Private Markets

# Private Market Secondaries

1H 2024 Market Outlook

BlackRock

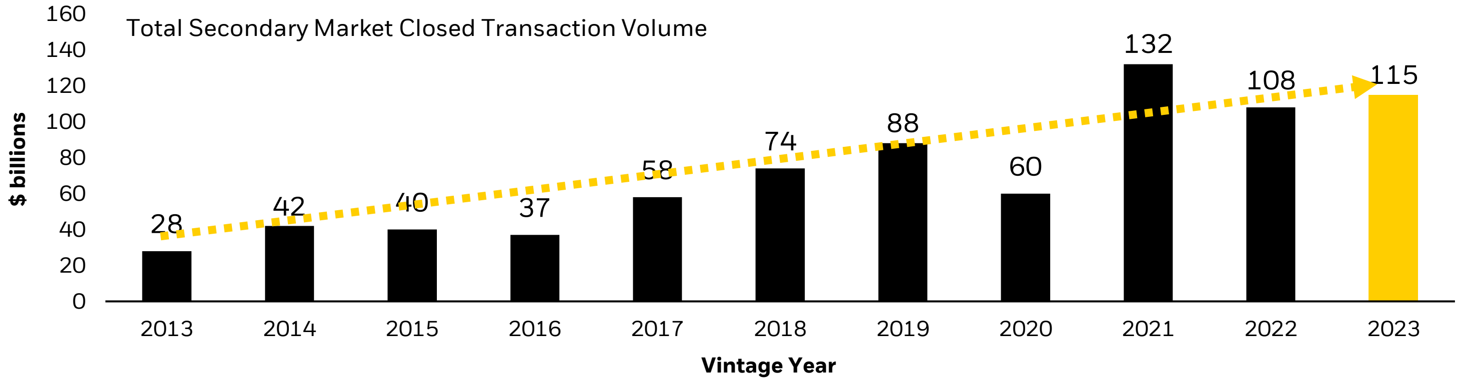
# A proven liquidity solution

1H 2024 Market Outlook

## Key Takeaways

- In 2023 we saw a continued search for liquidity which was met by robust buyer demand resulting in the 2nd highest year of closed transaction volume on record: $115bn.
- Traditional exit activity has slowed significantly, driving increased secondary market adoption by both LPs (55% of volume) and GPs (45% of volume).
- As supply continues to outstrip demand, buyers are achieving meaningful discounts (avg. 85% of NAV in 2023) for high-quality, diversified LP-led portfolios.
- Despite record fundraising of $117bn in 2023, growth in closed transaction volume has kept dry powder available to 1.3x closed volume, significantly below other private markets, creating a favorable buyer's market.

## 4x market growth in 10 years...




## ...and well positioned for continued expansion

| $10tn | ~1% → | $115bn | | $145bn | = | 1.3x |
|---|---|---|---|---|---|---|
| **Private capital NAV (2023)** | | **2023 secondary volume closed** | | **Secondary available dry powder** | | **Dry powder vs. 2023 secondary volume** |

With secondary volume representing only ~1% of total unrealized value in the private capital markets, the potential for continued growth of selling volume is significant. However, the availability of capital seeking secondary opportunities remains quite limited at 1.3x 2023 closed transaction volume. This compares favorably to the broader private equity market at a ratio of 4.5x. This report highlights the increased adoption of the secondary market by both LPs and GPs. With muted M&A and IPO activity, and the growth of active management, the market is presenting an unprecedented opportunity for secondary buyers.

Expectations may not come to pass. All dollar figures in USD. Source: Evercore – FY 2023 Secondary Market Survey Results, as of January 2024. Jefferies – Global Secondary Market Review, as of January 2024. S&P and Preqin fundraising data. Private equity strategies definition excludes secondaries and fund of funds.

# Continued strength in LP-led deal volumes

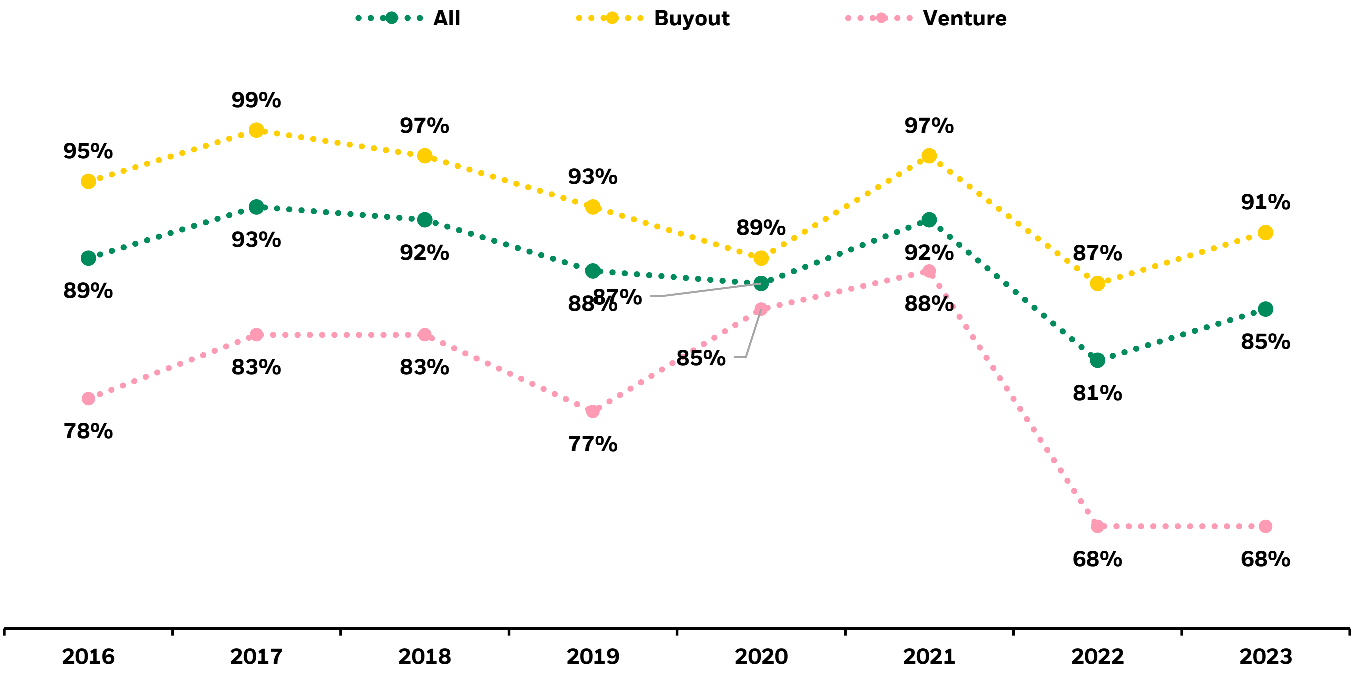
LP-led transactions maintained their prevalence throughout the year, comprising a majority of 2023 deal volume at 55% or $63bn, with closed LP-led transaction volume growing ~15% compared to 2022. The shift to more diversified transactions that we saw during 2022 continued, as sellers remained focused on monetizing high-quality funds or portfolio strips to manufacture distributions in the face of slower exit activity from traditional sources of liquidity. This can also be evidenced by shifting seller rationale, from portfolio rebalancing & PE overallocation being a leading cause in 2022 to generating liquidity & de-risking being the main consideration area in 2023[1].

As discussed in our 2H23 market outlook, on the buy-side, we experienced a flight to quality and renewed interest in younger vintages with greater perceived upside (w-avg of 2016 vs. 2014 in 2022), which helped narrow the bid-ask-spread, and was further supported in 2H23 by improving public market sentiment. Ample dry powder from record fundraises across the secondaries landscape also drove buyer interest (theme cont. on page 6), given the immediate diversification benefits of LP-led transactions and their ability to serve as a ballast to more balanced secondary strategies across various transaction types.

As alluded to above, discounts narrowed from 81% in 2022 to 85% in 2023 - with buyout-focused funds continuing to price stronger than other investment strategies.

**Secondary Market Pricing**

*(% of NAV)*




Source: 1 Jefferies – Global Secondary Market Review, January 2024. Source: Greenhill – Global Secondary Market Review - 1H 2023, June 2023. All dollar figures are in USD.

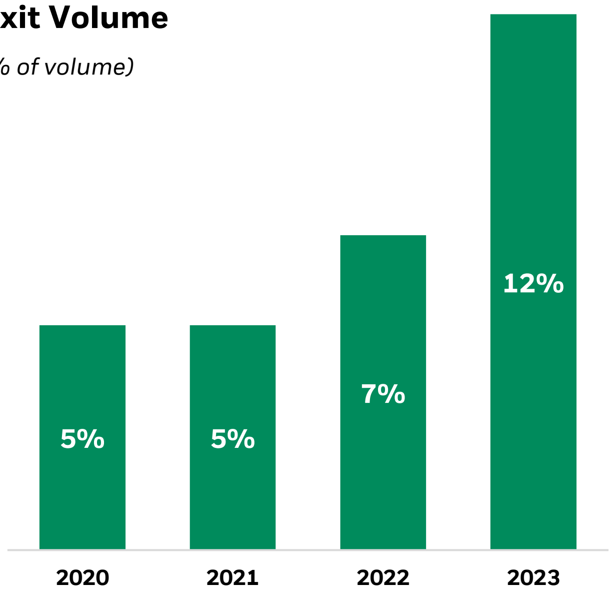
# GP-led deal volumes finish strong to end the year

The search for liquidity seen in the LP-led market has also permeated into the GP-led market and helped drive $50bn+ of closed GP-led transaction volume in 2023, which represents ~5% growth compared to 2022. From a buyer perspective, the bar was raised for GP-led transactions in 2023, with a particular focus on valuation, alignment and performance. From a seller perspective, LPs are increasingly expecting GPs to turn to the secondary market to offer liquidity for investors - as DPI is a key point of scrutiny in a challenged fundraising environment.

Over the year, we saw the recalibration in deal sizing in GP-led transactions, in favor of smaller deals that are more palatable for portfolio construction priorities and come with a higher certainty of close (i.e., less syndication risk). We saw this trend continue through 2023 as buyer appetite remained focused on mid-market opportunities with more attractive deal characteristics, which ultimately helped to narrow the bid-ask spread, with CVs often achieving 85%+ pricing.

**GP-led as % of Sponsor-Backed Exit Volume**

*(% of volume)*




Source: Lazard – Secondary Market Report, January 2024.; Preqin – Sponsor Backed Exit Volume

The staying power of the GP-led market and its broader acceptance can be evidenced by its growth relative to other traditional exit routes. While sponsor & strategic-backed M&A has historically been the most common exit path for GPs seeking liquidity, followed by IPOs, GP-led continuation vehicles comprised 12% of sponsor-backed exit volume in 2023 (up from 7% in 2022 and 5% in 2021). Further, 2023 GP-led secondary volume represented 76% of peak 2021 levels, compared to IPO volume of 20% and M&A volume of 39% - demonstrating the market's resilience in the face of a challenging macro backdrop.

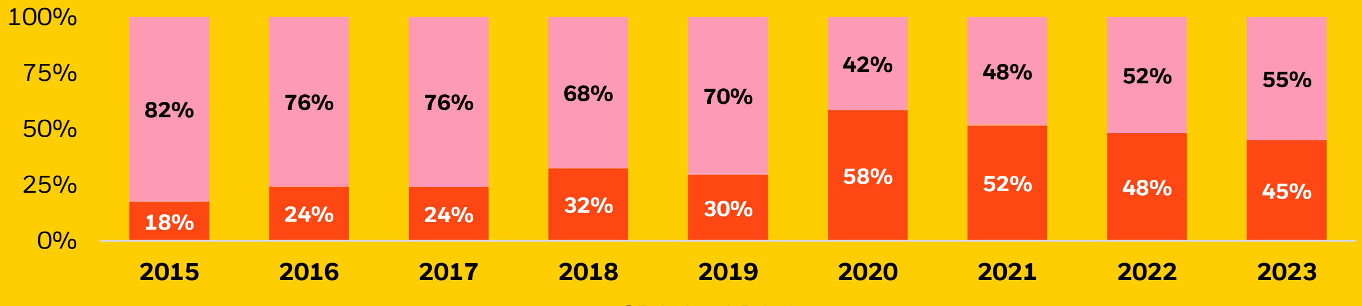
As we have seen over the past several years, there has been a material growth in the secondary buyer universe and 2023 was no different. Many new and established firms sought to build or enhance their secondary buyside capabilities. Given the breadth of information and relationships typically required to pursue LP-led opportunities at scale, we have seen many new entrants focus their initial foray into the secondary market on GP-led transactions, where there can be fewer barriers to participate.

Source: Jefferies – Global Secondary Market Review, January 2024. All dollar figures are in USD.

# Continuation Vehicles: Benefits & Considerations

Continuation Vehicles ("CVs") have grown considerably over the past five years as a tool for both LPs and GPs to manage their portfolios, and now represent nearly half of closed secondary transaction volume. With this rapid growth and increased adoption there is a healthy debate in the market regarding the benefits and considerations of these transactions. Below we review some commonly raised questions from the perspective of all participants, however it appears that CVs are here to stay as a powerful liquidity option.

**GP-led volume has grown to be a core part of the overall secondary market**




Source: Jefferies – Global Secondary Market Review, January 2024.

***How do LPs know they are getting a fair price?***

Fair valuations are rightfully a top priority for LPs. CVs are by nature conflicted transactions; however, market forces will ultimately lead to a fair and transparent valuation process. Secondary buyers know they must find a price that will solicit sufficient selling interest for a deal to materialize. Additionally, GPs know the importance of maintaining healthy relationships with their LPs. The increased focus from ILPA and the SEC on the valuation processes will also not only help to protect LPs but is a further proof point of the increased and sustainable relevance of CVs.

***What is the benefit to LPs?***

In a typical fund exit, LPs receive cash proceeds without the ability to maintain their exposure and with limited to no transparency into the process. With CVs, LPs benefit from an increased level of optionality through the ability to maintain exposure in the asset(s), which doesn't exist in traditional exits. The challenge is that many LPs are not resourced in a way that would allow them to take advantage of this optionality. Having the offer to roll their investment into a CV has caused some unrest at now needing to make an investment decision that they did not initially anticipate. However, in most structures, the default option is for LPs to take liquidity, which may be well received by LPs that find themselves overallocated in a slower distribution environment.

***How are the GPs incentives properly aligned?***

Alignment is critical for both the LPs and secondary buyers participating in the new CV. Understanding the GP's rationale for the transaction is a threshold question that should be asked to ensure the asset(s) will receive the same level of attention in the new structure as they did in the main fund. Typically, any carried interest the GP receives from the CV transaction should be rolled in the CV. Additionally, further alignment can be achieved by requiring incremental capital to be invested by the GP and/or the GP's current fund to show track record alignment.

As the market has evolved, GPs have used the secondary market to manage outsized portfolio positions, raise incremental unfunded capital for both defensive and offensive M&A, and realize strong performing assets that have achieved the targeted return for the current fund but also have strong future valuation creation opportunities. The ability to hold onto these assets creates substantially less friction with the company management and maintains capital structure flexibility since there is no change in control (i.e., the same GP is controlling the company even though the original fund is selling to the newly formed CV). Ultimately, the best deals are ones that provide a win-win-win for all parties involved.

## Secondaries fundraising reaches new heights

The secondaries market delivered record fundraising volumes of $117bn in 2023[1] on the back of allocators globally recognizing the strategy's ability to consistently deliver outsized returns in any market environment. The majority of private capital formation in 2023 was driven by secondary strategies, which saw fundraising volumes triple that of 2022. Specifically, ~60% of secondary private equity capital raised last year was driven by three large buyers[1].

Given the concentration of capital, there is now increasing evidence of return compression at the larger end of the market[2]. While the returns from the largest managers are still strong on an absolute basis, they are now more reflective of a secondary private equity index as those buyers are speaking for 30-50% of dollars deployed into the market each year. Outperformance still exists in the mid-sized space whereby players can exercise increased selectivity in less competitive transactions while having the resources to pursue the breadth of the market.

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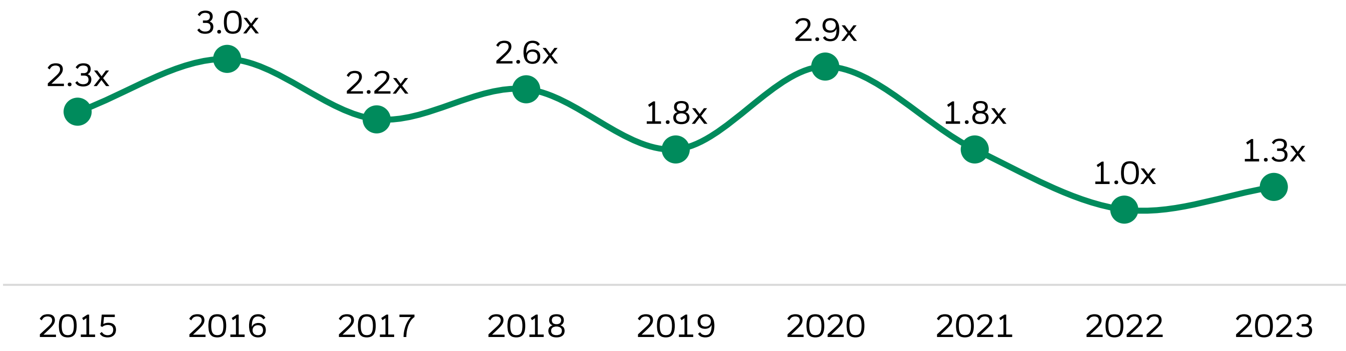
Despite record fundraising, the amount of dry powder relative to the broader secondary opportunity set remains highly attractive. According to leading secondary market advisors[3] the amount of dry powder in the secondary market only represents 1.3x 2023 transaction volumes, also defined as the capital overhang. This compares to the broader private equity asset class dry powder to 2023 transaction volume ratio of 4.5x[4]. In other words, secondaries remain relatively undercapitalized and with significant opportunities to find alpha.

**Secondary market capital overhang**




Source: 1 Secondaries Investor, as of 8 February 2024. 2 Performance per Preqin vs global secondary benchmark. 3 Evercore, Jefferies, PJT 2023 survey reports. 4 S&P and Preqin fundraising data. Private equity strategies definition excludes secondaries and fund of funds

# Navigating the Future: The Outlook for 2024

As we enter 2024 and look ahead, we expect many of the current themes in today's environment to continue and drive future expansion of the secondary market – on both the buy- and sell-side.

From a buyer's perspective, we believe that while constraints on traditional exit activity may begin to alleviate (i.e. IPO market re-opening), there remains a considerable backlog and demand from LPs and GPs to monetize their existing portfolios and achieve liquidity at scale – driving continued expansion of deal flow volumes and innovative transaction structures. Further, we expect that return benchmarks will continue to mature and there will be an increasing need to demonstrate differentiation among market participants.

From a seller's perspective, we anticipate that greater emphasis will be placed on portfolio quality to maximize price, as deal volumes continue to grow, and buyers look to be increasingly selective. Further, we expect sellers to adopt more programmatic approaches to secondary sales, and that first time sellers will remain active. Lastly, we expect that traditional secondary sellers will also become secondary allocators, beginning to incorporate secondary commitments as a core component of their private market exposure.

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