KEYNOTE INTERVIEW

A growing opportunity

Looking at turnover rates in other asset classes – for example, housing – can offer a window into the growth potential of the secondaries market, says Nick Lawler, head of secondaries at Churchill Asset Management

Q How would you describe the supply/demand dynamics in the secondaries industry today?

At the height of market activity in 2021, we saw record deal volumes in the secondaries market, with $134 billion of transactions completed. This year is on track to potentially eclipse that figure: Evercore's *Secondary Market Review* found that $72 billion of activity was transacted in H1 2024, and the second half (Q4 in particular) is typically the busiest period of each year. I would say, therefore, that secondaries is one of the most – if not the most – undercapitalised areas in alternatives.

There is currently around $180 billion-$190 billion of dry powder in the market, equating to a multiple of 1.4x-1.5x dry power to annual deal volumes. When you look back over the past 20 years, that supply/demand balance has sat squarely in the two to two-and-a-half years of dry powder to annual deal volume range. What that means, by extension, is that pricing power currently rests firmly with buyers.

Pricing has been fairly fluid over the past 18 months, responding quickly to macro shocks as they have occurred. As of today, pricing for quality buyout funds remains relatively strong for sellers in the 90-95 percent of NAV range, although this is still a far cry from funds trading at par or even a premium in 2019 and 2021. Other areas such as venture capital or real estate, meanwhile, are trading at wildly depressed levels.

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Q How is the GP-leds space operating at present, particularly as it relates to continuation funds?

People tend to think of the continuation vehicle market as having really taken off in 2018, but in reality, the technology has been around since 2012 (although it used to be called 'fund-level restructuring' and was used for very different purposes).

Today, continuation vehicles are almost always focused on trophy assets, allowing sponsors to deliver liquidity while extending the holding period and often raising incremental capital for

accretive M&A. While this market was initially dominated by large-cap deals, we are now seeing a proliferation of mid-market continuation vehicles with equity needs in the range of $200 million-$600 million.

Furthermore, while the majority of the largest 100 sponsors globally have completed a GP-led trade, that percentage falls dramatically when you move down the size spectrum. We believe, therefore, that there is a huge amount of white space remaining: this is a part of the market that is only going to grow.

Q What does it take to be successful in the mid-market continuation vehicle space?

Mid-market deals are harder to access than those in other size brackets, and syndications are few and far between. When billions of dollars are being raised, that obviously requires a sizeable number of groups to be involved; as mid-market deals are smaller in size, only a couple of investors will be required. Accessing these transactions is dependent on having a scaled platform built on deep sponsor relationships that allow you to tap or even lead and structure a deal. If you don't have one, or ideally both, of those capabilities, then you are definitely at a disadvantage.

Q Will growth in the continuation vehicle market be curtailed when M&A returns?

I don't think so. You only need to look back to 2021, which was a record year for continuation vehicles and a record year for private equity-backed M&A in general. These weren't companies that private equity firms couldn't sell by other means: they were companies that the firms truly wanted to hold onto for longer.

In today's challenging exit environment, continuation vehicles are certainly another tool in the toolkit, but ultimately these deals should be reserved for those stand-out businesses that sponsors really want to continue to grow and capitalise on.

Q What are the main differences – and, indeed, similarities – between continuation vehicles and co-investment?

With both continuation vehicles and co-investments, you are often investing in a single company alongside a sponsor – that is where the similarities end. With co-investments, you are often participating in the first buyout of a business and, as such, don't really know what you are buying until you have owned the company for a period of time. Yes, due diligence is undertaken and a value creation plan put in place, but you can never really know if you have got it right until you start to see results.

With a continuation vehicle, by contrast, the sponsor has already owned the asset for a number of years. They have already done the heavy lifting – optimising management, rationalising products, figuring out pricing strategies, or whatever it may be. Quite simply, the unknowns are dramatically reduced. As a result, our expectation is that return dispersions and loss rates should be significantly lower – that is now starting to be borne out in the data.

Of course, there are economics tied to a continuation vehicle, where there may not be with co-investments, but we welcome the opportunity to be fully aligned with the GP.

Q Do you believe there is also still room for growth in the LP-led market?

There is north of $10 trillion in outstanding private asset NAV currently out there. The annual churn rate, meanwhile, is around $130 billion – so, less than 1.5 percent. The US real estate market makes for an interesting comparison: according to Redfin data, in the modern real estate era, around 5 percent of homes are on the market at any one point in time. Houses are arguably the most illiquid assets that anyone can own – you have to physically move in order to sell. A private markets churn rate of less than 2 percent suggests, therefore, that there is still a lot of room for growth.

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Secondaries as an asset class has grown at around a 17 percent CAGR over the last decade, faster than private equity as a whole. However, the market has also expanded into different transaction types during that period with the advent of preferred equity and then GP-led deals. As such, I am absolutely convinced that there is a lot more growth to come.

Q What types of fund interests are attracting most attention by age?

There are different buyer groups for different situations. Some secondaries funds focus on tail-end vintages where cashflows should occur rapidly. Those funds typically make their returns by buying at a deep discount. Then there are other funds that focus instead on younger opportunities where there is more embedded growth potential at the underlying portfolio company level. Those interests tend to command higher purchase prices.

There is also, we believe, a sweet spot in the middle for fund interests that are between four and six years old, where you can find an interesting intersection of growth and value. ■