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Secondaries Innovation: Four Deals and Funds Shaping the Market in '24

By Tom Stabile
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Private fund secondaries have continued their fast evolution this year, as new moves signal where the sprawling market may be headed, including a mega-sale of limited partner stakes between Ares Management and Blackstone and what may turn into the first second-generation continuation fund.

A market that a decade ago largely focused on limited partners quietly selling off their stakes in private equity funds to a small group of dedicated secondaries managers has grown into a teeming bazaar with inventive transfers of ownership, complex fund structures, a wider array of asset classes and growing ranks of investors and managers taking part in deals.

The market's innovative streak has continued, especially during a lean stretch for many private market asset classes, with far lower deal volume and fundraising activity sending managers and investors to search for ways to get capital moving.

"Who knows when the market's liquidity will come back in full force?" said Liz Campbell, chief investment officer at FS Investments' Portfolio Advisors affiliate. "We've been in a prolonged period without liquidity where we're seeing more creativity on the structuring side. Managers are getting more creative because investors are getting more antsy."

The private markets are increasingly under-capitalized, and despite a "hot" market for both limited partner-driven sales of fund stakes and general partner-led deals, there is far less capacity from secondaries managers to handle the growing demand for liquidity, said Tosin Adeyeri, a partner in the funds department at Travers Smith.

"You would have to live under a rock to not realize the amount of deals that are available," she said. "That liquidity crunch will continue to drive the market."

Four notable deals and funds this year may point to the direction where demand may pull the market and where managers may continue expanding the secondaries toolset.

Mega-Swaps
Ares, which jumped into secondaries in 2021 with its purchase of Landmark Partners, executed its largest secondaries deal ever last month, buying a $1.1 billion portfolio of diversified limited partner stakes. But instead of buying the stakes from institutional investors, Ares instead acquired them directly from peer private fund manager Blackstone's Strategic Partners secondaries unit, according to a Bloomberg.

Another recent deal in that vein also topped $1 billion, with Goldman Sachs acquiring a portfolio of secondaries stakes from HarbourVest Partners.

Secondaries managers occasionally "trade" portfolios, but the notable aspect of these deals is their size – and the likelihood that more will follow, said Mike Bego, managing partner at Kline Hill Partners.

Much bigger secondaries funds – and their managers' need to deliver liquidity to their own investors – are key drivers, he said. One market broker this year indicated that 25% of its deal inventory was from secondaries managers, Bego added.

And larger secondaries funds also must deploy the capital they've raised, making huge deals a likelier phenomenon in the future, Campbell said.

Semi-Liquid Push

A hotbed of secondaries activity is developing in the high-net-worth advisor market. A rush of new private equity-focused interval funds, tender-offer funds and holding company structures – as well as vehicles more narrowly aimed at secondaries from Ares and Apollo Global Management and Carlyle – are starting to deploy capital into the secondaries market.

A private equity tender offer vehicle from J.P. Morgan offers one example. It allocated to a continuation fund from Ufenau Capital Partners and acquired a stake in Kohlberg & Co.'s ninth fund, according to a presentation earlier this month.

The amount of capital in these semi-liquid, non-traded vehicles is limited now, but will start to make an impact as they grow over the next few years, Campbell said. They most likely will compete to acquire limited partner, or LP, stakes or invest in continuation funds, she said.

"What happens if these funds get to five or 10 times their current size?" she said. "There is still so much supply out there of deals. But this would shift the supply-demand imbalance."

Many of these semi-liquid evergreen funds are from large managers such as Apollo, KKR, Partners Group and Brookfield Asset Management, and have big growth targets, said Will Normand, partner on the funds team at Travers Smith.

"These managers are putting a lot of resources, time and effort into these vehicles," he said.

An aspect to watch will be how these evergreen vehicles invest capital, which they collect from investors up-front, creating more urgency to deploy into deals, Bego said. "They're paying a lot more than other secondaries managers," he said.

Continuation Fund Doubles

Continuation funds – an increasingly popular model where private fund managers hang on to trophy portfolio companies by selling them into purpose-built follow-on vehicles – have grown rapidly since 2020. The depressed private fund exit market has made them even more relevant.

Now comes a twist – a continuation fund assembled in 2019 by PAI Partners may soon spawn its own continuation fund, as the manager explores options to hang on to its stake in Froneri, an ice cream business, according to Bloomberg.

Will continuation funds of continuation funds become the next big thing?

"We've seen it, we're hearing others talking about it," Bego said. "It's another mechanism to increase liquidity and provide an exit to investors, and also because of the increasing value of the underlying assets themselves."

The earliest deals will be important to watch, as they may set the tone for investor reception and appetite, Campbell said.

Venturing Forth

Venture capital has been somewhat late to the secondaries phenomenon. But the segment is growing, including a fund from Pinegrove Capital backed by Brookfield and Sequoia Heritage that aims to amass $1 billion in the market this year.

Kline Hill also closed a $105 million fund last month alongside Cendana Capital aimed at early stage venture funds, and StepStone Group is raising its sixth venture capital secondaries fund.

The market has many of the same drivers as other asset classes, Bego said. "LPs are cash-starved with regard to their venture and growth investments," he said.

Venture secondaries deals often feature much bigger ranges of discounts offered by buyers, in part because of the uncertainty of valuations for companies that are early in their lifecycles, but also because of the market's general turmoil since last year, especially after the collapse of Silicon Valley Bank.

"You have to proceed with caution," he said. "There are companies on life support, companies with funky cap tables... We're going after the ones we know are good."