KEYNOTE INTERVIEW

Why GP-leds are hard to ignore

GP-led deal activity is continuing apace. How should investors consider this segment in the context of their wider secondaries and PE allocations? Pantheon's Amyn Hassanally and Kevin Dunwoodie discuss

After accounting for around half of secondaries market activity for the past three years, GP-led deals have fast become an established part of the private markets ecosystem. While the new generation of GP-leds began life as a subset of broader secondaries fund allocations, their characteristics are quite different from more traditional LP portfolio position sales.

Speaking to *Private Equity International*, Pantheon's Amyn Hassanally, partner and global head of private equity secondaries, and Kevin Dunwoodie, a partner in the secondaries team, discuss current market trends, explain the differences in cashflow and risk-return profiles between GP-led and LP-led deals, and offer their perspectives on what is coming down the line.

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Q The GP-led secondaries market has grown markedly in recent years. What are the main reasons for this?

Kevin Dunwoodie: There has been a shift away from the negative perceptions surrounding the market – the idea that managers only opt for the deals featuring mixed-quality assets. Today's market consists mainly of top-quality GPs putting their best assets into continuation funds.

Another key feature is that GPs now understand the market better and are using it to offer their LPs the option of liquidity, or to roll into a new vehicle to benefit from further potential upside. That wasn't available previously: the choices used to be to sell earlier than the GP and LP might like and therefore miss out on value, or to hold on for longer without the option for LP distributions.

Amyn Hassanally: The growth of GP-leds has made them hard to ignore.

Part of that is down to the development and explosive growth of the single-asset continuation vehicle phenomenon. That has dramatically changed the exit routes available to GPs since 2020, and these deals have more recently – as other exit routes have become more challenged – been one of the few options open to enable GPs to make distributions to LPs. They have evolved to become a viable fourth exit route alongside IPOs, trade sales and secondary buyouts.

It's interesting to note, too, that we are seeing meaningful discounts to NAV on these high-quality assets for the first time.

Q Why have these discounts emerged?

KD: There is an imbalance between buyers and sellers currently; the supply of deals is far greater than there is capital. That allows buyers like us to secure better terms and discounts at a time when LPs are asking GPs for liquidity.

For GPs, this is still often a far better option than selling to a third party at a valuation they do not believe reflects the future value of a business. If they are willing to execute a GP-led transaction at a reasonable price while securing funding for continued value creation initiatives, many GPs would much prefer to keep hold of the asset and then benefit from the upside over time.

Q LP-led and GP-led transactions have different characteristics that LPs should be aware of. Can you explain these?

KD: GP-led deals – especially single-asset transactions – are far more concentrated than LP-led deals, which could include thousands of underlying companies in a single portfolio. That concentration means the due diligence required is much more extensive on a GP-led deal: you have to take more of a bottom-up approach, and it's possible to negotiate specific terms and conditions on these transactions because you are extracting an investment (or investments) from a fund and putting them into a new vehicle. In LP-led deals, the fund stays the same, but the ownership changes – you have little scope to negotiate on terms.

AH: The risk-return profile is very different in a GP-led deal. In LP-leds, cashflows come back to investors earlier and more regularly, and you are generally generating returns through beta. You're also acquiring an interest in a range of portfolio companies, where the quality of assets may be quite varied. By contrast, in GP-led deals, the cashflows are a bit more back-ended, but the target multiples and IRRs are higher as you are going for alpha generation. You can also curate the quality of assets you select in GP-leds and you can be more intentional in

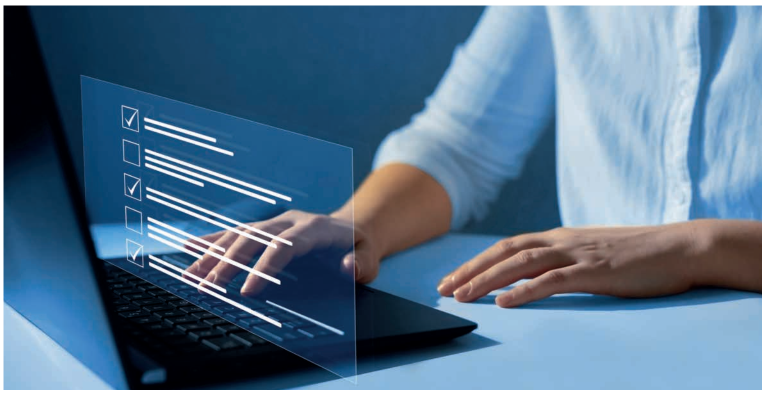
Q What should investors look for in a GP-led secondaries manager?

Amyn Hassanally: One of the most important attributes investors should look for is a long track record as a lead buyer in these transactions. That reduces risk because it means you know how to structure, underwrite and price these deals. Competitive advantage is another feature to analyse: secondaries is a very competitive part of the private equity landscape, and investors need to dig into how a manager has won deals in the past and how it will continue to win them going forward.

Pantheon's edge comes from the fact that we are also primary investors and co-investors in buyout funds, and so we may already be investors in the assets that become the subject of a GP-led transaction. As a result, we believe we can analyse and underwrite these assets with greater conviction than others, which enables us to move with speed as a lead buyer. That's a repeatable advantage.

I'd also stress the importance of having a team with deep direct investment experience, because the skill sets involved – including due diligence and underwriting approaches – can be very different from traditional secondaries deals, especially in single-asset transactions.

Kevin Dunwoodie: Relationships with the top GPs are important for sourcing and winning transactions. GPs often don't choose based on price alone – they are looking for investors whom they trust can execute deals and can have a strong relationship with over the next few years. I think it's also important to have broad geographical coverage with teams on the ground that can perform robust due diligence in a global deal environment.



your exposure to certain geographies, sectors and strategies.

Q Where should GP-led exposure sit in a private equity portfolio?

AH: Continuation vehicles with single – or a small number of – assets should really sit between traditional secondaries and buyout investments, including co-investments. That's because they generate buyout-style returns for secondaries-style risk. They are similar to traditional secondaries in that they involve known, mature assets – there is no blind pool risk. And these assets are already executing a successful strategy under the ownership and guidance of an existing management team and GP, all of which is typically not changing.

There is also less leverage risk than for buyouts. In single-asset continuation vehicles, the capital structure of the company typically remains the same, with only the equity changing hands. Overall, these types of GP-leds are less risky than, but comparable to, direct buyout investments.

KD: I'd add that, because the GP in a continuation fund deal has been invested in the asset for several years, it will know the risks and opportunities. This is unlike a new buyout deal, which can throw up surprises.

The other point is that alignment is stronger in GP-led deals than in buyouts. In the former, the GP commitment in Pantheon-led deals tends to be, on average, 9 percent of the continuation vehicle and is frequently a tiered carry structure. That's not the case with buyouts, where the GP commitment is usually around 1 to 2 percent and the hurdle for 20 percent carry is often a single data point of 8 percent IRR.

Q How are deals being structured in today's market, given the demand/supply imbalance?

KD: We are seeing discounts, but also preferred equity, deferred payments and earn-outs. There are a lot more deals in the market than the available capital can support – it's a buyer's market – so GPs need to make their deals attractive.

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> **KEVIN DUNWOODIE**

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>
> **AMYN HASSANALLY**

Earn-outs in particular are keeping deals moving, as they bridge the gap between buyer and seller expectations. This is particularly important in today's environment, where valuations are fluid. Some GPs have high near-term expectations of EBITDA on the deals they are bringing to market, yet it's hard for us to gauge how realistic these are because we are not as close to the asset as they are – earn-outs are helpful here.

Deferred payments are also attractive because they provide a boost to IRR, while preferred equity reduces our downside risk because it offers us seniority in the capital structure. Overall, we believe that the kinds of structuring we see today will allow us to increase the potential returns we can generate in this vintage, while also reducing the downside. In terms of portfolio construction, that helps us fund higher-risk, higher-return transactions as a complement to these lower-risk deals.

Q What future developments do you see in the GP-led secondaries market?

AH: The GP-led secondaries market is still relatively nascent, so there is plenty of room for it to evolve and grow. We're already seeing specialisations emerge in deal types – we do single-asset deals primarily, for example, while others prefer multi-asset transactions. Some specialise in tender offers, and some players are targeting just tail-end fund deals. There is also some specialisation by asset classes beyond private equity, such as in private credit, infrastructure and real estate. We could see sector specialisation emerge in the future, similar to the evolution witnessed in the primary market.

It's very likely we will also see a wide dispersion of returns in this part of the market. As track records in this space begin to form, it will become clear who the winners and losers are. This will be far more apparent than in traditional secondaries, where dispersion isn't as wide. This will be helpful for LPs, who will be able to benchmark performance by manager, but also against other private markets strategies.

KD: Demand will only increase as GP-leds reach a point of proof of concept and assets start to be exited from continuation funds. LPs will see these as an alternative to, or complementary to, buyout funds and co-investments, and, as they become more comfortable with these deals, they will start to enter as part of syndicates. That will help drive further growth in the market. ■

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