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Private Equity Now: The GP Perspective

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Challenging financing conditions and macroeconomic disruptions have ushered in a period of lackluster M&A activity the last few years. Sellers are reluctant to realize investments at what are perceived to be depressed valuation multiples. Buyers meanwhile are wary of overpaying and unwilling to meet sellers at multiples of a bygone era. The resulting valuation gap has contributed to a reduction in exits for GPs and thus reduced distributions – the lifeblood of private equity.

In a fundraising context, reduced distributions restrict the capital LPs can re-invest in PE, an otherwise self-funding asset class for the better part of the last decade. This challenging dynamic of scarce LP capital is driving a multitude of adverse knock-on effects for GPs. These include smaller LP check sizes, extended fundraising timelines, and enhanced LP negotiating power on pricing and terms.

Traditionally, GPs had five options to generate distributions: selling a minority equity position, or selling outright, executing a fund-to-fund sale, a dividend recapitalization, or an IPO. Each have drawbacks in today's market. The dramatic evolution and increased sophistication of the secondaries markets over the last five years have ushered in a new wave of innovative liquidity options including: continuation vehicles (CV), net asset value (NAV) facilities and fund level tenders.

GPs use CVs to recapitalize equity of portfolio companies while keeping control of the asset. LPs are offered a liquidity option for their interest in the portfolio companies, but also the option to rollover or re-invest proceeds alongside the GP and new secondary investors to benefit from continued growth. CVs are a more elegant way to execute what historically would have been a fund-to-fund sale by enabling an arms-length third party to establish a price. They also offer enhanced flexibility to both GPs and LPs by allowing for either liquidity and/or re-investment. Being an effective and trusted method of delivering distributions has CVs accounting for 9% of total private equity distributions in 2023, up from 5% in 2022 (per *Secondaries Investor and Baird*.)

NAV facilities are fund level credit facilities secured against the underlying portfolio assets. This financing solution offers GPs liquidity to distribute to investors at an attractive cost of capital without having to sell or liquidate equity positions in a suboptimal market. NAVs also give GPs flexibility from a portfolio management perspective, arming them with more ways to optimize capital calls.

A fund level tender process occurs when a GP arranges for secondary buyers to set a market clearing price for the purchase of LP interests in legacy funds. This gives LPs the option to sell all or a portion of their interests. Tenders grant the GP flexibility by providing LPs who seek distributions an option and enables the GP to retain control and extend the life of high performing assets.

While modern liquidity techniques offer ways to deliver distributions to LPs, GPs ultimately must consider the needs of their LPs to determine the optimal solution for all their constituents.