Fashionably late to the GP-led secondary party

Expert comment by **Daniel Roddick**

The private debt secondaries market has trailed the development of private equity, but a range of deals is now being seen – albeit with specific private debt characteristics

In the private equity secondaries market, 2020 was hailed as "the year of the GP-led". Once again, 2021 has been dominated by talk of single or multi-asset general partner liquidity solutions. The level of private equity secondary dealflow led one participant to tell me, "It's a GP-led party!". While private debt players are not really known for being party animals, they are increasingly leaving the sides of the disco and are now tentatively beginning to step towards the dancefloor.

By a GP-led deal, what we mean is any secondary transaction instigated by the general partner, as opposed to the limited partner. One of the most common forms of private equity secondaries is a sale of one or more assets from a mature existing fund to a new continuation vehicle managed by the same GP.

The new fund will usually have one new lead LP which has set the price for the transfer (usually after an auction process), and existing LPs typically have the option of taking liquidity today or rolling into the new fund.

The rationale for doing so could be that the regular exit routes do not fully value the business(es) and/or there is further upside to the asset(s), but it would take longer than the expected remaining life of the fund to realise that full potential. Additionally, if a fund has legacy LPs that no longer consider the GP to be core to their strategies, a GP-led transaction can allow those LPs to take liquidity, ideally lock in a strong return, and enable the GP to renew its LP base with new investors who are likely to be more favourable towards its strategy.

The alternative to a GP-led could be to extend the duration of the existing fund or run a tender offer process, and a good GP would explore all options

Case study: Eurazeo's continuation vehicle

In December 2021, Ely Place Partners announced it had acted as exclusive adviser to asset manager Eurazeo on a €109 million credit secondary, involving the establishment of a fund continuation vehicle and the provision of liquidity for investors across three funds.

The transaction followed the recent closing of Eurazeo's latest direct lending fund, the €1.5 billion Idinvest Private Debt V, where Ely Place secured a €100 million single investor commitment for its repeat client.

Two of the funds were co-investment vehicles alongside Eurazeo's flagship funds, and therefore it was important for the GP that it maintained the management of these assets in order to control the underlying loans.

The credit secondary was run as a two-stage competitive auction involving potential bidders across traditional LPs, funds of funds and private debt secondary buyers. Pantheon, a global private markets investor with a $4 billion private debt platform and a specialised focus on credit secondaries, led the successful investor syndicate alongside Pennington Partners and Oddo-BHF Private Equity.

Toni Vainio, a partner at Pantheon, said of the deal: "This type of portfolio solution transaction, while fairly standard today in private equity, was relatively novel in private debt. However, it demonstrates how the secondary community can partner effectively with private debt managers to create a win-win-win situation for existing investors, the GP and for new LPs."

with its LP advisory committee before embarking on any given transaction.

To date, we have not seen many private debt GP-led deals announced in public. While some private debt secondary players tell us that the majority of their dealflow is picking up LP stakes, others tell us that much of what they transact on consists of bilateral partnerships with GPs – financing portfolios of co-investments, warehoused assets sold into separately managed accounts, strip sales and so on – which tend not to be reported.

This is perhaps why the published figures on private debt secondaries arguably don't show the entire picture. According to Evercore for instance, private debt accounted for 2 percent of total secondaries in H1 2021, making an annual dollar value of around $2 billion, assuming total secondaries at circa $100 billion for the year. Most private debt secondary players would however tell us they see more like $10 billion to $15 billion of annual dealflow, with around $5 billion of that closing. In a recent conversation I had with the private debt secondary team at Pantheon, they told me that they anticipate that number growing above $15 billion in 2022, of which roughly half is expected to consist of GPs exploring liquidity solutions, with the rest being LP stakes.

"While private debt players are not really known for being party animals, they are increasingly leaving the sides of the disco"

Portfolios, not deals

The one difference the Pantheon team pointed out is that in private equity, most GP-led deals tend to be single asset continuation vehicles, whereas in private debt they are mostly made up of portfolios of loans. They therefore prefer to use the term "GP portfolio solutions" as opposed to "GP-led deals".

I have argued that in many respects GP-leds/GP portfolio solutions are more relevant for private debt managers than private equity since the former usually do not have the same level of control over the liquidity timing of their portfolio. We certainly appreciate the rationale for private debt GPs wanting to partner with secondary investors such as Pantheon, and believe in the year to come we will see more private debt managers step forward to embark on these deals that are now commonplace on the private equity side.

We have just closed one such transaction with Eurazeo, the Paris-based manager, which in many respects, was a first of its kind in private debt – a consolidation of assets from three mature funds on behalf of a private debt manager into one continuation vehicle, funded by three LPs.

The dynamics of this deal made perfect sense for the sellers, buyers and GP combined. For existing LPs, it enabled three sub-scale vehicles to be wound up. The tail-end portfolio comprised equity and subordinated debt as well as senior loans and, given that many of the assets were on a recovery path from the impact of covid, it provided welcome certainty on timing and return.

For the buyers, they were able to make their own assessment of the downside risks, what upside the equity

The growing menu of private debt secondaries

Here is a short summary of some of the private debt secondary deals we've been working on:

Tender offer/replacement of cornerstone
In a GP-led tender offer, the GP seeks the most competitive price for its existing fund(s) and presents this price to its LPs. This offer could be made to a broad LP base or to one dominant LP. We have seen situations whereby private debt funds have been 'cornerstoned' by a single LP that has decided not to re-up to the subsequent fund due to a change of allocation strategy. This leaves the GP with an existential problem, giving it the motivation to seek a replacement cornerstone.

Warehousing assets for SMAs
If the GP has access to a warehouse facility (eg, on the GP's balance sheet), it can place the assets in the facility until there is sufficient scale, and then sell those assets into an SPV funded by a secondary investor. The GP will negotiate a management fee and carry on the SPV, which can be scaled over time, possibly with the use of leverage.

Strip sale/portfolios of co-investments
A strip sale of the largest assets in a fund enables the GP to rebalance the portfolio by lessening any outsized concentration risks. If the fund is still in the investment period, the deal frees up capital in the fund, allowing the GP to recycle the proceeds of the strip sale into new deals. The 'stripped' assets are placed in a new vehicle funded by the secondary investor and managed by the GP. Alternatively, the GP may be looking to wind up existing co-invest vehicles (as in the case of Eurazeo), or free up liquidity, say, in a business development company.

offered and, combined with visibility on some early distributions, it enabled them to make an attractive offer on the assets.

Finally, for the GP, it consolidated the portfolio into one vehicle, thereby lessening the administrative burden. It also allowed it to pay out carry to previous employees and realign the newly formed fund with the existing team, as well as bring in new LP relationships.

What we saw here, therefore, was a GP taking advantage of the progress in the private debt secondary market to essentially 'tidy up' its portfolio. It provided liquidity for those LPs that desired it, created the appropriate duration and economics around its remaining portfolio, and renewed its LP base.

Given how mature the private debt market has become, we expect to see far more of these types of deals in the coming months. Judging by the private debt secondary funds being raised, clearly the buy side believes there is more dealflow to come in 2022. Private equity secondaries giant Coller Capital launched a dedicated credit vehicle last year, while Apollo Global Management also created a splash with a new credit secondaries business. Meanwhile, the likes of Tikehau Capital and Pantheon continued to be active fundraisers.

"In many respects the GP-led/GP portfolio liquidity solution is more relevant for private debt managers than private equity"

So how else should we expect to see GPs partnering with this growing secondary LP capital? I discussed some of the ways we are seeing private debt clients partnering with secondary LPs in the article I wrote in *Private Debt Investor*'s April 2021 edition, and in the above panel we list the other deals we are active with: tender offers, replacement cornerstones, warehousing assets for SMAs, strip sales and funding portfolios of co-investments.

I am sure we will see a lot more of these types of deals in 2022, as additional capital is raised, private debt managers become more confident in the tools available to them and begin to appreciate the benefits for them as a manager, as well as for their LPs. Private debt managers may be turning up fashionably late to the party, but as far as they are concerned, it is just getting going. ■

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