INSIGHTS

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LIQUID CURRENTS

PRIVATE MARKET TRENDS TOWARDS A FLEXIBLE FUTURE



LIQUID CURRENTS

A closer look at the liquidity-focused solutions emerging in private markets, their current value, and the longer-term feasibility to building more flexible fund structures

Private markets undercurrents of late suggest a distinct focus on liquidity, and understandably so – Private Equity Wire's (PEW) Q1 2024 survey of over 70 private markets GPs revealed 61% of firms have experienced increased LP demands for distributions in the past 12 months. Macro conditions and their impact on deal activity explain these expectations, and near-term solutions to the liquidity crunch have been quick to emerge.

The secondaries marketplace, particularly for LP-led transactions, is thriving – Bain & Company reported in March that secondaries grew faster than any other asset class in 2023, raising a staggering 92% more capital last year than they did in 2022. PEW's research found 22% of GPs have launched a secondaries fund in the past 12 months.

Borrowing against net asset value (NAV) has been a headline-grabbing, increasingly popular strategy – our survey finds 26% of firms did so in the past 12 months, and mega funds are stepping in to provide the financing where required. Other fund structures that offer LPs liquidity and flexibility – evergreen, multi-strategy and open-ended, to name a few – have all been taken up by 20% or more GPs in the same period.

The question remains as to whether the flexibility inherent to these structures is a fix for short (or medium) term economic conditions, or if they have more staying power to address private markets illiquidity. The increasingly apparent focus on private wealth as a frontier for fundraising – particularly among mega funds such as Blackstone, Apollo and others – and murmurs of the gradual retailisation of private market asset classes, if indeed a plausible reality, are all trends that would fuel the flexibility frenzy.

The future of the industry will be a product of how these factors conflate, with distinct, liquidity-focused nuances emerging from one asset class and strategy to the other.

CONFLUENCE OF FORCES

PEW spoke to Stephane Barret, Head of Private Capital Group at Credit Agricole CIB, about future directions. For him, the pressure

from LPs on GPs relates as much to the denominator effect as their need for liquidity. “Particularly after secondaries transactions, investors are happy to receive staggered or deferred payments – they’re not cash constrained, they just need to rebalance their ratios,” he says.

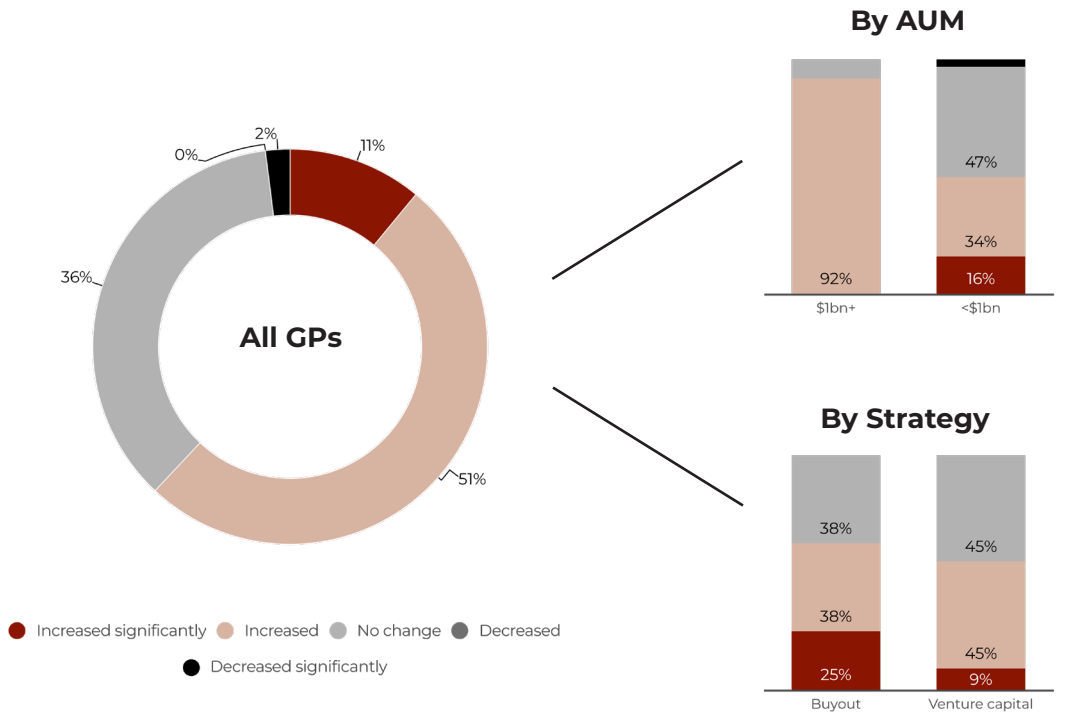
Offloading assets at any rate appears to be a distinct priority – The Financial Times has cited Jeffries research to report that US institutional investors, particularly pension funds and endowments, sold a remarkable 99% of their private equity holdings at par or lower on the secondaries market through 2023.

But liquidity is a priority too – Barret says GPs are currently being pulled in opposite directions. “On the one hand, LPs that have recently committed capital are applying pressure for this to be deployed. They were satisfied when – in the wake of geopolitical uncertainty and disruption in the credit markets – deal activity was muted, but they’re now expecting GPs to put this money to work.”

At the same time, he suggests, LPs want returns paid out on their existing portfolios. If this entails offloading assets on the secondary markets, they prefer the burden be taken on by GPs, which often means a loss on assets and carried interest on deals. “It’s up to the managers to align with buyers on pricing and subsequently distribute the returns.”

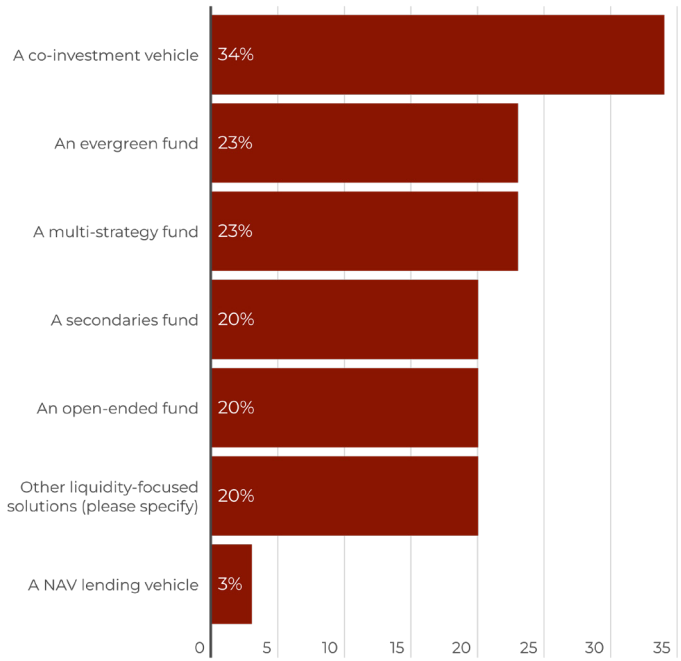
It’s no secret that finding this alignment has been a significant challenge. The Bain & Company report cited above puts the

Figure 1 How have LP demands for distributions evolved in the past 12 months?



Source: Private Equity Wire GP Survey Q1 2024

Figure 2 In the past 12 months, which of the following products has your firm launched? (Please select all that apply)



Source: Private Equity Wire GP Survey Q1 2024

number of assets currently in buyout portfolios worldwide in the ballpark of a staggering 28,000, with around 40% being over four years old – symptomatic of how challenging the valuations landscape has been.

NAV financing is one option available to GPs to abate investor liquidity demands – the growing instance of borrowing against portfolios suggests managers are open to this avenue. But Barret, and other commentators in the market, suggest that leveraging funds to pay LPs dividends – or boost IRR – is not a sustainable option. “At the end of the day, we’re here to build businesses – if a fund is short on liquidity to finance a bolt-on or expansion strategy, that makes sense, but not otherwise.”

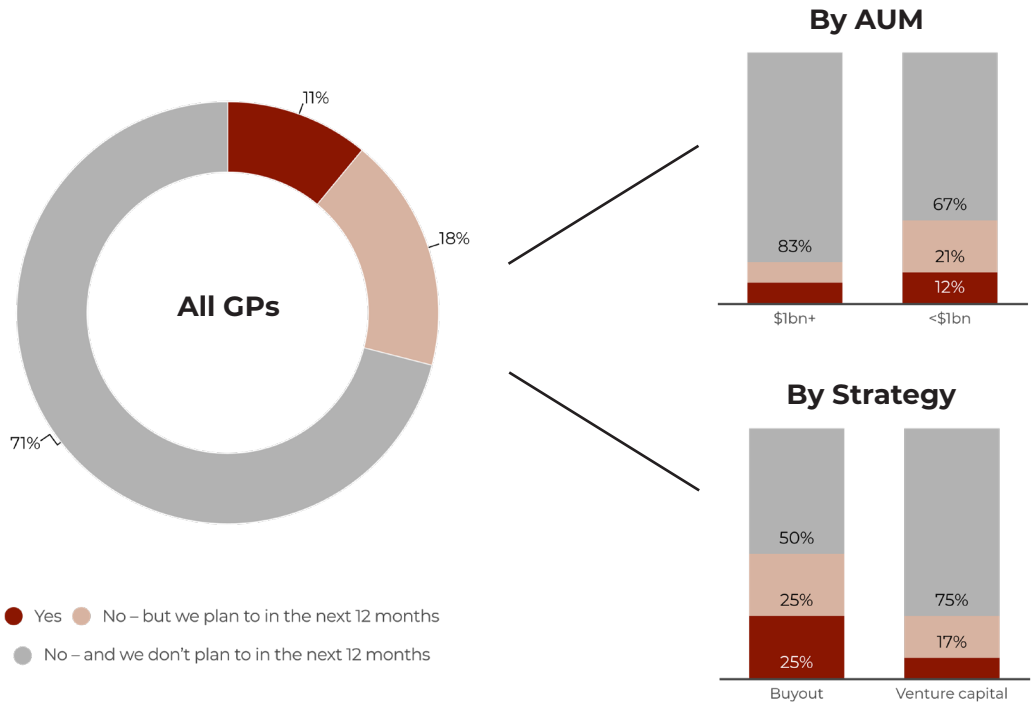
Setting up a NAV lending strategy, on the other hand, could be lucrative in current conditions – banks are still not very active in that space, Barret suggests, and there are good returns to be made give the elevated interest rates. Still, only 3% of PEW’s respondents have set up a NAV lending facility I the past 12 months, despite a growing interest in credit as an asset class.

As for flexible fund structures, whether evergreen, semi-liquid or others, there are details to iron out if, or when, they are to become an industry-wide norm. “In theory, semi-liquid structures are appealing – capital is locked up for the first three-to-five years and then investors have the option of a staggered exit. But there are complications to iron out, particularly in private equity, when it comes to volatility in valuations, turnaround processes and the overall impact on long-term liquidity.”

A Financial Times opinion article from April cites Preqin data to report the number of evergreen funds has doubled over the last half a decade, amounting to a NAV of $350bn – many mega funds have gotten involved. The closed-ended structure, the report says, provides a "reality check" on NAV, which the open-ended firm will have to find a way to replicate. It also represents a convergence of alternative and traditional investment strategies.

Given that mega funds have all gotten involved in the evergreen space, the months and years to come will demonstrate just how much this convergence will manifest – particularly amid trends of retailisation, a focus on private wealth as a fundraising frontier and a wider focus on flexible, liquidity-oriented solutions.

Figure 3 In the past 12 months, has your firm borrowed against NAV?



Source: Private Equity Wire GP Survey Q1 2024

KEY TAKEAWAYS

The need for liquidity, while challenging, also presents opportunities to those on the right side of transactions – whether lending in the NAV space or buying in the secondary market.

There are fund structures in place to offer LPs more liquidity, but managers should consider whether these threaten fund performance, or the essence of alternative assets altogether

PRIVATE EQUITY WIRE

CONTRIBUTORS:

Aftab Bose
Head of Private Markets Content
aftab.bose@globalfundmedia.com

Johnathan Glenn
Head of Design
johnathan.glenn@globalfundmedia.com

FOR SPONSORSHIP & COMMERCIAL ENQUIRIES:

Enrique Schindelheim
Business Development Manager
enrique.schindelheim@globalfundmedia.com

Published by: Global Fund Media, Fox Court, 14 Gray's Inn Rd, London, WC1X 8HN

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