

KEYNOTE INTERVIEW

Time to scale up



Investors need to re-evaluate outdated allocation models in light of an explosion in GP-led secondaries deals, says New 2ND Capital founder Tjarko Hektor

Q How would you describe the fundraising market today, particularly as it relates to secondaries?

Clearly, the past 12-18 months have not been easy for anyone. A lack of liquidity and the breakdown of allocation models have affected LPs' ability to make new commitments.

However, despite those challenges, many secondaries funds have been successful. We ourselves closed our third GP-led secondaries programme, with more than \$875 million in commitments at the end of last year, surpassing our initial target. I would certainly say that from a fundraising perspective, the secondaries industry has proved relatively immune to the struggles that have been faced elsewhere in private markets.

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Q Where do GP-led secondaries generally sit within investors' allocation models?

This is one of the biggest problems that exists for our part of the market right now. Most investors have buckets for buyouts, for venture capital, for growth capital and for secondaries. The secondaries bucket tends to be relatively small, and some investors may not have one at all. The secondaries bucket also tends to be primarily geared towards LP-led secondaries.

I believe that this classic way of thinking about allocations is outdated. Investors need to think about their

portfolios more dynamically, particularly as it relates to secondaries. Secondaries is a separate asset class that can provide private equity-level returns, with a shorter duration and lower risk. These characteristics can be especially true for certain GP-led secondaries managers. The minute an investor grasps this, their interest is immediately piqued.

With a GP-led secondaries strategy, we believe we can deliver returns that are similar to a buyout fund, but with a shorter duration and lower levels of risk, because we are buying attractive, known assets. And in most cases, we are buying those assets at a discount and with lower leverage profiles.

I believe that one of the biggest tasks we have as secondaries professionals, and particularly those of us that

are focused on the GP-led side of the market, is the need to convey this message to investors. We need to challenge investors to adjust their allocation models, to start thinking about the secondaries asset class in a more nuanced way and to allocate more to GP-led secondaries.

Q Is the industry able to prove those comparable returns, or is the GP-led market still too nascent?

We are certainly starting to see those statistics emerge. Evercore and Morgan Stanley are among those that have released returns data that demonstrates the GP-led market is delivering returns on par with the direct buyout market. And in my view, this is being achieved with lower risk.

Q How have you seen the nature of GP-led dealflow evolve over the eight years that you have been active?

Dealflow is off the charts. The volume of opportunities we are seeing is simply phenomenal, and that has been the case for quite some time now. In fact, the biggest constraints that the secondaries industry faces are access to capital and human capital, in the form of experienced people. Those are the two factors that are limiting the growth of the market, rather than any lack of dealflow.

Not every deal should get done, of course, but the level of pent-up demand for GP-led secondaries that we are witnessing is tremendous. Sponsors increasingly understand the benefits that these transactions can offer. New 2ND Capital and other players are advocating for these transactions, and sponsors are increasingly getting more familiar with them. This started at the top of the market, and it is gradually trickling down into the mid-market and even the lower mid-market.

The North American mid-market is the part of the private equity landscape that we have chosen to focus on,

because we believe it is where the deepest opportunity set exists, given the sheer volume of GPs that operate here. We are truly excited about the breadth and depth of this still largely untapped part of the market.

Q Given the scale of the potential opportunity, how can investors select which transactions to back?

There are a number of ingredients required to make a good GP-led secondaries deal. First, of course, you need good companies. Good companies can generally generate good returns. That is true wherever you are in private equity, and it is just as relevant in secondaries.

The second essential ingredient is good people. In other words, you need to be sure that you are partnering with a strong GP. Not only does the GP have to be strong, they also have to be a good fit for the asset. There is no point doing a mid-market transaction with a mega-cap GP, for example, because the skill sets won't match.

Equally, you want to be partnering with a GP that has the appropriate sector expertise, as well as experience with

the relevant deal type. If the investment theme is an M&A roll-up, then you need to be backing a GP that has a proven track record in that area. It is all very well investing in a great company, but you also need a GP that has the skill set to fulfil its value-creation plans.

Finally, we believe it is critical to create alignment between all the constituents. The right incentives have to be in place to ensure that the GP, the management team of the company and we as secondaries investors are all rowing in the same direction.

Q Do GP-led secondaries investors have a role to play after the initial investment?

We seek to work interactively with our GPs, helping them out along the way with capital and expertise, as appropriate, as well as occasionally resetting terms to ensure that end results are delivered. GP-led transactions are complex deals and this is how we earn our keep. We forge long-term partnerships with GPs and with portfolio companies, as well as with investors. Our business is all about long-term relationships with all the relevant parties.

Q Do you see a role for artificial intelligence in the GP-led secondaries market going forward?

This is something that I am extremely excited about, and we are running a number of pilot initiatives. I see a role for AI in making the back office more efficient, for better portfolio monitoring and better reporting.

I also see a role for AI in making the front office more successful too, in terms of proactive deal-sourcing, as well as enhanced due diligence, with information being gleaned from a broader variety of sources, and more quickly. I see real potential for this technology, and I believe that the way in which firms approach the integration of AI will prove a huge differentiator within the next 12-36 months. ■

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