THE LEAD
https://theleadleft.com/private-equity-now-the-gp-lp-relationship/

Private Equity Now – The GP/LP Relationship

THE LEAD | December 10, 2024

In this series we have explored the challenges GPs face today across the full private equity lifecycle – fundraising, deployment and exits. The most adaptive private equity managers are those who are the most creative and strategic in partnering with their limited partners. In the always shifting GP/LP power equation, both are seeking trusted partners with whom they can build a long history of collaboration, transparency, and customization.

Co-investments have become one of the first stops for sponsors and their investors looking to collaborate and deepen their relationship. Increasingly GPs have equity co-investments as a permanent element of their operating model. In a recent Dechert survey of 100 private equity firms, 73% now offer a co-investment program.

It is a clear win-win. GPs can customize the deployment and portfolio construction of their funds — particularly crucial in a limited exit world – juggling concentration risk and extending the deployment of their existing vintage. Likewise, LPs get access to advantaged deal flow in a highly cost-effective structure with the potential for outperformance. LPs can then see under the hood to gain deeper insights into how a GP thinks and invests.

As the co-investment asset class has proliferated, different flavors have also emerged. These include co-sponsorships, post-deal syndicated co-investments, and non-discretionary co-investment sidecars. To be a successful partner, GPs must know which model fits each LP.

As holding periods elongate, GPs explore ways to drive value and play offensive in existing portfolio companies. Whether for add-on acquisitions or organic growth initiatives, junior capital can fill a middle-of-the-balance sheet solution when other financing sources are constrained. In most scenarios, this flexible capital is the only alternative to infusing incremental equity, which can dilute returns.

Likewise, in new buyouts, junior capital can bridge a pricing gap. GPs benefit from its customizing features – particularly fixed-rate and non-cash pay – and investors receive premium pricing.

Lastly, GPs have increasingly turned to the secondaries market to generate liquidity. As discussed last month, a broad range of secondary tools have emerged: CVs, NAV facilities and fund tenders among them. Taking the GP/LP relationship a step farther are instances where GPs may sell a piece of the management company. Investors can share in the management fee and carried interest revenue, while managers gain capital for growth or liquidity as part of succession planning. In the same Dechert survey, 34% of GP respondents are exploring GP-stake divestitures in the next two years.

Underpinning all these partnerships is trust and alignment. GPs and LPs will gravitate towards platforms where they have time-tested and broad-based relationships. Those with comprehensive scale will have multiple avenues through which to collaborate – a true differentiator.