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SECONDARY MARKET UPDATE H1 2019

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Contents

Data Pack

The data behind all of the charts featured in this report is available to download for free. Ready-made charts are also included that can be used for presentations, marketing materials and company reports.

To download the data pack, please visit: www.preqin.com/SECH119

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The State of the Secondary Market

As recently as 15 years ago, the largest fund dedicated to secondaries investments totalled $2bn. Fast-forward to 2019, and the largest secondaries fund being raised has a target of $18bn[1] – the sixth-largest private equity fund ever raised. Indeed, since 2013, annual transaction volume in the secondary market has grown at a CAGR of around 40% to an estimated $75bn last year.

Against this backdrop of unprecedented growth, the market continues to evolve and encompass increasingly complex transactions across both the sponsor-led and LP-led segments of the market.

Holcombe Green

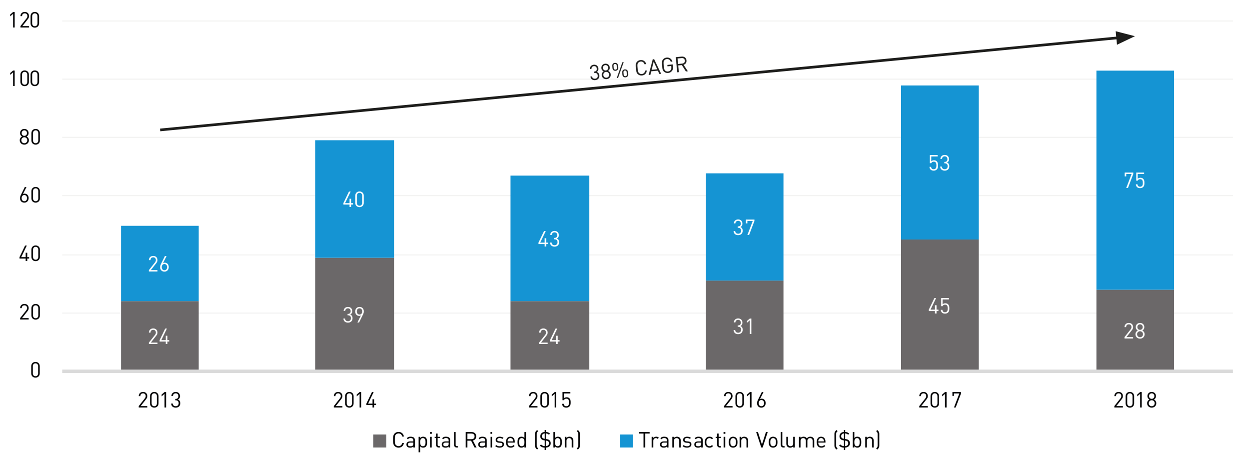
Global Head of Private Capital Solutions, Lazard

Sponsor-Led Secondaries: Driving Innovation

2018 was another record year in the sponsor secondary market and Lazard estimates that market volume reached $28bn, of which $22bn closed across 53 transactions. This represents growth in transacted volume of 38% over 2017 and triple the volume for 2016. Deal flow was driven by transactions completed by several of the largest sponsors in the world, including Texas Pacific Group (TPG), New Enterprise Associates (NEA) and Nordic Capital, among others. Moreover, all major geographies are seeing growth in sponsor-led activity.

Transaction structures in 2018 varied by sponsor and were highly dependent on the desired outcome and LP

Fig. 1: Aggregate Secondary Transaction Volume, 2013 - 2018



Source: Lazard estimates, capital raised per Preqin

[1] *Source: Secondaries Investor. Includes $12bn secondaries vehicle and $6bn co-investment capital.*

base. The three most common transaction structures were fund recapitalizations, tender offers and spin-outs. 'Club-deals' also became much more prevalent, particularly at the larger end of the market. Given the increasing size of transactions and secondary buyers' typical aversion to concentration risk, the amount of capital a secondary buyer can commit to a single transaction has a limit, driving a need for syndication. Last year, one-third of Lazard-advised transactions included three or more co-investors.

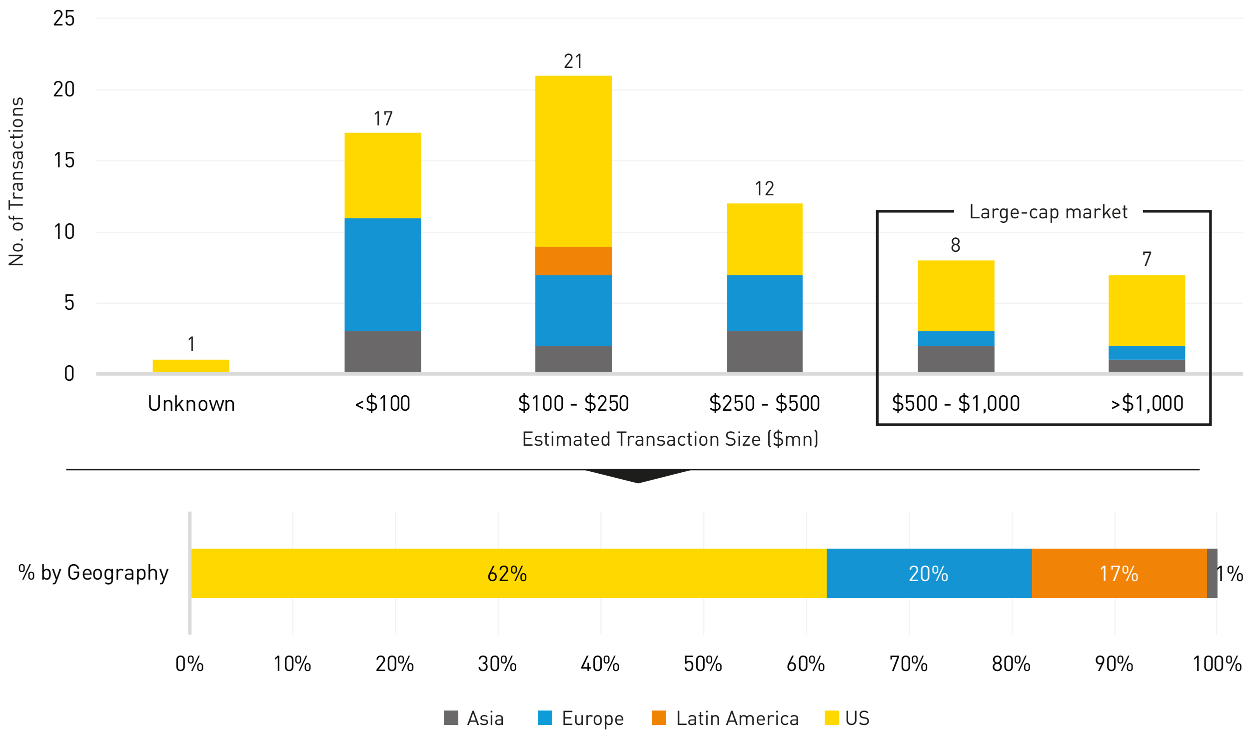
Growing acceptance of sponsor-led secondaries has led to the market expanding into asset classes beyond traditional buyout. In the venture capital space, the imbalance between capital deployed and the number of exits in venture-backed companies has resulted in an increasing backlog of unrealized net asset value (NAV), particularly in 2006 and 2007 vintages, and as such venture capital sponsors are increasingly turning to the secondary market to accelerate distributions to their investors. In 2018, our client NEA completed a landmark transaction in which it spun-out 31 companies held across four funds to a vehicle managed by a new venture capital firm, NewViewCapital Management, creating one of the largest first-time venture capital funds. We also advised Altos on the creation of a continuation vehicle for a portfolio of 17 early-stage investments across the US and South Korea, which was heavily over-subscribed.

Moreover, a growing number of independent sponsors have accessed the secondary market. Independent sponsors raise capital on a deal-by-deal basis. Secondary investors can provide liquidity to these original investors on either a single-company or portfolio basis, along with capital to continue to fund growth in those companies or to make new investments. These transactions further allow independent sponsors to create a first-time institutional fund and build an institutional track record.

LP-Led Secondaries: A Proliferating Market

LP-led secondaries now account for around two-thirds of the transaction volume in the market, down from 92% in 2013. Transaction volume increased to an estimated $50bn last year, up from $37bn in 2017. Pricing remains near all-time highs, despite the volatility in the public markets, and the average across all funds was around 93% of NAV in 2018. Capital call facilities are now being used by 75% of managers, which has supported pricing along with increasing pools of buyside capital facing significant deployment pressure. We see sellside volume from all types of

Fig. 2: Sponsor-Led Secondary Transactions in 2018



Source: Lazard Estimates

investors, with the North American pension funds and fund of funds groups being particularly active.

In terms of composition, 2016 and 2017 saw a surge in mature, tail-end portfolios sold as LPs sought to monetize NAV that had been locked into pre-crisis funds. Recently, however, younger vintage interests have become more prevalent as sellers increasingly view the secondary market as a way to actively manage and optimize their portfolios. In the past 18 months, 30% of the funds Lazard priced were of 2013 vintage or later.

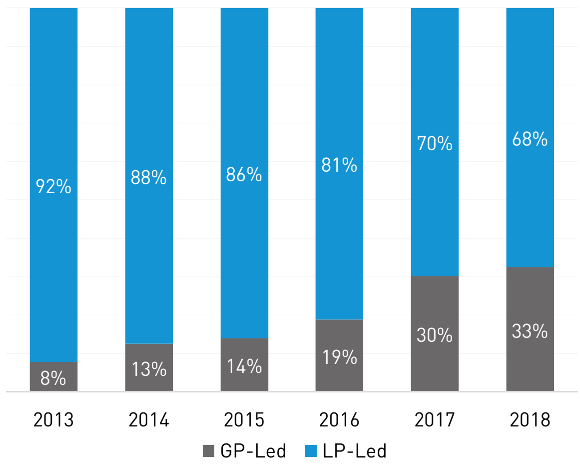
In the current macroeconomic climate, managing risk of a downturn is a common theme, and a number of our clients have sought to rebalance their exposure to outsized positions by completing partial sales of their interests ('strip-sales'). Such transactions allow LPs to maintain exposure to managers they wish to continue relationships with and de-risk investments that have already outperformed, while also freeing up capital to redeploy into other opportunities.

Moreover, the size and diversity of the portfolios being sold has expanded. Secondary buyers for fund of funds, private credit, energy and infrastructure funds have emerged over recent years, and vehicles with commensurate return targets for these strategies have been raised. Preferred equity solutions have been developed to bridge the bid-ask spread for more esoteric portfolios. Structuring is more commonplace, and the use of deferrals and, increasingly, deferred closings, which mitigate counter-party credit risk, have been used to boost pricing.

Looking Ahead

As we look ahead to 2019 and beyond, we see further expansion of the secondary market and anticipate that total volume will grow to $85bn in 2019, largely driven by the continued evolution of the sponsor-led segment.

Fig. 3: LP-Led vs. GP-Led Share of Secondary Market Volume, 2013 - 2018



Source: Lazard Estimates

While LP-led transactions will still comprise the bulk of the market over the next few years, we expect volume to grow more moderately. At the intersection of GP-led and LP-led secondary transactions, we have started to see traditional secondaries investors access the market to create continuation vehicles for their own funds, and we expect the lines between GP-led and LP-led transactions to further blur. Here, sponsors are conscious of the need to give liquidity options to their own investors, but are reluctant to prematurely liquidate portfolios where they see further upside remaining. Similarly, innovation in single-asset transactions will develop at a rapid pace, with sponsors seeking alternative, more flexible sources of capital to continue holding successful investments beyond the constraints of a traditional 10-year term.

Lazard

Holcombe Green is a Managing Director at Lazard Freres & Co. LLC in New York, New York. He is the founder and global head of the secondary advisory business at Lazard and has over 20 years of experience in secondary advisory and investment banking. The secondary advisory business at Lazard operates from offices in New York, London, Paris and Singapore and advises leading institutional investors and private investment firms in creating liquidity and capital raising solutions for alternative investments.

www.lazard.com

Overview of the Secondary Market

Healthy supply and demand has ensured a robust and growing secondary market in recent months

$20bn

Amount secured by private equity secondaries vehicles closed in 2018.

$72bn

Aggregate target size of the 43 private equity secondaries funds in market as of July 2019.

$757mn

The average size of private equity secondaries funds closed in 2018.

A Strong Fundraising Market

Secondaries funds continued to attract high levels of investor capital during 2018, and 83% of funds closed in the year surpassed their initial target size – a record-high proportion (Fig. 4). The five largest secondaries funds that closed during 2018 each attracted more than $1bn of investor capital, demonstrating the healthy fundraising environment enjoyed by fund managers.

Ardian and Lexington Partners continue to fundraise for ASF VIII and Lexington Capital Partners IX respectively (Fig. 5); each target a record $12bn which would surpass the $10.8bn secured by Ardian's ASF VII in 2015. It is also a possibility that these vehicles may exceed their initial $12bn target size, given the successful fundraising rounds completed by each fund thus far.

The Rise of GP-Led Deals

As the secondary market matures, more and more GPs are proactively exploring liquidity options, inflating the frequency of GP-led transactions in recent years. For a fund that has exceeded its expected lifespan, a GP-led deal typically occurs when the remaining assets are rehoused into a new vehicle. For GPs, these types of transactions can provide greater portfolio control and help to maximize the value of the remaining assets in a fund, while also satisfying investors' needs. On the other hand, an LP can benefit from increased liquidity in a GP-led deal, and is also able to exit a fund with potentially underperforming assets.

So far in 2019, there have been some notable GP-led transactions in the secondary market. Under pressure to comply with Japanese regulation affecting banks with overseas operations, Norinchukin Bank sold a portfolio worth up to $5bn to Ardian in Q2. The deal comes a few months after the bank sold approximately $1.3bn worth of fund stakes to Lexington Partners.

A consortium of secondaries firms has also backed the GP-led process on EMERAM Capital Partners' 2013 vintage fund, EMERAM Fund I. Arcano Capital, Schroder Adveq and Unigestion have acquired stakes from exiting LPs in the fund. Park Hill Group advised on the process.

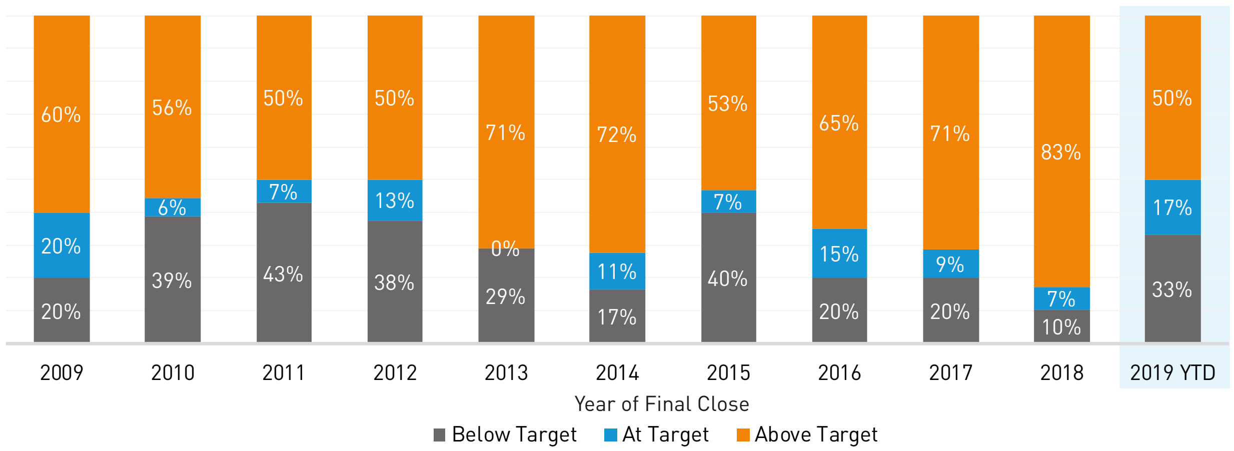
As investors continue to look favourably on GP-led transactions, it is likely that fund managers will increasingly innovate in this area and execute more complex transactions.

The Future Looks Bright

The supply and demand observed for secondaries vehicles in 2018 has firmly continued into 2019. Investors are driving supply by demanding more active management of their portfolios: 958 investors tracked on **Preqin Pro** have demonstrated an interest in selling fund stakes over the next 12 months. The demand for GPs to provide liquidity solutions to investors in long-running funds has also boosted deal flow.

As we move into the second half of 2019, the secondary market is in a healthy state. Transaction volume has accelerated, and we expect this growth to continue, provided there are no further economic and political shocks. Investors have become more experienced operators in the market, and GPs are offering a wider variety of transaction types along with greater diversification in terms of strategy and asset class exposure.

Fig. 4: Fundraising Success of Secondaries Funds Closed, 2009 - 2019 YTD



Source: Preqin Pro. Data as of July 2019

Fig. 5: Largest Secondaries Funds in Market

Fund	Firm	Headquarters	Geographic Focus	Target Size ($mn)	Fund Status
Lexington Capital Partners IX	Lexington Partners	US	North America	12,000	First Close
ASF VIII	Ardian	France	Europe	12,000	First Close
Coller International Partners VIII	Coller Capital	UK	Europe	9,000	Raising
Strategic Partners VIII	Strategic Partners Fund Solutions	US	North America	8,000	First Close
Vintage VIII	Goldman Sachs AIMS Private Equity	US	North America	7,000	Raising
Dover Street X	HarbourVest Partners	US	North America	6,500	First Close
Hamilton Lane Secondary Fund V	Hamilton Lane	US	North America	3,000	First Close
Pantheon Global Secondary Fund VI	Pantheon	UK	North America	2,000	Second Close
Secondary Opportunities Fund IV	Glendower Capital	UK	North America	1,750	First Close
ICG Strategic Equity Fund III	ICG	UK	North America	1,600	First Close

Source: Preqin Pro. Data as of July 2019

Fundraising

Modest fundraising for H1 is no concern as big funds line up to close in H2

Global Fundraising Healthy

In H1 2019, seven private equity secondaries funds secured an aggregate $2.4bn, representing a 71% decrease from H1 2018 when $14bn was raised from 23 secondaries funds (Fig. 6). Although a notable decline, this is partly due to the cyclical fundraising environment, as a large proportion of prominent secondaries fund managers held final closes for their dedicated vehicles between 2017 and 2018. With two of the largest ever secondaries funds currently in market and yet to hold a final close, the low fundraising figures for the first half of the year belie the true state of the market, which is strong and healthy going into H2.

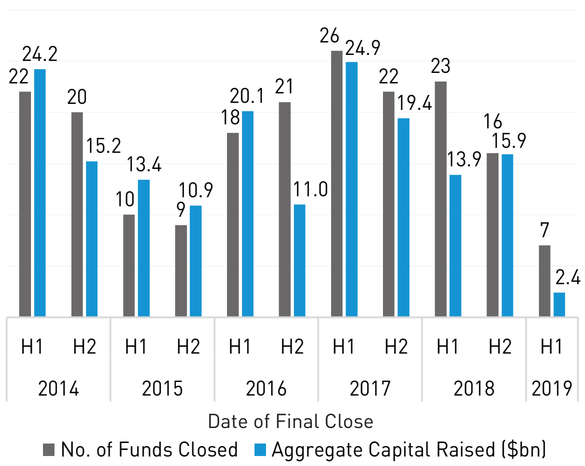
Fundraising has steadily increased over past consecutive years. Although the average size of secondaries funds closed in H1 2019 is less than half that of funds closed in 2018 (Fig. 7), a large proportion of vehicles currently in market have much larger target sizes in comparison to previous years. Once these funds hold a final close, average fund size is expected to increase again.

Notable Funds Closed

Landmark Partners closed the largest secondaries vehicle of 2018, securing $7.0bn for Landmark Equity Partners XVI. The fund surpassed its target of $4.0bn and aims to acquire interests in buyout funds on a global scale and to make direct co-investments. Landmark Partners also closed the largest real estate secondaries vehicle in 2018, the $3.3bn Landmark Real Estate Fund VIII, which targets core, value-added and opportunistic real estate strategies.

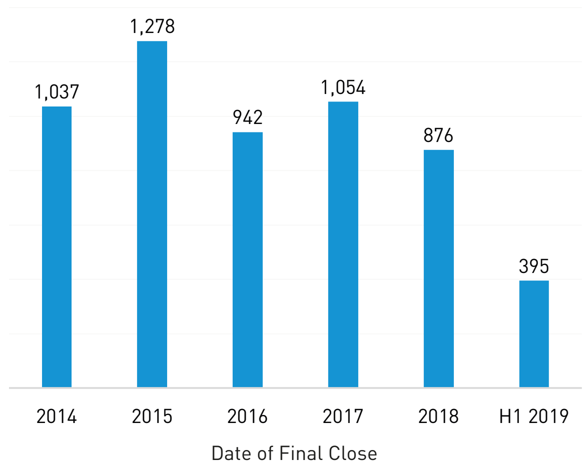
Pomona Capital raised the second largest secondaries fund of 2018, securing $1.8bn for Pomona Capital IX. The fund follows a similar investment strategy to its predecessors, seeking to acquire interests in mature

Fig. 6: Global Secondaries Fundraising, H1 2014 - H1 2019



Source: Preqin Pro

Fig. 7: Average Size ($mn) of Secondaries Funds Closed, 2014 - H1 2019



Source: Preqin Pro

private equity funds on a global scale as well as direct stakes in private equity management companies.

During H1 2019, Adams Street Global Secondary Fund VI held a final close on $1.05bn. Investors were attracted by the vehicle's focus on more complex secondary transactions to offer liquidity solutions and investment opportunities. Adams Street Partners, a $36.4bn fund of funds manager, accesses the secondary market through a variety of transactions, including investing in early secondaries and tail-end funds, as well as participating in stapled secondary and GP-led transactions.

Large Funds Are in Market

As we head into H2 2019, there are 51 secondaries vehicles in market, seeking a combined $77bn in capital (Fig. 8). Compared with the start of 2018, the number and aggregate target size of funds in market are up by 14 and $56bn respectively. While the launch of two mega secondaries funds has greatly inflated the aggregate target capital, the increase in the number of funds in market emphasizes the continued demand for these specialized fund types.

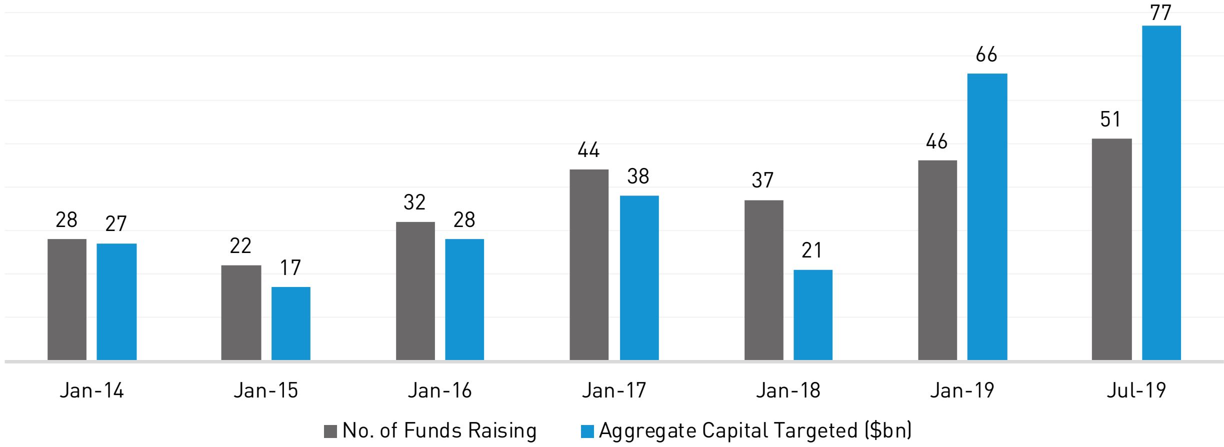
Approximately 73% of secondaries funds seeking capital are targeting North America, a 54% increase compared to the end of H1 2018. The number of Europe-focused secondaries vehicles in market is down by one fund in comparison; however, the collective capital sought by these funds is up from $7.3bn to $25bn in July 2019.

The majority (84%) of secondaries funds currently seeking capital are focused on private equity investments. At this time, there are six dedicated real estate secondaries funds in market, seeking an aggregate $2.4bn in capital, the largest of which is Goldman Sachs AIMS Private Equity's Vintage Real Estate Partners II with a target of $1.25bn. There are currently two infrastructure secondaries vehicles in market, targeting $1.9bn in capital; Pantheon Global Infrastructure Fund III accounts for over half of this amount with a $1.2bn initial target.

Other notable secondaries funds in market have been launched by secondaries specialists, including Coller Capital's International Partners VIII and Strategic Partners Fund Solutions' eighth fund in its series, which are seeking $9.0bn and $8.0bn in investor capital respectively.

With many large funds in market, investors are clearly exercising a positive demand for secondaries vehicles. Given that a significant number of the funds currently in market are expected to close at or above their target size, the secondaries fundraising environment looks favourable for fund managers heading into H2 2019.

Fig. 8: Secondaries Funds in Market over Time, 2014 - 2019



Source: Preqin Pro. Most Up-to-Date Data

Avoiding the Pitfalls in GP-Led Deals

The Emergence of the GP-Led Deal

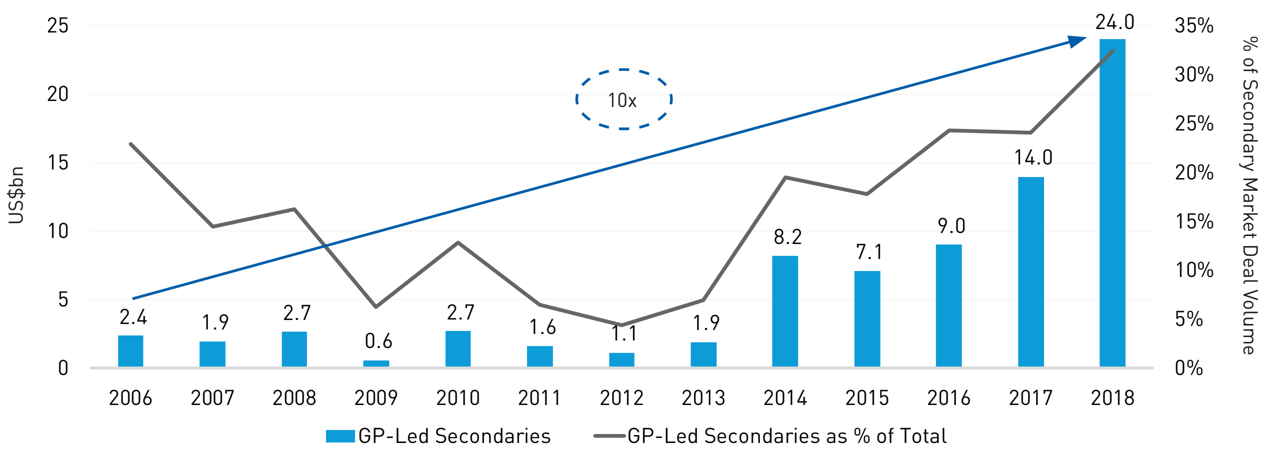
One of the most notable features of the secondary market over the past few years is the inexorable rise of the GP-led deal. Once a niche within a niche, GP-led deals have grown to account for over 30% of the secondaries market, which itself has grown nearly 5x over the past 10 years.

Secondary deals that are not just purchases of LP interests in existing funds have been around for some time, mostly in the form of spin-outs of captive teams from financial institutions, where the spin-out of a team to a form a new independent firm is combined with the purchase of the assets from the balance sheet of the financial institution. These deals were variously described as 'secondary directs' or 'structured secondaries,' and typically accounted for 5-10% of a secondaries market running at $10-20bn a year.

Charles Smith
Managing Partner, Chief Investment Officer, Glendower Capital

However, in the past five years, the market has evolved and the term 'GP-led' has now come to mean anything that is not a straightforward purchase of LP interests in an existing fund. In particular, fund continuation/fund restructuring transactions have

Fig. 9: GP-Led Secondaries Transaction Volume, 2006 - 2018[1]



Source: Glendower Capital

[1]*Glendower Capital analysis based on Greenhill Global Secondary Market Trends & Outlook, January 2019; Greenhill Secondary Market Trends & Outlook, January 2018; and Dow Jones Private Equity Analyst Guide to the Secondary Market, June 2017.*

emerged, in which some or all of the remaining assets of a fund are sold to a new vehicle managed by the same GP, with existing investors offered the option to cash out (financed by a secondary investor) or roll into the new structure.

The 'Win-Win-Win' of GP-Leds

GP-led deals are effectively tripartite negotiations between the GP, the existing LPs and the secondary buyer. To be successful, they need to be fair to each party and hopefully represent a win-win-win for all three.

For the GP, such a restructuring offers the ability to hold on to assets for longer than originally planned, while fulfilling their original commitment to LPs to generate liquidity in a 5- to 7-year timeframe. Many GPs tell us that they like their existing portfolio more than what they could buy on the market today at an equivalent valuation. Additionally, GPs see GP-led deals as an opportunity to manage transitions within their firms, for example by reallocating carry to team members actually working on the assets.

For an LP, the restructuring offers a liquidity option at a market price at a time when they might have been invested in a fund for 10 years and are looking to deploy capital elsewhere. Almost all GP-led deals these days include a 'status quo' rollover option where existing LPs can reinvest the new deal on substantially the same terms as they had before.

In a market where plain vanilla LP interests trade at single-figure discounts or even premiums, these deals can represent an attractive risk/reward opportunity for a secondary investor. They also offer the ability to back a manager who knows the assets well, do more substantial due diligence than is typical in a secondary purchase of an LP interest, and to structure a new vehicle to reset the alignment of interests between the GP and the new investor base.

Pitfalls for Secondary Buyers

So far so good, but GP-led deals do represent more complex deals than the traditional purchase of an LP interest in an existing fund. In some ways, the skillset is more akin to that of a direct investor, involving detailed due diligence on the underlying companies, with an overlay of a renegotiation of the fund terms and the negotiation of a PSA.

GP-leds also typically involve more concentrated portfolios, and sometimes involve funds that have underperformed to date and/or GPs that have 'hit a bump in the road.' Therefore, secondary investors need to exercise caution in the selection and structuring of GP-led deals.

We have been structuring and investing in GP-leds since the inception of our business in 2003 and have developed a series of filters for GP-leds to help us avoid the pitfalls:

- **Understand the rationale for the transaction** – GP-led deals are a tool which can solve several issues for a GP. We have found, however, that many managers are unclear as to exactly what they are trying to achieve. We believe that only with a clear understanding of the GP's objectives can a win-win-win deal be structured.

- **Focus on early realizations** – early cash flows both generate distributions to secondary fund investors and de-risk the transaction.

- **Don't buy the hockey stick** – GPs have owned these assets for several years; what is different now?

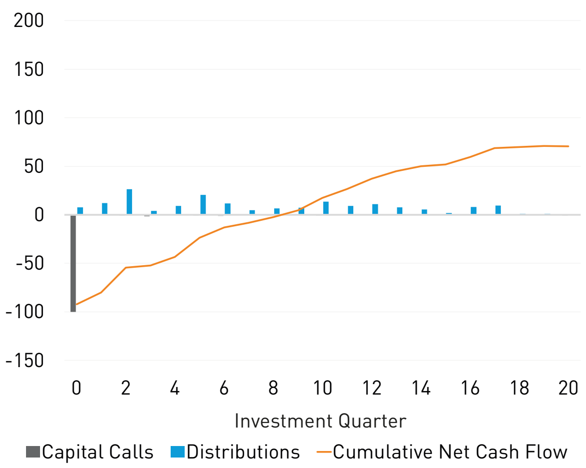
- **Be careful with follow-on capital** – part of the rationale for a GP-led might be to support portfolio companies with more capital. But such capital should be to continue to pursue an existing strategy rather than for transformative acquisitions or making new primary investments.

- **Focus on governance with the GP** – a secondary fund investing in a GP-led transaction typically accounts for 50-100% of the deal and, as such, is much closer to the deal than a typical LP is to a fund portfolio. We believe a secondary investor backing a GP-led deal should therefore have more governance rights than is usually the case in a vanilla LP transaction, particularly around follow-on capital or if the deal starts to underperform.

GP-Leds and Portfolio Construction

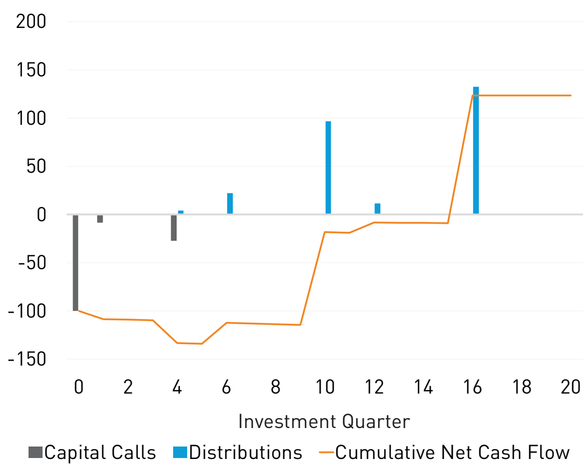
Further, secondary managers need to be aware that GP-leds represent a different risk and cash flow profile than a typical secondary fund. An LP purchase

Fig. 10: Illustrative LP Deal – Rebased Cash Flow Profile



Source: Glendower Capital

Fig. 11: Illustrative GP Deal – Rebased Cash Flow Profile



Source: Source: Glendower Capital

transaction is typically diversified over a number of funds and tens of underlying portfolio companies, whereas a GP-led is usually more concentrated and might include capital for follow-ons. This leads to very different cash flow profiles for the two types of deals, as shown in Fig. 10 and Fig. 11.

In building a portfolio for a secondary fund, a secondary fund manager needs to balance the two types of transaction to generate the desired cash flow and risk profile for the secondary fund investors.

In Conclusion

GP-led transactions have emerged to become a major part of the secondary market and have become a standard tool in a GP's toolkit to help them manage their LP bases. They can offer attractive investment opportunities for secondary investors but deals need to be structured carefully to balance the risk and return for the secondary buyer with the needs of the GP and the existing LPs, and secondary investors need to be mindful of the change in risk and cash flow profiles they represent.

Glendower Capital

Glendower Capital is an independent secondary private equity firm founded in 2017 by its Partners, who have worked together in secondaries for more than 15 years. Glendower acquires secondary private equity assets providing liquidity solutions to investors globally. The team has a long history of executing a range of transactions with sellers – from the acquisition of limited partnership interests to the more complex GP-led transactions. Headquartered in London, with offices in New York, Glendower manages over $5bn in commitments dedicated to secondaries.

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Performance

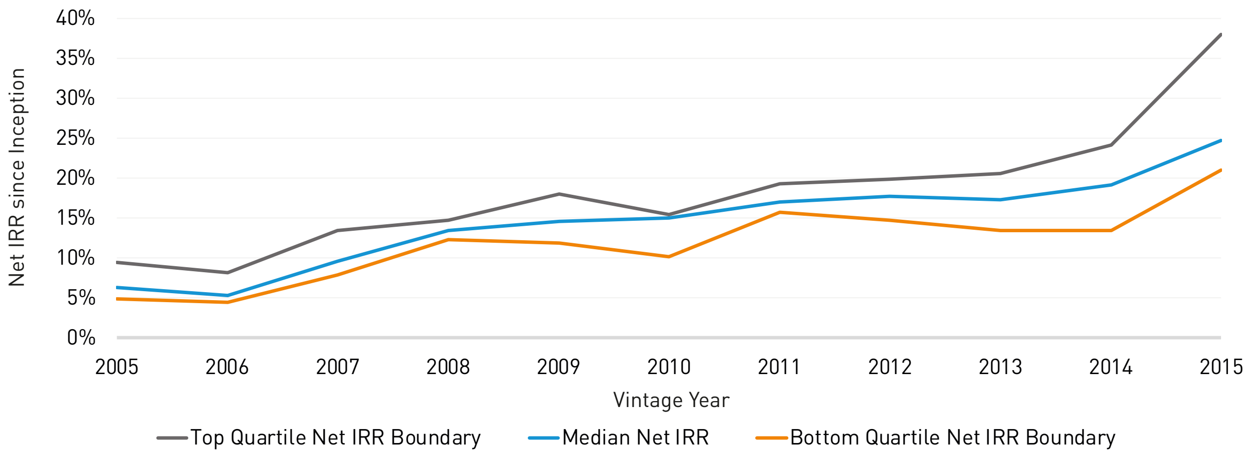
Secondaries funds outperform private capital funds for most vintages

Secondaries funds are exhibiting positive performance across the board, with particularly strong returns for recent vintages. Among the vintage years examined in Fig. 12 (2005-2015), bottom-quartile net IRR returns are positive across all vintages, with a low of 5.3% for vintage 2006 funds. Returns for secondaries funds are also relatively close together, with an average interquartile range of six percentage points over the vintages examined, compared with 11 for private capital. This highlights the relatively safe investment nature of secondaries funds.

Given that secondaries funds have shorter holding periods than private capital funds, and are often available to purchase at discounts, they typically provide attractive IRRs. For vintages 2007-2015, median net IRRs for secondaries vehicles exceed those of private capital (Fig. 13). Vintage 2015 secondaries funds have the highest median net IRR (+24.8%) across the vintages examined, although this is subject to change as these funds mature in the coming years.

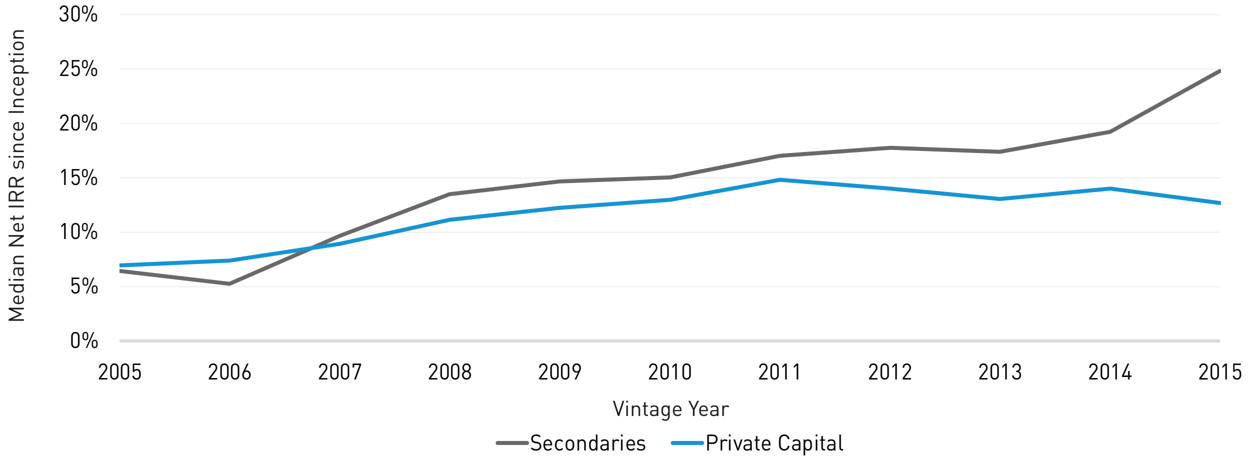
Over the past 10 years, for most vintages, secondaries funds have recorded higher median net multiples than private capital funds (Fig. 14). The largest differences are seen in the most recent three vintages, which is expected as secondaries funds may be buying near or during the harvest phase of a fund, and thus experience accelerated distributions.

Fig. 12: Secondaries Funds: Median Net IRRs and Quartile Boundaries by Vintage Year



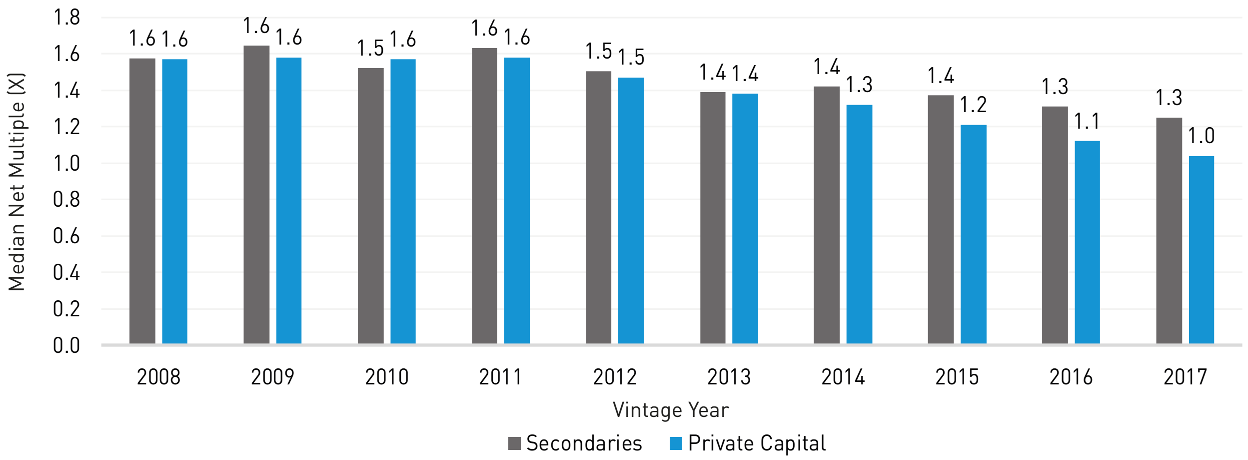
Source: Preqin Pro. Most Up-to-Date Data

Fig. 13: Secondaries vs. Private Capital Funds: Median Net IRRs by Vintage Year



Source: Preqin Pro. Most Up-to-Date Data

Fig. 14: Secondaries vs. Private Capital Funds: Median Net Multiples by Vintage Year



Source: Preqin Pro. Most Up-to-Date Data

Investor Intentions

Buyer demand outweighs seller supply, but the opportunities are increasingly diverse

Following a record-breaking 2018 in terms of transaction volume, appetite for buying and selling fund interests on the secondary market has remained strong in the first half of 2019. Many LPs are now experienced players in the market, and a variety of transaction types were in play in H1. While there is an ever-growing number of buyers and sellers in the secondary market, those that have become familiar with the market have generally been those investors able to allocate large sums of capital to potential opportunities. As a result, the market has been dominated by a small group of large investors.

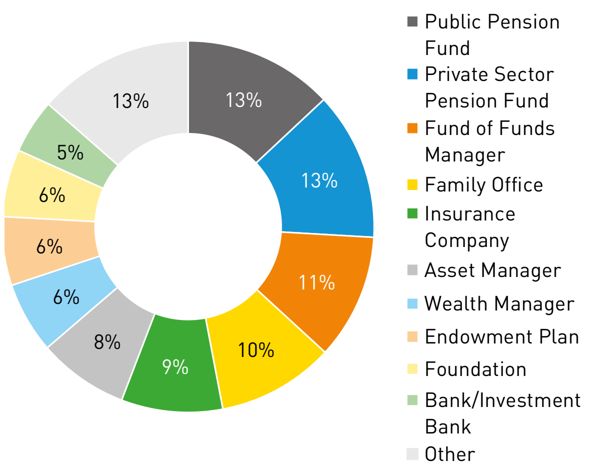
While these buyers now have a much wider offering in terms of strategy and asset class, it is unsurprising that the market has been led by appetite for private equity fund stakes.

Buying and Selling: The Benefits

A common advantage for buyers purchasing stakes on the secondary market is mitigation of the J-curve effect, whereby cash can be returned to investors in a shorter time span. Other benefits include vintage-year diversification, as well as access to top-quartile funds or vehicles with high minimum subscriptions. Preqin currently tracks over 1,200 potential secondary market buyers, including dedicated and experienced fund managers such as Coller Capital, which recently backed the $1bn fund restructuring of assets belonging to Investcorp.

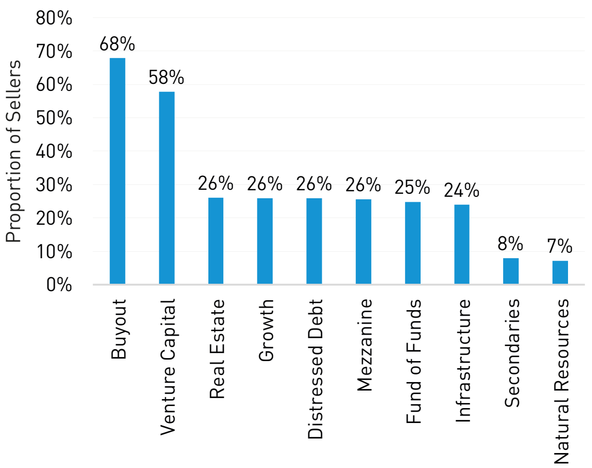
Selling can also have major advantages, and in recent years the high level of demand has created a competitive environment for buyers and therefore attractive pricing: many LPs have considered selling

Fig. 15: Expected Secondary Market Sellers in the Next 12-24 Months by Firm Type



Source: Preqin Pro

Fig. 16: Fund Types Expected to Be Sold by Secondary Market Sellers in the Next 12-24 Months



Source: Preqin Pro

fund interests on an opportunistic basis as a result. As of July 2019, Preqin tracks 960 sellers on the secondary market, of which 130 are highly likely to sell fund stakes over the coming year. The remaining 830 take an opportunistic selling stance.

Who Are the Buyers and Sellers?

As Fig. 15 shows, private and public pension funds each represent the largest proportion (13%) of sellers within the secondary market. Many private sector pension funds have actively sold fund interests in recent years, as they become more comfortable operating in the market. Since CalPERS announced back in 2015 that it was looking to sell up to $3bn worth of real estate fund interests, the public pension fund has continued to offload stakes to reshape its portfolio and sell portfolios worth billions of dollars. Fonds de Pensions Nestlé has also been an active seller in 2019, transferring interests in private equity vehicles to dedicated secondaries fund managers.

Fig. 16 highlights the opportunities available to potential buyers, with buyout (68%) and venture capital (58%) representing the largest pools of funds available on the secondary market. Though the market has been traditionally crowded out by private equity opportunities, a notable 26% of sellers are looking to sell real estate-related fund interests. A significant proportion of LPs are also considering offloading infrastructure fund stakes, further diversifying the available opportunities in the market.

A Sophisticated Market

Over recent years, the secondary market has matured and attracted a wide variety of institutions to buy and sell fund interests. While the demand for fund stakes currently outweighs the potential opportunities, a significant number of LPs have been utilizing the market not out of necessity, but through opportunism and attractive offerings. This has widened the seller pool and provided more diversification to buyers.
As more investors learn the advantages that the secondary market affords, it is likely that aggregate secondary transaction volume will approach the levels set in 2018 following a busy H1 2019.

Fig. 17: Sample Secondary Transactions Completed in H1 2019

Seller	Buyer(s)	Fund(s) Sold	Transaction Value (mn)	Secondary Intermediary	Transaction Type	Transaction Date	Information
EMERAM Capital Partners	Arcano Capital, Schroder Adveq, Unigestion	EMERAM Fund I	-	Park Hill Group	GP Restructuring	2019	Arcano Capital, Schroder Adveq and Unigestion have purchased fund interests from exiting limited partners in a tender offer on the vintage 2013 EMERAM Fund I. EMERAM Capital Partners wanted to inject more capital into the fully called 2013 vintage fund and make additional investments before the launch of a new fund.
Avenue Capital Group	Pantheon	Avenue Europe Special Situations Fund II	-	Park Hill Group	GP Restructuring	2019	The deal gave LPs in Avenue Europe Special Situations Fund II the option to sell their fund stakes at par or roll over into a new vehicle. Pantheon has emerged as the lead backer, months after it announced that it was considering raising a debt secondaries fund.
Norinchukin Bank	Ardian	N/A	5,000 USD	Greenhill Cogent	Fund Portfolio Sale	2019	The portfolio consists of approximately 35 fund stakes, 75% of which were unfunded. Norinchukin Bank sold the portfolio to comply with Japanese regulations affecting banks with overseas operations.
West Midlands Pension Fund	Lexington Partners	IK 2007 Fund, Italian Private Equity Fund IV	-		Fund Portfolio Sale	2019	
Invesco Private Capital	Portfolio Advisors	Eden One	-		Sole Fund Interest	2019	

Source: Preqin Pro

Staples: More Aligned than Meets the Eye

Jonathan Abecassis
Director, Credit Suisse Private Fund Group

The 'primary staple,' where a secondary buyer makes a primary commitment alongside a secondary purchase, is almost as old as the secondary itself. In our view, it was common practice on an ad-hoc basis long before the current surge in GP-led secondary transactions. Today we are seeing the rising incidence of GPs seeking staples, driven by a surge in GPs raising new funds. This trend highlights the importance of understanding the motivations of the different parties involved in a stapled secondary transaction. Our experience suggests that there are real benefits to pricing from having a GP's full engagement in the process. Specifically, the balance that a primary component brings to the return profile and the increased alignment between buyers and a GP help to create the conditions for a positive outcome.

The GP

Contractually, most limited partnership agreements put little to no obligation on the GP to provide any services to LPs related to secondary sales. GP discretion to approve third-party transfers is significant – in many cases, the qualifier that the GP has 'not unreasonably withheld' approval is absent. We believe regulation works against the secondary market, with a transfer involving additional administration as it relates to Know Your Customer (KYC), tax, and – for funds with a US nexus – the monitoring of publicly traded partnership quotients. Accordingly, in LP-led trades GPs tend to assist with transfers solely for the softer reasons of maintaining good relationships with both incoming and outgoing LPs, and in the ordinary course there is no incentive nor obligation for a GP to 'go the extra mile' in order to get best pricing for selling LPs.

In contrast, a GP-led staple process introduces the incentive of obtaining a primary commitment from a buyer, in our view. This is a significant motivator for GPs to commit meaningful resources towards generating maximum pricing for selling LPs – creating excellent alignment between the GP and the sellers. Crucially, the volume of primary capital the GP secures is typically driven by a fixed ratio, often between 2:1 and 3:1 of the volume of secondary acquired by the buyers. To secure substantial seller volume, a process must (a) provide sellers an attractive price, and (b) provide sellers sufficient comfort that their interests have been protected in the process. In our experience, the GP's time and interests in a stapled process are highly attuned to the interests of sellers.

The Buyer

Secondary buyers seem to have a love-hate relationship with staples in our experience. Their core strategy is deploying capital into existing investments, and so with some audiences they will bemoan the requests of GPs to commit capital to new funds. On the other hand, they are looking to deploy capital in volume with GPs they trust, and so are happy to promote their ability to offer meaningful amounts of primary capital as a competitive advantage when speaking with GPs.

Whether the staple component is dilutive, neutral or accretive depends on what the limiting factor for pricing is. In a well-run, competitive GP-led process, we believe modelled returns are the chief limiting factor, as a buyer must bid the highest price they are prepared to pay. What this means in practice is that pricing will depend heavily on a buyer's view of both asset quality and manager strength, both of which can be informed by a GP's added involvement.

When forming a view on asset quality, buyers always prefer to have more information rather than less. In nearly all cases, information availability is significantly superior in GP-led processes than standard LP-led processes, in our experience. In assessing GP quality, when a manager commits significant time and effort to educating prospective buyers on its firm's strengths and its strategy for the investments, a buyer's view of GP quality is likely to improve – which we believe provides an indirect benefit to modelled returns and to the pricing the buyer can offer.

For buyers, the confluence of these factors – greater access to portfolio information, improved understanding of the GP and greater alignment with the GP – may lower their overall discount rate and therefore improve pricing on the secondary.

The Seller

In a well-run GP-led staple process, existing LPs are presented with the option to sell their interest or to keep their investment on a pure 'status quo' basis. For existing investors that are not making primary commitments to the GP's next fund, we believe the process provides a natural, market-tested avenue for LPs to achieve liquidity, reduce administrative burden and redeploy capital elsewhere within their programs – all without burdening the seller with the time and resource requirements necessary to support a sale on their own.

For sellers that are open to selling an interest managed by the GP, the decision to sell or not primarily comes down to price, with particular attention paid to whether it meets or exceeds what could be obtained in the LP-led market. Questions often arise around the staple element of the transaction, focusing on whether it adversely impacts price. While there is unlikely to be a clear 'all else being equal' answer to this question, we believe providing transparency around the range of bids and staple ratios is likely to show that higher bids came from those with a better primary offering – which should provide comfort. Many fund sellers have increasingly received inbound pricing from intermediaries or buyers for their positions on an opportunistic basis away from the GP-led process. They therefore benefit from a point of comparison by which to judge if the process has secured a better price – and in our experience it typically has.

Even in the absence of such a clear comparison, most sellers are increasingly aware of broader secondary market options and conditions, and can therefore take a view as to whether the price on offer beats what may be achievable on their own, which should be the key question to resolve.

In Conclusion

The Credit Suisse Private Fund Group believes GP-led secondaries allow buyers to secure meaningful volume in investments they find attractive, underwrite positions with greater clarity, achieve a more balanced return profile and improve GP-LP alignment. Sellers can benefit from the service provided by GPs through a structured process that supports pricing. In most cases, the presence of a staple does not diminish the central outcome of sellers being better served via a competitive GP-led process than in the LP-led market. In our experience, the benefits of such a process outweigh the additional considerations.

Credit Suisse Private Fund Group (PFG)

The PFG is one of the largest and most experienced global private capital advisory firms in the industry, having raised over $520bn of capital for over 380 funds since 1994. The group has a global team, with locally based professionals in New York, London, Hong Kong, Chicago, San Francisco, Dallas, Santiago, Tokyo, Sydney and Seoul. The PFG's Secondary Advisory Solutions team provides customized solutions, utilizing a variety of transaction structures in the execution of secondary sale processes on behalf of its clients, and has advised on c.$37bn of secondary transaction volume. The team's expertise encompasses a full spectrum of alternative assets, including private equity, real estate, hedge funds, venture capital, mezzanine/credit, infrastructure and direct asset portfolios.

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