KEYNOTE INTERVIEW

A step-by-step guide to GP-led deals

From selecting a lead buyer to rolling over carry, Charles Smith, CIO and managing partner at Glendower Capital, outlines the key components for completing a successful GP-led secondaries deal

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Q Which assets are most suitable for GP-leds? What are secondaries buyers looking for?

We have been executing GP-led transactions since our first fund back in 2006. In that time we have seen significant growth in the market for GP-led deals, but the underlying assets involved in these transactions have several themes in common. While GP-leds were something that historically happened at the tail end of a fund's life involving the left-overs of a fund, they are now taking place a lot earlier in a fund's life and often involve single, high-quality trophy assets. Today, GP-led portfolios are made up of strongly performing companies with stable, incumbent management teams and clearly defined strategies.

We look for what we call a join the dots strategy – we want the continuation vehicle to execute an extension of a proven strategy already being deployed. If the strategy for the GP-led is a buy-and-build, for example, we want that to be a continuation of that existing value-creation plan and not something that is brand new. If you can tick those boxes, then there are a variety of assets that can feature in GP-led deals.

Q How should firms be thinking about selecting a lead and then building a syndicate?

The buyer landscape has evolved significantly. Any GP considering a GP-led transaction needs to understand the transaction dynamics, which are not the same as a typical sale process involving a secondary buyout, IPO or trade sale. These deals are tripartite negotiations between the GP, the secondaries buyer and the LPs in the fund. In that sense, they are more

complex and time-consuming for a GP to put together.

In these circumstances it can be difficult to run a process with 10 or 20 buyers so you need to think about the type of secondaries buyer you want to have as a lead and then go to a small number of firms to secure a lead counterparty.

Once the terms are agreed with the lead, you can then build a syndicate of investors that are willing to follow that lead. These are two separate processes – you need to find a lead that will not only write a sufficient ticket but that also has the credibility to bring others along with them. There are not that many players in the market today that meet those criteria.

Q Is there a difference between working with new entrants and more established players?

I think that established incumbents have more credibility when it comes to building that syndicate around them. When selecting a lead, you want to ensure you are working with someone that has done this before. You ideally want to reference that lead with other GPs that have worked with them on GP-leds. That is important because these are long-term relationships.

There will be issues that crop up through the course of that relationship and you need to be partnering with someone that has the capability and bandwidth to engage on those issues. Experienced secondaries investors are more likely to have that bandwidth and experience to engage meaningfully.

Q How much time should a GP expect one of these deals to take from launch to execution?

The process involves the sale of the asset and setting up the continuation vehicle, as well as syndication if there is more than one secondaries buyer involved. There is also usually an LP election period, when the LPs make their roll or sell decision. These deals are reasonably time consuming, but they typically complete within six months.

Q How should the GP manage its LPs?

LPs are extremely busy today with new investments, re-ups and now these roll or sell decisions, so it is important for GPs to flag the fact that they are considering a GP-led early on, particularly with the LPAC, in order to give them sufficient time to digest the proposal. When an election process is launched, the wider investor base should be given a reasonable amount of time, as well as adequate information to make an informed decision.

Q How should GPs persuade more critical investors of the merits of the transaction?

First, the GP needs to be clear about the commercial rationale. Why does it make more sense to go down this route than to sell or IPO the business? Second, the GP should position the continuation vehicle as an option that the LP can either choose to exercise or not. They have the choice of achieving liquidity now or gaining additional value by going round the block again with an asset they will have got to know through the initial hold period.

It is worth noting that many of these LPs will need to take the decision up the chain to their own committees, so I would re-iterate that providing adequate time for them to do so can smooth the process on both sides.

Q How much carry will the GP be expected to roll over and why is that important for buyers?

Alignment is critical for secondaries buyers. We look to ensure that the GP is thinking about this transaction with a buyer's hat on as much as a seller's hat. We are therefore looking for the majority of carry to be rolled over. If there are individuals who have left the firm there may not be a need to roll over, but as far as the team involved in the ongoing management of the vehicle is concerned, that carry rollover should be virtually 100 percent. In some cases, we see re-investment above and beyond this initial rollover.

Q What about investing from a subsequent fund?

That is another way of demonstrating alignment, particularly if it is a significant investment for the successor fund because it means that the GP is clearly committed. However, in this scenario, the secondaries buyer needs to consider the implications of the duration of the hold period. If there is a new fund making an investment, the expected hold period may be five or six years, compared to the perhaps three or four years that secondary buyers may be looking for.

So, yes, investment from a successor vehicle can make sense but that investment needs to align with the strategy and hold period that the GP is proposing for this asset or assets in order to be additive.

Q Does the same deal team need to manage the asset?

As I mentioned at the outset, what we are looking for in these deals is continuity. That includes continuity of the deal team as well as in terms of the underlying company management team.

Q Can the GP ask for a primary staple?

As a secondaries investor, staples can be difficult. There are different ways of making new capital available for these assets if the rationale is there. But investing in a new primary fund does cause issues, particularly around the duration of the investment. It can also create conflicts of interest between the GP and its investors because it can look as though the GP is subsidising that LP investment through the GP-led. It is much cleaner if the two are separated. ■