Mergers & Acquisitions
How Will PE's Liquidity Crisis Resolve Itself?
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With around 29,000 companies held in private equity portfolios, experts say there aren't enough potential buyers out there to acquire them all. Thus, providing liquidity to LPs in spite of the excess is a systemic challenge. How will it wind up? Dealmakers weigh in.

Private equity's liquidity crunch has prompted different explanations over recent years: The denominator factor; the gap between buyer and seller price expectations; macroeconomic uncertainty, and so on. But last year, at least, the issue could be distilled down to a simple equation: LPs received less money from exits than the $600 billion they were asked to commit to new deals.

With limited distributions to paid-in capital (DPI) returned from exits, LPs struggle to finance new commitments. And for GPs, failure to return capital to investors makes fundraising harder. Or, as one speaker at the recent SuperReturn conference in Berlin put it, "No DPI means you die."

"The PE industry needs somehow to deliver liquidity over time or it won't be the growing asset class it is," says David Wachter, founding partner and CEO of W Capital Partners, which specializes providing GP solutions, or offering secondary liquidity for minority stakes in GP portfolio companies to free up capital.

"The industry has gotten so big that there's no one to buy all those 29,000 companies," Wachter tells Mergers & Acquisitions. The very success of private equity in acquiring assets and taking public companies private, has resulted in fewer public companies and strategic buyers to acquire companies from PE owners, he says.

"The industry has effectively cannibalized its own exit," he says. "Hence the need for a direct secondary market."

As of the first quarter, there were small signs of an upturn. Last year's $468 billion in global buyout exit value was made up of continuation vehicles worth around $70 billion; some $116 billion in minority equity sales; and the rest in classic M&A, according to Bain & Co. recent annual PE report. Sponsor-to-sponsor deals and IPOs were up 34 percent over 2023. That was the good news. But the total was well below the five-year average of $540 billion. As a percentage of the $4.2 trillion in total buyout assets under management, it was one of the lowest on record, at just 11 percent.

Continuation Vehicles are Driving Liquidity

For now, the buzz in the industry is all around GP-led continuation vehicles as a way to provide liquidity to LPs. Mike Bego, managing partner of lower mid-market secondaries firm Kline Hill Partners, says that in GP-led deals, about 90 percent of existing LPs choose to exit because they need the cash. That is up from around 70 percent five years ago.

But Wachter argues that the 70 single and multi-asset CVs completed last year doesn't even scratch the surface of private equity's total portfolio. He says there are other ways to return capital to investors, such as traditional LP-led secondaries. Kline Hill, for instance, has separate teams working on GP-leds and LP-leds.

Wachter stops short of acquiring majority stakes, which he says is effectively sponsor-to-sponsor M&A and requires the GP to give up control. And he doesn't provide loans, which he argues add more leverage and are not an exit.

Private Credit's Impact

The growing private credit industry can also provide liquidity with lending to portfolio companies or NAV loans at the fund level. But here, too, many lenders counsel caution.

"We don't think burdening good companies with increased leverage is a terrific idea," says David Lyon, head of Capital Solutions at Neuberger Berman. He points out that the firm's credit is "not a substitute for debt capital, but only for equity capital that the sponsor is temporarily unable to provide. "There's a ton of talk about rescue capital in today's market, where PE assets that cannot sustain their current debt burdens are seeking non-cash instruments to relieve annual interest costs. We don't play in this arena.

"Not all managers share our point of view," says Lyon, adding that Neuberger only lends to sponsor-backed companies, never at fund level. "We never believe in piling on debt in unsaleable assets. It's a bad business."

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