INVESTMENT PERSPECTIVES

CapitalDynamics
TRULY INVESTED.

MAY 2022

GP-LED SECONDARIES

RESHAPING THE LANDSCAPE FOR INVESTORS, FUND MANAGERS AND PORTFOLIO COMPANIES

Over the last few years, GP-led secondary transactions have become an integral and dominant part of the private equity secondaries market, with an abundance of blue-chip sponsors and billion-dollar deals now commonplace. Although still a young asset class, GP-led secondaries constitute about half of the secondary market transaction volume today compared to less than one quarter of the market in 2017[1]. Yet, the GP-led segment of the market is poised for further growth in a secondaries market expected to exceed USD 200 billion by 2025.[2]

In this paper, we explore several themes, including:

- The prominence of GP-led secondaries and key drivers of growth;
- The benefits and risks of GP-led secondaries, and what investors should consider when participating in these deals;
- The link between ESG and GP-led secondaries;
- Capital Dynamics' own approach to GP-led secondaries; and
- What is next for the GP-led secondaries market

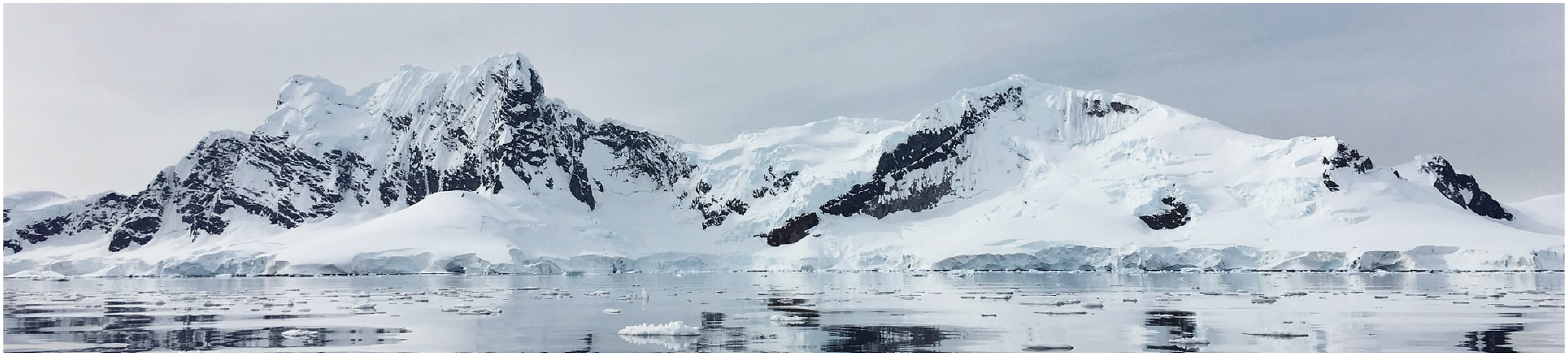
[1] *Source: Greenhill 2021 Global Secondary Market Review (January 2022)*
[2] *Source: Lazard Private Capital Advisory, 2021 Sponsor-led Secondary Market Report (January 2022)*

THE PROMINENCE OF GP-LED SECONDARIES AND KEY DRIVERS OF GROWTH

WHAT ARE GP-LED SECONDARY TRANSACTIONS?

As the name suggests, the General Partner ("GP") initiates the deal in a GP-led transaction. The motivations for these transactions vary, but in general, GP-leds allow the manager and investors a combination of liquidity (i.e. returning cash to current Limited Partners ("LPs")) and ability to prolong the holding period. Through various means, GPs are able to retain exposure and/or management of what is typically a high-quality asset or share of assets. In this way, they are able to maximize an asset's value, and (importantly) avoid being forced to sell an asset with significant potential upside at the end of a fund's life. In a typical transaction, a fully-baked and negotiated liquidity solution is presented to LPs who are given an option to either: **(i)** exit/sell and receive a pro-rata portion of the cash purchase price; **(ii)** retain or "roll" their pro-rata interest in the existing fund into the new, restructured (or 'continuation') vehicle; or **(iii)** in certain cases, both. In this way, investors benefit from being offered the option to effectively cash out of the fund or retain investment exposure to the assets – typically an additional several years' exposure to the fund's upside, which can be boosted by the inflow of new capital.

For GPs, much of the benefit is in the additional time; if their funds have neared the end of their lives, but they haven't exited all of their assets or portfolio companies, a few more years of time enabled by the continuation vehicle can allow them to be more strategic about exit options while benefitting from continued upside. As GPs typically invest a significant amount of their own capital in the continuation fund, LPs are comforted that there is strong alignment of interests between them and the GPs. Overall, investors have the ability to realize either liquidity or greater returns, and GPs can hold onto an asset for longer while continuing to earn carried interest.



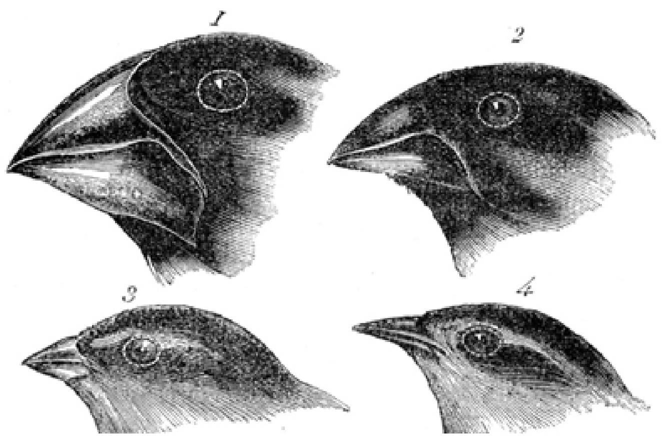
WHAT ARE THE DIFFERENT TYPES OF GP-LED SECONDARY TRANSACTIONS?

Much like the Galápagos finches, GP-led transactions have evolved and adapted over time to meet a variety of GP and LP needs, creating a wide variety of deals. While GP-leds typically occur in the context of a multi-asset continuation fund, there are several unique types of GP-led secondary transactions that are most common in the market today.

Multi-asset continuation fund
The sale or transfer of portfolio asset(s) into an extended duration vehicle managed by the same GP at a valuation determined by secondary buyers. LPs have the option to either sell, roll over their capital into the continuation fund, and/or, in many cases, maintain the status quo. Additional capital may be provided for follow-on investments. The holding period is extended to maximize the value of the assets.

Single-asset continuation fund
The sale of a single-asset to a special-purpose vehicle ("SPV") managed by the same GP at a valuation determined by secondary buyers. The selected asset typically has significant remaining upside, and is usually triggered by either a **(i)** duration mismatch between the asset's harvest period and the fund life, and, increasingly, by **(ii)** a fund's trophy asset which has materially appreciated with some LPs expressing a desire for early liquidity.

Partial/Portfolio sale
The sale of a specified selection or percentage (sometimes referred to as a "strip") of direct interests in assets held by a fund, typically to an SPV managed by the same GP at a valuation determined by secondary buyers. LPs receive liquidity, the ability to de-risk, and in many cases, rebalance their existing portfolio.



Tender offer
A coordinated option for LPs to obtain liquidity through a market-priced tender offer for fund interests. The pricing for LPs is often improved over individual secondary transactions due to the transaction achieving critical mass. It is typically triggered by a group of LPs having indicated an interest in liquidity.

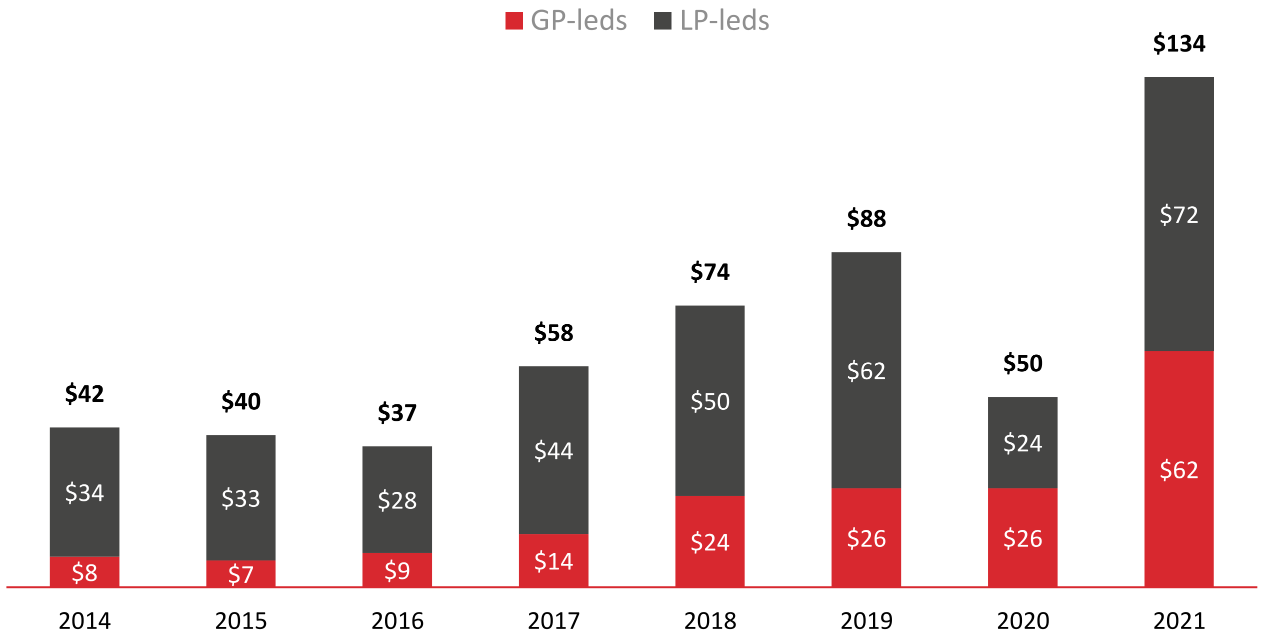
Fund-level preferred equity
Non-debt financing at the fund level to catalyze distributions, support assets, or in certain cases, fund GP commitments. It is usually triggered by either **(i)** a portfolio requiring follow-on capital or an equity cure or **(ii)** LPs having indicated an interest in liquidity (as an alternative to a portfolio sale).

Stapled transactions
In combination with any of the above, the buyer agrees to simultaneously make a primary commitment to a new fund managed by the same GP. This may have the benefit of balancing attractive early cash flow from the secondary with long-term capital appreciation of the primary, which is funded by the secondary component.

WHAT HAS DRIVEN THE GROWTH OF THE GP-LED MARKET?

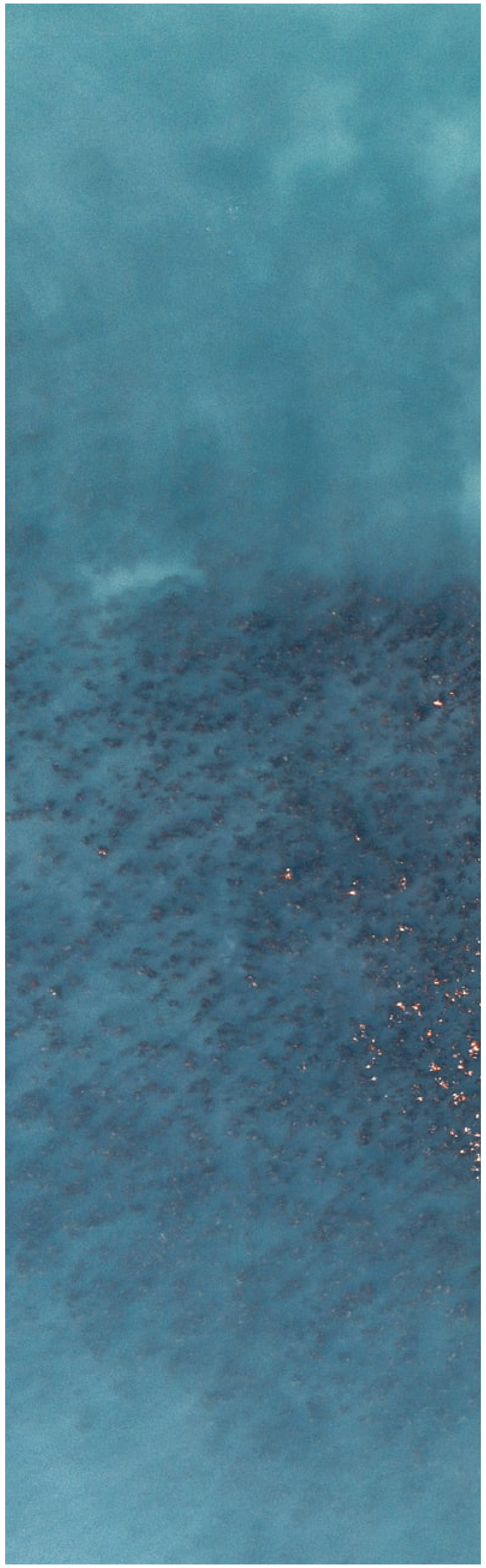
It is important to view GP-leds in the context of the wider secondaries market. Despite a significant drop in secondaries transaction volume at the beginning of 2020 (from nearly USD 90 billion in 2019 to USD 50 billion in 2020), the secondaries market reached a record high in 2021, with volumes that exceeded USD 100 billion (see **Figure 1**). According to Preqin, there is approximately USD 8 trillion in private equity AUM, and in their latest Investor Outlook report, 44% of investors surveyed said they were planning to invest more capital in private equity. As a proportion of this AUM is turned over on the secondaries market, the outlook for further growth of the secondaries market looks strong. And within the secondaries market, GP-led transactions have also grown considerably – by a 28% compounded annual growth rate since 2013, according to Greenhill. Although they are a young asset class, GP-leds now constitute nearly half of the secondary market, accounting for 46% of the total secondary volume in 2021.[4] With market volumes expected to exceed USD 200 billion by 2025, the GP-led market is poised for further growth.[5]

Figure 1: Annual Secondary Transaction Volume – Breakdown of GP-leds and LP-leds (USD BN) [6]



GP-led Share (% of Total Volume)						
Below 20%	24%	24%	32%	30%	44%	46%

[3] *Preqin data, as of September 2021, Preqin Investor Outlook: Alternative Assets, H1 2021*
[4] *Source: Greenhill 2021 Global Secondary Market Review (January 2022)*
[5] *Source: Lazard Private Capital Advisory, 2021 Sponsor-led Secondary Market Report (January 2022)*
[6] *Source: 2021 Greenhill Global Secondary Market Review, January 2022*



THE EVOLUTION OF THE GP-LED MARKET

The GP-led market has continued to evolve over the last decade-plus. Contributing to the market's recent (i.e. 2018 and onward) growth has been the increasing use of GP-leds to extend the holding period of an asset. Even more recently, as the pandemic weakened company valuations in 2020 and beyond, GP-led transactions such as single-asset continuation funds allowed GPs more time to weather volatile markets and ultimately grow asset valuations. Further compounding this growth is the fact that an increasing number of well know, 'blue-chip' GPs view these types of transactions as an important, if not now a necessary, tool to address both portfolio and investor needs.

Both GPs and LPs can be motivated to initiate or participate in a GP-led process. **For GPs, some of the key objectives/transaction-rationale now include:**

- A term extension (for an expiring fund)
- Additional primary and/or follow-on capital, which helps optimize the performance of the existing portfolio
- Enhancing Distributions to Paid-in Capital
- Re-setting GP/Sponsor economics
- Managing a key-man event at the GP/Sponsor
- Facilitating a GP/Sponsor spin-out from a parent platform (e.g. bank, insurance company, bigger GP)

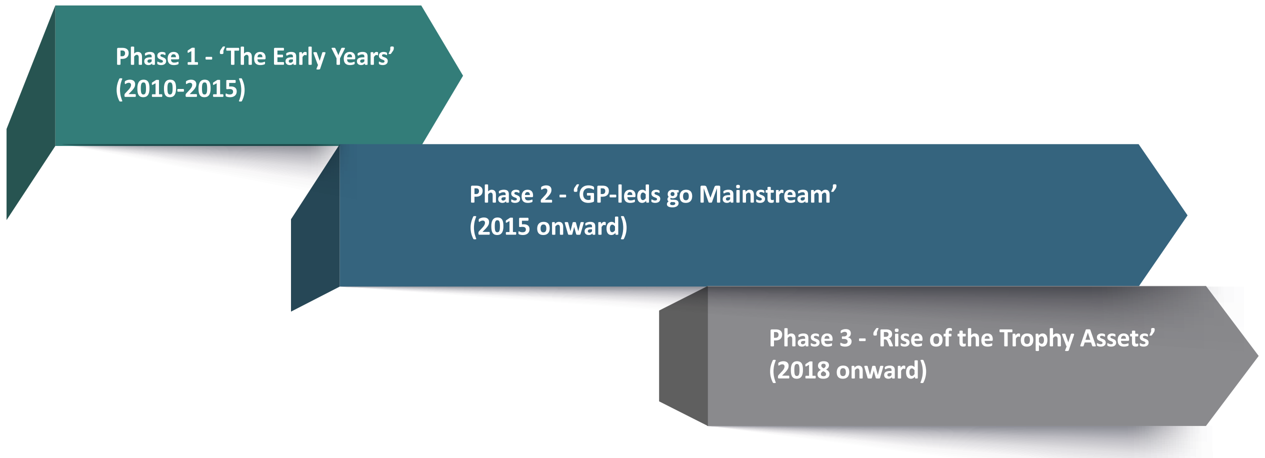
For LPs, a GP-led process may allow them to:

- De-risk their portfolio
- Accelerate liquidity
- Retain equity ownership and potential upside
- Accommodate an LP strategy shift or change a cornerstone LP
- Provide stability to the GP/Sponsor so that it continues to manage the asset(s)
- Resolve regulatory issues or provide strategic considerations for the parent company

Three distinct growth phases of the GP-led market

In the 'Early Years' **(Phase 1)** of the GP-led market, from around 2010 to 2015, liquidity solutions were provided for suffering funds to solve a duration mismatch between assets and expiring funds. Some assets required follow-on capital and typically the quality of the GPs and funds participating in these transactions were lower. Then, beginning in 2015, GP-leds began to go mainstream – what we refer to as **Phase 2**. During this period, which is ongoing, reputable large-cap sponsors began utilizing GP-leds to actively manage their portfolios. The GP-led transaction rationale expanded to **(i)** extend asset duration, **(ii)** secure additional growth capital and **(iii)** proactively generate liquidity for LPs. Finally, in 2018, GPs began to opportunistically use GP-leds to hold onto their most promising assets while providing a liquidity option for LPs. This period, what we call the 'Rise of the Trophy Assets', also saw the increasing use of single-asset continuation funds as an alternative to traditional exit paths (e.g., M&A, IPO) for the sponsors' best performing assets.

Figure 2: Growth Phases of the GP-led Market



BENEFITS AND RISKS OF GP-LEDS

WHY ARE GP-LED SECONDARIES ATTRACTIVE TO INVESTORS?

In general, GPs increasingly use GP-leds to hold on to their most promising assets to help generate superior returns for investors. However, there are a number of additional attractive factors to pique investor interest in these deals, including:

1 **Positive Selection Bias**
GPs have an intimate knowledge of their portfolio companies and (perhaps unsurprisingly) prefer to continue to manage their most promising assets, the 'trophy assets' driving the Phase 3, "Rise of the Trophy Assets," growth we previously defined. As a result, the continuation-vehicle's market-opportunity set is skewed towards the most attractive assets under high-performing funds and quality managers. The market has adopted a "back the winners" mentality.

Capital Dynamics believes that the best GP-led opportunities are alongside brand-name sponsors (with demonstrable track records of success), in the star assets where they have a strong conviction to stay invested in, and where there is a strong rationale to provide the option of early liquidity to interested LPs.

2 **Strong GP Alignment**
In a GP-led fund restructuring, GPs can roll 100% of any crystallized carry from the assets in the existing fund and also often invest very significant additional commitments; in our experience, it is not unusual for a GP to increase their commitments by 3-5% of the purchase price. Additionally, secondary investors are able to negotiate the terms of the continuation fund to bolster the alignment of interests between the secondary investors and the GP – for example, the majority of continuation funds use a ratchet mechanism with different hurdles before the GP can begin to realize carry. These additional GP commitments (enhanced with term negotiability) are strong indications of their belief in a deal or asset and provide an opportunity to improve alignment between the GP and investors.

3 **Outdated Reference Dates**
GP-led due diligence processes typically take longer, often leading to outdated reference dates. Very often, the fair market values on which purchase prices are based can be outdated by six to 12 months or more, with assets having experienced strong growth in the interim, leading to higher effective discounts

4 **Risk Mitigation and Accelerated Value Creation (Limited Blind Pool Risk)**
It is generally less risky to bet on assets with which the GP, particularly a high-quality GP, is already familiar. GPs are keenly aware of the most pressing issues and opportunities to address within management, operations and the market in which the assets operate, leading to accelerated value-creation plans.

In many ways, GP-leds limit the blind pool risk generally associated with traditional private equity investing, and allow secondary buyers the opportunity to look through a portfolio or asset and diligence deals to a point where there are very few questions left unanswered.

5 **Lower Management Fees and Carry**
Management fees typically range from 0.50% to 1.25%. Tiered carry structures are normally used and the standard 20% carry is not achieved by the sponsor unless certain hurdles are met.

6 **Higher Underwriting Targets**
Both multi-asset and single-asset GP-leds are being underwritten at higher net multiples than diversified LP portfolios.

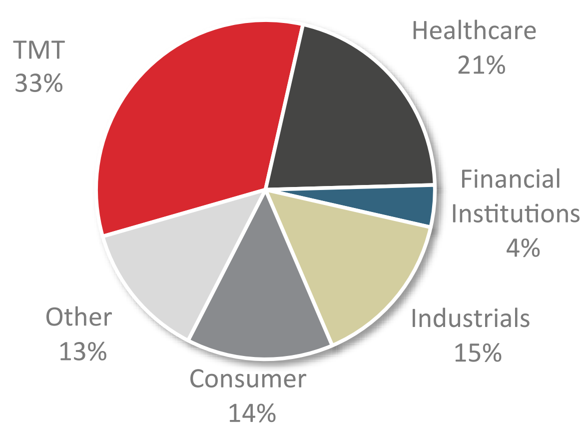
7 **Favorable Supply and Demand**
Since 2015, GP-leds have gone mainstream with brand-name sponsors, and since 2018, 'trophy assets' have surged in the deal flow opportunity set. GP-led transactions accounted for an estimated USD 62 billion of secondary transaction volume in 2021 – approximately half of overall market activity. There is more GP-led deal flow than ever before and the sponsor and asset quality is the highest it has ever been.

8 **More In-depth Portfolio Information**
GP-leds differ from traditional secondary transactions in that buyers gain access to data rooms that contain in-depth portfolio information beyond a fund's regular reporting. This allows for deep direct-style diligence of the assets in the portfolio and further reduces blind pool risks. This enables a secondary buyer to properly assess the asset, the industry, and the ability of the GP to execute on its operational and value-creation plans.

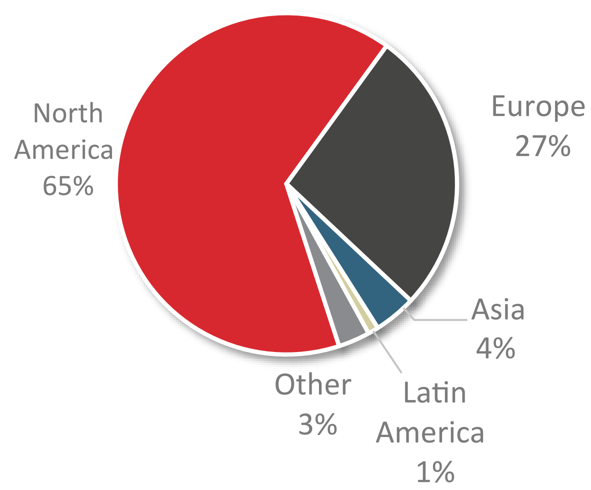
9 **Diversification and Portfolio Construction**
GP-leds are more concentrated transactions: the majority of multi-asset continuation funds have three to six (with some concentration in the top 3 assets). In addition and as mentioned earlier, single-asset continuation funds represent a large portion of GP-leds. This concentration allows a knowledgeable secondary buyer to target specific industries, assets and geographies – this may be particularly important during periods of inflection in the global economy.

Figure 3: 2021 GP-led Deals Breakdown [7]

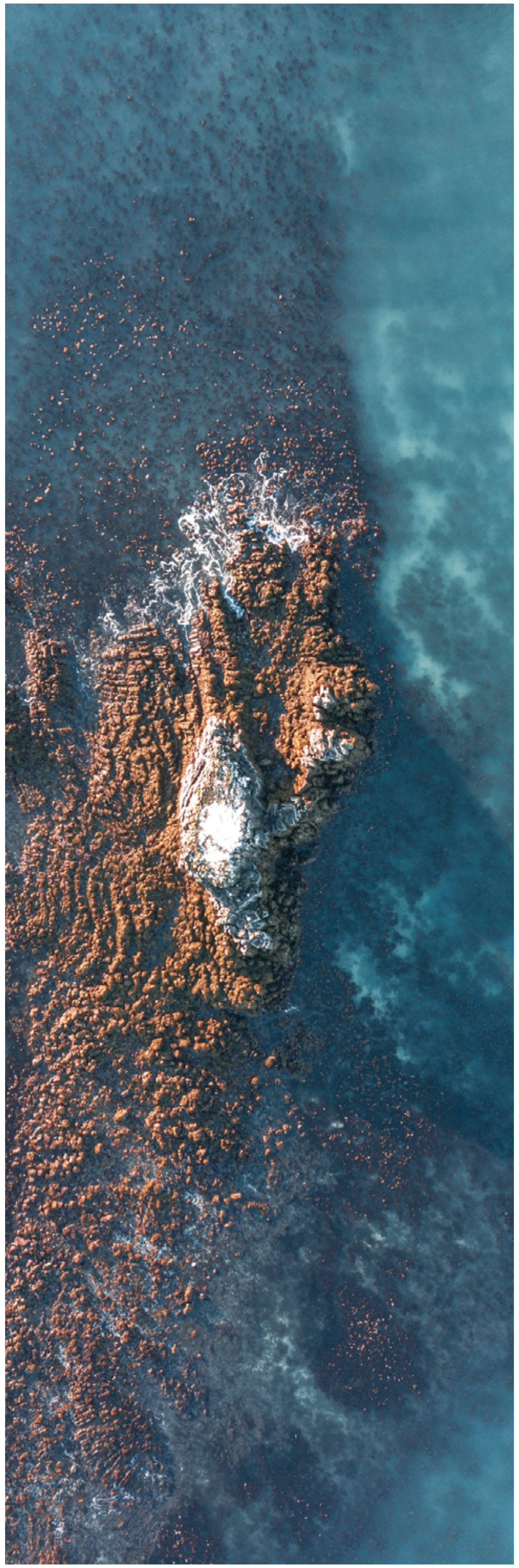
By Industry of Underlying Companies



By Geography of Underlying Funds



[7] *Evercore Private Capital Advisory 2021 YE Secondary Market Survey (January 2022)*



WHAT ARE SOME RISKS ASSOCIATED WITH GP-LED SECONDARIES? AND WHAT SHOULD INVESTORS CONSIDER?

In general, GP-led secondary transactions can provide a number of benefits: optionality and liquidity for LPs; allowing LPs to restructure their portfolio; adding more time and capital to assets and therefore additional potential value; and incentivizing the GP. They are not however without risk, and given the many potential conflicts of interest, should be approached carefully.

Each GP-led deal is unique, and so there is no “one-size fits all” approach to considering a transaction. It’s therefore important for investors to consider the merits of each transaction individually as well as within the context of their broader portfolio. While deal terms and the quality of the manager and underlying asset are important considerations, the following are a selection of others.

Risk	Considerations	Mitigants

Asset concentration	GP-leds often concentrated on 3-4 key assets	• Portfolio construction
		  ▪ No single company to exceed a certain threshold (e.g., 3-5%)
		  ▪ Prioritize deals with several value drivers
		• Focus on the ‘trophy assets’: the finest historically-performing assets, managed by top quartile funds and managers
		• Focus on resilient businesses with little debt
		• No leverage on GP-leds
		• Have an appropriate unfunded envelop for unforeseen capital needs
		• Preferred equity structures can provide downside protection

A lot of capital is chasing ‘resilient’ deals in the ‘Covid Era’	Resilient sectors (Healthcare, IT Services, Consumer staples) particularly sought after by investors – leading to higher entry multiples	• Investors with the following characteristics have, and will continue to have, access to more attractively priced opportunities:
		  ▪ Relationships with a wide network of GPs (e.g., secondary funds operating within a large primary platforms) can provide a sourcing advantage
		  ▪ Operating in the less competitive market segment: the small end of the mid-market equals less competition

Selected other considerations	
Additional costs and reporting requirements	In a GP-led deal, LPs are required to invest in a newly-formed investment vehicle, potentially creating the need for substantial additional due diligence related to legal, tax, accounting and reporting obligations. If these activities require engaging other third parties or outside legal counsel support, it may result in further costs for LPs.
Legal: Ensuring GP alignment/ commitment	A GP’s commitment is a strong indication of their faith in a deal or asset; a small commitment may suggest little belief in a deal, while a larger commitment can signal to buyers that they are significantly aligned with the GP.
Price setting mechanisms & conflicts of interest	GP-led secondaries transactions can create a number of conflicts of interest given the potential benefit to GPs on both sides of the transaction. In accordance with their fiduciary duties, GPs should disclose all conflicts and potential risks of the transaction to the buyer and be aware of potential scrutiny from relevant regulatory bodies (e.g. SEC).
Valuation	Valuation of an asset or of a fund’s portfolio can be challenging in turbulent markets. Fairness opinions, transparency and third party valuations can help to address potential issues around a fair purchase price.

THE LINK BETWEEN ESG AND GP-LED SECONDARIES

ESG TAKES CENTER STAGE FOR REGULATORS – WHAT IT MEANS FOR GP-LED SECONDARIES

Awareness of issues related to environmental, social and governance ("ESG") have increased significantly over the last few years. Once a relatively small part of the conversation, ESG is now driving discussions and influencing corporate agendas globally. While changes around ESG have historically impacted the public markets, private equity as an industry has become pulled in as LPs, portfolio companies and other stakeholders are becoming increasingly vocal and demanding more sustainable and socially responsible behavior from managers.

Regulators have also been quick to formalize around ESG. in March 2021, as part of the European Commission's Sustainable Finance Action Plan, the new Sustainable Finance Disclosure Regulation ("SFDR") was introduced, requiring fund and asset managers in the EU or marketing in the region to disclose certain information on ESG considerations to investors on their websites and collateral. While SFDR is a disclosure framework, it supplements existing transparency requirements under the Alternative Investment Fund Managers Directive, and will surely be followed by more guidance and requirements from regulatory bodies.

In November 2021, The Institutional Limited Partners Association ("ILPA") released a new ESG due diligence questionnaire and a diversity metrics template to help with ongoing monitoring of progress related to diversity, equity and inclusion and other topics. The refreshed ILPA DDQ includes sections on co investments, credit facilities, data security/ technology, and – notably – a dedicated section (6.0) for GP-led Secondaries / Continuation Funds. The questions focus on transaction details rather than specific ESG topics, but since it is included in the overall ESG DDQ, it's significant because it shows that GP-led secondaries are given the same level of scrutiny as more established asset classes and topics (e.g. co-investments, credit facilities) when it comes to ESG due diligence and transparent disclosures.

CLIMATE RELATED DISCLOSURES: THE NEW NORMAL?

Last year in the U.S., the Securities and Exchange Commission ("SEC") announced that it had created a Climate and ESG Task Force in the Division of Enforcement comprising more than 20 members – a sign that ESG, and in particular climate change, is being looked at from a financial risk perspective by the agency. More recently, in March 2022, the SEC proposed rule amendments, which would require registrants (including public companies) to disclose climate-related metrics in registration statements and periodic reports – in line with TCFD recommendations. The new requirements, which if adopted, would take effect in fiscal year 2023 at the earliest, and would mean that any privately-held company preparing for a listing would need to comply with the SEC rules and disclose key climate-related metrics. Due to the pass-through nature of reporting requirements, private (even foreign) companies may be subject to emissions reporting if they are suppliers or customers to, or even received investments from, any public companies subject to the proposed rule. The potential for new SEC rules may be daunting when considering the already existing disclosure regulations in Europe. However, for GP-leds in particular, the rules could allow asset managers in the U.S. an additional layer of information that could improve analysis of climate-related risks and opportunities, which at present are still often lacking or represent poor data quality.

As part of our firm's Net Zero Asset Management pledge and ambitious 5-Year Climate Plan, our secondaries and primaries platforms have committed to investing predominately in managers who consider GSH reduction targets and direct GHG emission underwriting and reduction planning.

HOW THE GP-LED DEAL PROCESS SUPPORTS ESG INVESTING

The unique qualities of GP-led deals allow for ESG levers to be pulled at the due diligence phase and other stages in the transaction process. Given the direct-style due diligence of GP-leds (where GPs are eager to engage and share information with potential buyers), in many ways, these transactions allow for a more transparent process and much more comprehensive review of the GP's underlying assets, including how they impact or are impacted by ESG issues – an attractive quality to investors wanting to align to sustainable, environmental or net-zero investment portfolios.

The main difference with GP-leds that allows them to uncover and add value to ESG-conscience investors is when the buyer investigations turn to review of the GP/fund manager itself.

- Potential buyers can press a GP on any ESG red flags at the manager, fund and/or asset level, sometimes fast-tracking remediation initiatives
- With GP-led deals, secondary buyers can meaningfully vet a portfolio or asset, speak with the management teams and more completely understand how the business is positioned

A distinct advantage for secondaries investors (as opposed to primary investors) is being able to scrutinize existing assets already in the portfolio, allowing for greater degree of insight and risks. Ultimately, GP-leds inherently create access to information and create very little to no blind-pool risk to the buyers, which means no question about the deal goes unanswered.

CAPITAL DYNAMICS' APPROACH TO GP-LED SECONDARIES

OUR GP-LED CO-INVESTMENT STRATEGY

Focus on smaller deals

- Focus on **smaller GP-leds** with USD 20-200 million of an area of the market characterized by higher target returns and direct-style diligence
  - This segment of the market has by far the highest number of deals and is much less competitive because larger funds (which make up the bulk of the secondaries market) rarely pursue GP-leds with less than USD 200 million of FMV
  - By the same token, there are very few experienced buyers at the smaller end of the secondaries market with the experience to lead more complex GP-led transactions, from both a structuring and underwriting perspective

Create portfolio diversification

- Target a composition of at least 75% GP-led transactions, and up to a 25% exposure to high-quality LP fund interests for **enhanced diversification** benefits
- Prioritize investment in resilient industries (e.g. consumer staples, healthcare, IT services) resulting in **prudent portfolio construction and risk management**

Leverage our broad sourcing abilities

- Sourcing enabled by a strong **information advantage** achieved by leveraging our primary, co-investment and credit platforms
- Regularly monitor developments of 350 managers and over 700 funds
- Leverage our footprint across 14 offices in Europe, North America, Asia and the Middle East, allowing us to **'chase value' globally**

Deploy a specialized skillset

- Take advantage of **structuring benefits**, as GP-leds are directly negotiated and can therefore be structured with enhanced downside protection (e.g., preferred equity)

How Capital Dynamics evaluates GP-led secondaries opportunities

Criteria	Descriptions	Relevant Capital Dynamics Deal Examples
Attractive Industries	• Resilient industries with an emphasis on Consumer staples, Healthcare and IT services • Strong secular Growth and Tailwinds • High barriers to entry and low risk of substitutes	**PROJECT A** A selected portfolio of consumer, IT and logistics business in the biggest Asian market
High-quality Assets	• 'Trophy assets' that quality sponsors want to hold on to • Strong market power, defensible market position • Superior financial performance, attractive growth prospects • Experienced management team with skin in the game	**PROJECT B** A portfolio of European tech leaders in the healthcare and services space
Favorable Deal Dynamics/ Terms	• Emphasis on smaller GP-leds outside of processes, lower effective entry valuations • Negotiated downside protected structures (e.g. preferred equity), deferrals on the purchase price • Outdated reference dates leading to higher effective discounts to fair market value • Lower management fees and tiered carry structure	**PROJECT C** A selected portfolio of consumer and healthcare businesses in the emerging markets underpinned by a preferred equity structure
Strong Value Creation Plan	• Operational improvement and/or cost savings opportunity • Accretive M&A opportunity	**PROJECT D** A portfolio with well-defined value creation revenue and cost levers
Mitigation of the "J-curve"	• Target holding periods of 3-5 years, early liquidity anticipated on a portion of the fair market value • Sponsor already owns and knows well the asset therefore can quickly continue developing the business plan • Assets at favorable "inflection points", about to benefit from growth & profitability scaling effects	**PROJECT E** A portfolio of growth equity companies which has returned 0.5x of its cost within one year of closing
High-quality and Aligned Sponsor	• Brand name sponsors with demonstrable track records of success, typically on the Capital Dynamics 'Core managers' list • Highly relevant investment and operating experience • Strong alignment through 100% rolled carried interest and increased GP commitments	**PROJECT F** A consumer and healthcare portfolio with one of Capital Dynamics' core European managers

WHAT'S NEXT FOR THE GP-LED SECONDARIES MARKET?

CONTINUED GROWTH EXPECTED

Why now is a good time to be invested

While a young asset class, GP-leds now constitute the majority of the secondary market, accounting for about half of the total secondary volume in 2021. GP-leds are continuing to evolve and become more widely used by the broader private equity market.

Fast-growing opportunity set	+	Increasingly high-quality transactions	=	...Opportunity to 'cherry pick' to create high-quality portfolios...	...with anticipated returns accretive to 'traditional' secondaries
GP-leds normalized as viable alternatives to traditional routes to exits and liquidity equals huge new deal flow pipeline Major Investment Banks entering the market to expand their advisory capabilities Growth across all geographies (Europe and Asia catching up) plus fast growth of lower-middle market transactions		Brand name GPs participating 'Positive selection bias': opportunity set skewed towards the most attractive assets GPs wish to continue to manage ('keep the winners') 'De-risked' assets familiar to GPs		Exposure can be finetuned to desired industries and sectors (e.g. over allocation to Consumer staples, healthcare and IT services - more resilient industries)	Multi-asset GP-leds underwritten to 1.70-2.0x net Majority of firms underwrite single-assets to returns of greater than 2.1x net The GP-leds investment thesis is increasingly validated from the first realizations

RECENT TRENDS IN GP-LEDS

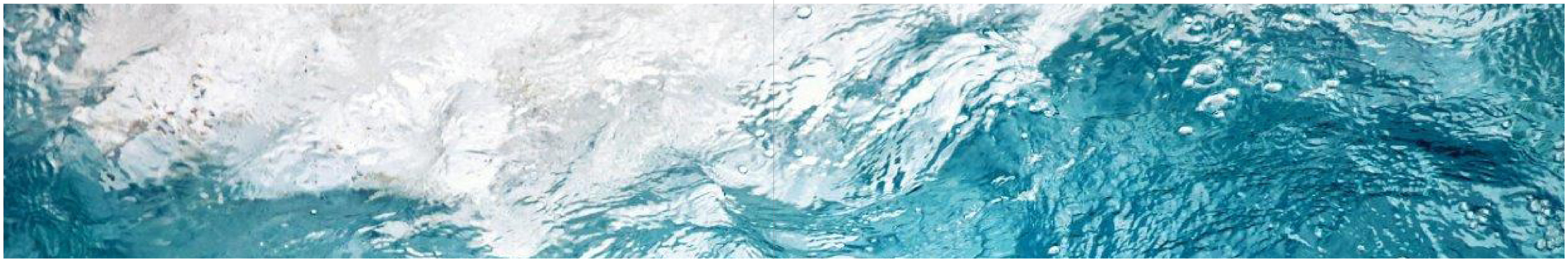
Rise of Single-Asset Continuation Funds and Emergence of Strip Sales

Single-asset continuation funds have continued to gain favor and market share. While GP-leds have largely driven the growth of the secondaries market, a closer look reveals that even within the GP-led deal volume, the primary driver of GP-leds has been continuation vehicles. While multi-asset deals made up the majority – 46% – of GP-led volume in 2021, single-asset continuation funds followed closely behind and contributed 39% to the total GP-led volume within the same time period, representing an increase of 8% from 2020 according to the January 2022 Global Secondary Market Review by Greenhill, a secondary market intermediary. Because single-asset transactions allow GPs to hold on to their highest performing assets, they became a valuable solution in 2020 and 2021 to resolve short-term negative performance caused by the impacts of the pandemic. Once referred to as 'zombie' funds involving underperforming or tainted assets, perspectives have shifted since the beginning of the pandemic, and recent transactions have shown that single-asset deals increasingly involve more blue-chip sponsors and their best-performing asset.

Figure 4: Select recent examples

- **GIP's USD 4.2 billion** sale of a 50% stake in Gatwick Airport to a continuation fund (2019)
- **3i's USD 3.02 billion** sale of Dutch discount retailer Action to a continuation fund (2019)
- **Warburg Pincus' USD 1.5 billion** sale of Allied Universal to a continuation vehicle (2019)
- **CapVest's USD 1.5 billion** sale of Cirium Pharma to a continuation fund (2020)
- **Clearlake's USD 2 billion** sale of DigiCert to a continuation fund (2021)

This trend has increased buyer appetite for these types of deals, and if this corner of the GP-led market follows the rising tide of the broader secondary market, the outlook looks promising.



EMERGENCE OF STRIP SALES

In a period marked by high valuations, private equity firms are looking to tap unrealized value by selling well-performing assets that have hit concentration limits at the fund level with strip sales. In strip sales, a private equity firm sells a percentage of the holdings in all or some of the underlying assets in its funds to a special purpose investment vehicle backed by one or more secondary investors, but still managed by the private-equity firm. Strip sales have generally made up a very small percentage of overall secondary transaction value, accounting for 4% of the USD 134 billion total secondary deal volume in 2021 and about 3% of the USD 60 billion in total secondary deal volume in all of 2020, according to a January 2022 report from Greenhill & Co.

Strip sales are also attractive because they allow growth equity and venture capital funds with unrealized gains in their funds a way to generate liquidity for their investors, often also increasing distribution to paid-in capital (DPI) from their funds, which reflects the realized, cash-on-cash returns generated by fund investments at a certain valuation date. Generating DPI and liquidity for fund investors is particularly useful to managers that are pitching new funds.

CONCLUSION

The GP-led secondaries market has evolved immensely over the last few years, more than doubling in size in the last year alone. These transactions vary in complexity and size due to the unique characteristics of each portfolio of assets and motivations of the seller. For existing investors, the benefits are in realizing strong returns, and in many cases having the option to remain in their investment. For new investors, gaining access to attractive and otherwise unavailable assets is particularly enticing. GP-led secondaries transactions have proven to be a useful tool for managers to generate returns and meet investor objectives, and they will no doubt continue to evolve and become more prevalent in the future.

Awareness of issues related to ESG have increased significantly over the last few years. Once a relatively small part of the conversation, ESG is now driving discussions and influencing corporate agendas globally. The unique qualities of GP-led deals allow for ESG levers to be pulled at the due diligence phase and other stages in the transaction process. In many ways, these transactions allow for a more transparent process and much more comprehensive review of the GP's underlying assets. With a greater degree of scrutiny applied to GP-leds compared to traditional transactions, there are now many ways for both buyers and investors to identify and remedy ESG related risks.

Capital Dynamics' strong relationships with more than 350 global mid-market managers, combined with a focus on smaller GP-led opportunities, allows us to source and capture many GP-led secondaries, while achieving favorable terms and structures and reducing downside risk.

ABOUT CAPITAL DYNAMICS

Capital Dynamics is an independent global asset management firm focusing on private assets, including private equity (primaries, secondaries co-investments), private credit, and clean energy. Created in 1988, the Firm has extensive knowledge and experience raising closed-ended funds and developing solutions tailored to meet the exacting needs of a diverse and global client base of institutional and private wealth investors. As of Q1 2022, Capital Dynamics oversees more than USD 13 billion in assets under management and advisement[8], and employs approximately 160 professionals globally across 14 offices in Europe, the Middle East, North America, and Asia.

With over three decades of experience, Capital Dynamics has developed long-term relationships with over 350 private equity fund managers globally, enabling powerful and propriety deal flow across primaries, secondaries, co-investments, and private credit opportunities.

Capital Dynamics Clean Energy is one of the largest renewable energy investment managers in the world with one of the longest track records in the industry. The Clean Energy strategy was established to capture attractive investment opportunities in the largest and fastest growing sector of global infrastructure – proven renewable energy technologies, with a focus on utility-scale and distributed generation, solar and wind. The Platform's asset management affiliate provides highly-specialized services to help ensure optimal performance and value from projects.

Capital Dynamics is a recognized industry leader in responsible investing, receiving the highest marks from the UNPRI for its Strategy & Corporate Governance, and investment strategies. The Firm combines robust returns with market-leading ESG practices, including designing, implementing and trademarking the Capital Dynamics R-Eye™ Rating System – a unique, best-in-class approach to diligence and rating of each investment based on UNPRI principles and UN Sustainable Development Goals.

[8] *As of March 31, 2022. Assets Under Management are calculated based on the total commitments as of the final closing date for all funds currently managed by Capital Dynamics, including amounts that have been distributed. Assets Under Advisement includes assets for which Capital Dynamics provides services such as reporting, monitoring and risk management.*

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