EXPERT Q&A

Tightened liquidity and a volatile economic outlook will continue to drive the market forward, according to Rakesh (Rick) Jain, partner and global head of private credit, and Toni Vainio, partner and head of European private credit, at Pantheon

Credit secondaries pipeline as robust as ever

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Q What are the current drivers of demand in private credit secondaries and how is the market shaping up for 2025?

Rakesh (Rick) Jain: We are continuing to see increased market acceptance from sellers in using the secondaries market to facilitate liquidity, risk management and general portfolio management needs. Historically, liquidity needs have been driven primarily by market factors like the denominator effect or a regulatory issue.

Today, in addition to those historical-use cases, demand for liquidity can be a portfolio management consideration as well. For example, some LPs may want a more opportunistic bent to their portfolios, while others may want to reduce the number of GP relationships offering similar exposure to yield-orientated strategies.

In terms of the market outlook, we originated approximately $36 billion of dealflow last year and Pantheon invested close to $3 billion of private credit capital. We continue to see our pipelines as robust as they have ever been. We expect that continued drags on liquidity in the market, along with market uncertainty, will drive demand going forward.

Toni Vainio: When we consider the market outlook, we have seen larger and larger transactions coming to market. Five years ago, it was one or two funds in a deal sized on aggregate at less than $100 million; now, it is large single-fund stakes or portfolios of funds across senior as well as opportunistic credit funds.

We also see another layer of dealflow coming from general partners looking to proactively accelerate distributions back to their LPs, whether that is via continuation vehicles, transfers of separately managed accounts to a secondaries buyer, or balance sheet liquidity transactions. There is a lot more of that activity taking place at scale, with deal sizes often in the $100 million to $1 billion range.

There are few scaled players out there, but those that have the scale and the platform are seeing bigger transactions to meet the liquidity needs of the market.

Q What about the buyside – is the market undercapitalised at this point and how do you see that changing?

RJ: From a supply-demand perspective, it depends on where you play in the market as a secondaries buyer. For smaller transactions, particularly smaller LP trades, there are numerous choices for buyside capital.

At the larger end of the market, for more complex deals with bigger deal sizes, the buyer universe is not as deep. That is why the scale, depth and breadth of a platform, plus track record and relationships in the market, are so important. Undercapitalisation does exist, but it depends on where you play and what your edge is.

TV: To put that in context, in private equity secondaries, there is generally one-and-a-half to two years' worth of dry powder available to service annual liquidity needs in the market, with more than 100 players.

In private credit, because market participants focus on different strategies, geographies and types of deals, generally we see less than a handful of players and there's a lack of consistency in market or deal participation. We think the dedicated dry powder available is closer to six months to a year. In specific instances, where there is scale and complexity, we've distinguished ourselves as the go-to player in the market.

Q What are your predictions for growth in credit secondaries moving forward?

RJ: We are incredibly optimistic about growth because the primary asset class is large and expanding. There are clear trends driving the growth of private credit even further, such as the demand for yield, for asset class performance and for capital efficiency. As the primary market continues to scale, there will be accelerated demand for secondaries market liquidity.

We expect to see another $140 billion of deals cumulatively over the next three years and everyone is going to have an opportunity to participate in different parts of that market over time.

TV: The $1.7 trillion private credit market figure really only includes primary closed-end funds, but you also have other evergreen vehicles, SMAs and balance sheet credit exposures that add to that. So, the market is actually quite a lot larger than people fully appreciate. In periods of heightened liquidity need or in periods of rebalancing due to macro events or uncertainty, our type of capital is in high demand.

For investors coming into an illiquid asset class, we are providing that opportunity for rebalancing and tapping liquidity that is a feature of a robust and healthy market moving forward. That is what drives our optimism about future growth trends.

Q How are LPs viewing the asset class – what benefits are they getting beyond the obvious?

TV: There are two strands to the benefits. First is the investor experience, with higher velocity of capital, faster deployment, immediate uplift due to discount reversals and immediate yield meaning this is a complementary way to get access to the asset class.

Second is the risk profile, with visibility into high-quality diversified credit portfolios meaning the probability of getting an attractive risk profile is high, given the lack of single loan concentrations.

Q How do risks and returns in credit secondaries compare with other parts of the secondaries market?

RJ: Fundamentally, the drivers of return are different in private credit compared with other asset classes. Our investment philosophy in credit is focused on capital protection, buying high-quality portfolios or assets where we have an edge in terms of information, sector or company knowledge, or GP relationship. We are then capturing value through coupon/contracted yield, purchase price, structuring and identifying embedded value. In other words, there are multiple ways to drive value and compelling outcomes.

We bring value to the table through active portfolio management, whether through governance on recycling, increasing GP alignment on portfolios or through better structuring of fund terms. We are less interested in buying portfolios that are significantly troubled from a performance perspective, are heavily mismarked or have binary outcomes. Our clients are focused on predictability, consistency and stability in terms of performance.

That means we also avoid or discount certain sectors that are more cyclical or capital-intensive in nature. We avoid strategies that depend on high levels of leverage to achieve returns, for example, and large single loan exposures.

TV: One thing we try to do is identify pockets of attractive valuation from a 'pull to par' perspective on these loan books. That may be where there is a technical reason why loans are not held at par and we can identify pockets of value, or there may be some small equity exposures that lenders mark conservatively.

We can find pockets of value in a different way than in private equity, which is much more geared to underwriting earnings growth and multiple arbitrage on exit as opposed to underwriting income generation and some 'pull to par' in the book.

Q Where are the biggest areas of growth and innovation in credit secondaries today?

RJ: Thematically, it has been around GP liquidity solutions. This is an area we have deep expertise in, having completed 40-plus transactions over the last five years, but that is a category that continues to experience meaningful growth.

The penetration of those types of opportunities is still extremely low, but GPs are recognising the benefits to them and their investors. We are seeing several multi-billion-dollar asset portfolios coming to market where GPs are looking to simplify their fund complexes, drive liquidity back to their clients and use the credit secondaries market to grow their platforms or stay incumbent in portfolios.

Another area of innovation on the capital formation side is related to insurance interest in the asset class. We have a large insurance client base and they are increasingly attracted to rated and capital efficient structures to access private credit secondaries and the benefits of those portfolios.

TV: A lot of the initial focus in credit secondaries was around the senior secured direct lending space. We have started now to see more activity and liquidity needs coming out of opportunistic credit, asset-backed lending and special situations strategies. The need for liquidity is growing substantially there, so that is gaining more attention.

The other growth area is around evergreen vehicles from a fundraising perspective. We have seen the growth in capital formation for secondaries-focused private equity evergreen funds and we believe there is a role to provide investors with credit secondaries as an evergreen product as well. We see interest from wealth channels in particular, and we think this is an area for us to be relevant as a provider of interesting vehicles and products.

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>
> **RAKESH (RICK) JAIN**

Q What are the dynamics in GP-led versus LP portfolio deals and how are volumes changing over time?

TV: Five years ago, this was mostly an LP liquidity market. These days, from the top of the funnel, there is almost as much coming from GPs as LPs. That is either GPs calling us because they have an LP that needs liquidity or they are looking at the existing vehicles they manage to accelerate liquidity via continuation vehicles, SMAs or balance sheets. It is broader than just one type of GP solution.

GPs are now much more actively managing their own vehicles to bring in duration where, because of a lack of M&A and covid, duration has extended.

GP-led are very different in private credit versus private equity because we are looking at portfolios of sometimes 300 loans rather than single assets. The motivation to do a GP-led in credit is to optimise the investor experience and accelerate liquidity as opposed to riding the upside for longer on a trophy asset.

RJ: We look at both GP-led and LP-led deals similarly in terms of risk/reward, but they have their respective benefits and considerations as well from a channel perspective. Private credit is now a $1.7 trillion asset class with around 1,200 GPs and many different growth drivers. It is hard to predict which of those LP or GP channels will scale the fastest and how volumes will change going forward. However, as a long-standing capital provider in credit secondaries, we have the scale and experience to invest across all deal types. ■

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