs towards things that are multi-asset, with tenders also coming back."

Tender offers are back in favor, allowing GPs to hold auctions to find secondaries firms willing to buy up a certain amount of fund interests from their existing LPs. Such deals had fallen out of fashion with buyers who did not like the amount of work required upfront with little certainty on the outcome.

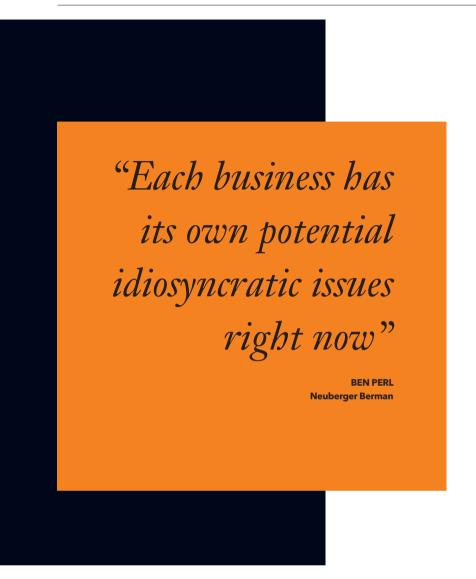
Appell says: "Now we have a backdrop that has the right ingredients for those transactions. You have liquidity needs on the LP side and a primary fundraising market that is challenging, allowing for a rotation of LPs who can take liquidity from the transaction and use that to commit to a new fund, or to something else that is going to be core to their program going forward. The buyers that are stepping in are hopefully getting an interesting value orientation, and the sponsor is getting a little more momentum on their fundraise through some primary capital to support that.

"These tenders have elements that are relevant to all the different counterparties right now, but to be successful they need to be for the right sponsor with an attractive strategy, team and track record."

#### **Bridging the gap**

While some deals are still getting done in the secondaries space, Sola Adeleye, who heads Citi's secondary advisory team, says it has been challenging to bridge the valuation gap: "We are seeing good assets with great GPs not able to clear the market because of the bid/ ask spread. It is tough as a GP to put something in front of the LP Advisory Council if there is a large headline discount. We continue to see supply on both the LP-led and GP-led side but the hit rate in terms of deals getting to the finish line has been lower than prior quarters. As audited year end NAVs get reset in Q1 2023, we expect to see an increase in transaction volume."

He points, however, to green shoots in the current market around credit and real assets. "We've seen recent pricing for some portfolios that were actually



higher than it was in Q1 and Q2 of this year, because LPs and secondary funds are craving yield and they can get that from seasoned credit and infrastructure funds," he says. "Certain portfolios are getting bid up by both traditional secondary funds and non-traditional buyers as well.

"Given the undercapitalization on the dedicated secondary fund side, the net needs to be cast wide in order to reach a broader set of buyers, especially when it is a large transaction. Advisers' ability to access a wider pool of capital outside of dedicated secondary funds is extremely important to reduce execution risk. We are advising our sell-side clients that it is a buyers' market, and we expect that to continue over the short term. As a seller, you can influence that dynamic by being thoughtful about the size and type of asset or portfolio you bring to market."

Chris Robinson, partner in the private funds group at Proskauer, says that syndication of large deals can be challenging right now. "If large investors have marketed to their LPs that they are primarily seeking to take lead investor positions, this may cause them to pass on syndicate opportunities, thereby limiting the universe of potential buyers that can step in to help on some of these larger transactions," he says. "That is adding to the complexity in getting some of these deals to the finish line. The syndication process can become extremely difficult, depending on your closing timeline, as you start to try and line up investors that need to get up to speed pretty quickly."

There have been a few instances of pulled deals and limited examples of buyers coming back for revised pricing discussions where deals have been in the market for a while and reference dates needing to be updated.

But advisers are finding ways to bridge valuation gaps. Robinson says: "We have done a number of transactions where valuation is a concern but where GPs are confident in where a portfolio company's performance may ultimately end up, and we have been able to use alternative transaction structures, including preferred equity or performance based earnouts, to help bridge the gap. Where there continues to be a bid-ask spread, I expect to see more of these structures implemented."

#### Getting deals done

Adeleye says there are several factors influencing which transactions can get done, for both LP-led and GP-led deals. "Entry valuation is important in this volatile market environment," he says. "It is tough to make money when you overpay, so your entry price is probably your biggest value creation lever. While GPs are hesitant on marking down their books, buyers are maintaining price discipline as a result of the supply-demand imbalance that works in their favor."

If price can be agreed, alignment then becomes exceptionally important on GP-leds, as buyers look for the right mindset and expect GPs to double-down on the GP commit. Perl says:

# "As bid/ask spreads reduce we will see a real rebound across the board"

CHRIS ROBINSON Proskauer

"Alignment isn't something you can easily summarize in one word – we sort of know it when we see it. Buyers are looking for GPs who want to re-risk, not de-risk. If the transaction is about de-risking for them, that doesn't necessarily mean buyers don't look at it, but it is typically a big negative and is likely difficult to overcome. The gold standard is the sponsor rolling over, not taking liquidity – save for maybe some exiting partners – and they are actually committing new capital."

Adeleye adds that existing relationships are also proving critical to getting transactions closed for GP-led deals: "In this market, buyers are laser-focused on existing GP relationships. The deals getting done tend to be led by one or two investors that are existing LPs of that GP and know the types of behaviors that GP exhibits in good times and bad. In most transactions, it is really about existing LPs leading and anchoring transactions."

Perl says: "Capital is precious and every deal has to stand out in this environment. If it's an average deal, there will be another deal like it in three to six months' time. Buyers today are looking for the best assets, the best risk-adjusted returns, good sponsors, good alignment and good valuations – it all needs to hang together."

#### What happens next

Looking forward, Robard argues that today's undercapitalization will set the secondaries market up for growth in the coming years.

"You have an undercapitalized market that is going to stay undercapitalized for a period of time," he says.

"But, as history shows, all of this resolves itself over time and over the cycle. When you look at 2009, there were lulls in the market during a period when bid/ask spreads widened, but then you had a decade of boom in secondaries, growing from \$10 billion in 2009 to \$134 billion in 2021. I see a similar thing happening now: in a 2022 world we could hit \$100-125 billion this year, which is a bit less than last year. But I would watch this space closely as it's going to set us up for tremendous growth in 2023, 2024 and 2025 as we deal with that pent-up liquidity."

Perl says the pendulum has swung in favor of buyers right now, but it may take time for volumes to materialize. "The markets will set in, the reality of higher interest rates will set in, and we are already starting to see a realization from GPs as to the power of these GP-led solutions," he says.

"That is one of the only attractive options they have when they need to

create liquidity for their LPs. No one wants to sell in a bad market, but a lot of people need liquidity, so those will tick back up and unlike other exit options, these give investors the flexibility to choose what is best for their specific needs."

Robinson predicts the last three quarters of next year will be particularly busy. "I think the first quarter will mirror what we are seeing right now with a softer market," he says. "With the number of sponsors in the market raising capital and pent-up demand on the sell side, we will likely see a race to get deals done.

"Portfolio transactions will probably come back first at a higher volume than GP-led transactions because there is an immediate need there that has to be addressed with motivated sellers and there are a number of buyers that may be a little overweighted with the flurry of GP-led transactions done over the last 12 months so those buyers will likely look to balance their investment mix with high quality LP portfolio transactions. Additionally, as bid/ask spreads reduce we will see a real rebound across the board."

It is true that 2022 has been a challenging year, but once the recapitalization starts taking shape, expect more secondaries growth to come.

# Navigating Liquidity: Proskauer's Secondaries Pulse Check

New York – June 2023

Proskauer>

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