KEYNOTE INTERVIEW

The drivers of record-breaking volume

Industry-wide transaction volumes are on track for a record-breaking year as demand for liquidity remains strong, says Adam Graev, managing partner of CVC Secondary Partners

Secondaries market volume peaked in 2021 with $132 billion of transaction volume. Now, after two years of volumes in the range of $110 billion-$115 billion, the market is once again testing all-time record highs: according to mid-year reports, executed transactions in the first half of 2024 were substantially above the same period last year, with some reporting volumes in excess of $70 billion. With these figures in mind, Adam Graev, managing partner of CVC Secondary Partners, tells *Private Equity International* where the biggest opportunities lie in this rapidly developing area of the private equity landscape.

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Q What does the market look like as of the halfway point of 2024?

The first half of 2024 was highly active; the market has seen record volumes for a first half, with traditional LP-led secondaries accounting for more than half of all completed transactions. Our team has sourced over $100 billion of dealflow so far in 2024, and we expect this strong supply to continue through the second half and beyond. The level of activity in our pipeline demonstrates the robust opportunity set across both LP-led and GP-led transactions.

The main driver of market activity is the consistently slower pace of distributions to LPs. For LP-led transactions, sellers are motivated by wanting liquidity today rather than waiting for distribution activity to increase in future, thereby choosing certainty over uncertainty – albeit at a potential discount. Many LPs are actively managing their portfolios – this has been a consistent growing theme in the supply side of the secondaries market over the last decade.

On the GP-led side, we have seen both repeat and first-time GPs in the market with single-asset and multi-asset transactions, often in a bid to return capital to LPs that elect to sell. We are seeing funds that are in year three, four or even five that haven't yet returned any capital to investors; as such, these GPs are under real pressure from their LPs and advisory boards to generate liquidity. Over the years, we have generally seen significant improvement in the quality of assets and managers in GP-led transactions, with sponsors looking to hold on to their star assets for longer.

Q What are your expectations for the months ahead?

The last few months have been exceptionally busy, and we expect continued high volumes over the remainder of 2024. Typically, the first half is a slower period for secondaries, so if that pattern repeats this year, market commentators believe we could potentially see transaction volumes of $140 billion-$150 billion for the whole of 2024.

At CVC Secondary Partners, we purchase both GP-led and traditional LP-led secondaries with a focus on mature, cashflow-positive companies like those typically found in buyout strategies. Within the buyout segment, there has been a noticeable decline in the annual pacing of distributions; this will undoubtedly be a driver of more LP-led and GP-led deals as investors utilise the secondaries market to achieve their liquidity objectives.

Over the summer, we saw multiple sellers launching diversified LP portfolios, as well as sponsors exploring new GP-leds or continuation funds aiming to generate liquidity before year-end. Traditional exit routes have primarily been through a sale to strategic buyers, another sponsor or via an IPO – today, continuation funds have become a proven fourth exit option. At a time when bid-ask spreads remain in the M&A market and the cost of debt is relatively high, GPs would rather hold and develop trophy assets by raising a continuation fund.

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Q How do you view single-asset GP-led deals, as opposed to multi-asset?

Single- and multi-asset continuation funds are both viable liquidity solutions for sponsors and LPs. Single-asset deals have become more common in recent years, representing more than half of the GP-led market today, according to many advisory reports. This plays well into our areas of focus: we will look at multi-asset deals and have completed multi-asset deals, but typically prefer the profile offered by single-asset assets because we can establish an edge through extensive due diligence and relationships. We prefer doing a deep dive on a single trophy asset, as opposed to multi-asset deals, where occasionally we have seen some of the bad bundled with the good. To us, taking a leading role in a GP-led transaction is important to setting the right terms, including strong governance and alignment between buyer and GP.

We believe that in multi-asset opportunities, there is an increased risk of an asset not performing or needing additional capital, which could hamper other assets and affect overall returns.

Q How have macro challenges affected secondaries investing over the past 12 months?

Inflation and rising interest rates flow through the entire private equity ecosystem, but some strategies and industries are more directly impacted than others. For strategies using leverage, the cost of capital has increased with rising interest rates; the interest expense in portfolio companies is naturally higher, and that can erode free cashflow. We've also seen disruption to supply chains and high demand for labour causing some pockets of wage inflation.

Refinancing risk is another key issue we focus on as a team. Many debt arrangements were made during conditions that were very different to those we see in today's market. As these arrangements start reaching maturity, good companies with strong cashflows that are not over-levered will be able to access markets and refinance. However, businesses with mixed performance that don't have strong cashflows may struggle to refinance or may have to look to non-traditional lenders to refinance their capital structures on less attractive terms.

It is important to consider that as a secondaries manager, we can look in the rearview mirror and take into account all the challenges described here in our underwriting. We are analysing an existing portfolio or asset before we buy, which is typically at a discount with the potential for near-term liquidity. This is a strategy that has worked in rising, flat and challenging markets because secondaries GPs have visibility and can reprice assets according to what has actually happened in the past, while concurrently taking into account current market conditions. CVC Secondary Partners is looking forward to the potential opportunities available through the end of this year and into the next. ■