



KEY WORDS:

Omnigence Asset Management, Arvore Partners, equity, secondary, LP, GP, duration, distributions, DPI, portfolio exits, continuation funds, discounts, diversification, alternatives, portfolio rebalancing, exit channels, single-asset continuation fund, multi-asset continuation fund, Net Asset Value (NAV), discounts, deferred con-

INTRODUCTION:

sideration, preferred equity.

The secondary market for private equity has matured considerably in recent years. It is predicted to grow annually by 20%+ due to increased institutional participation positioning it as a critical asset class for diversified portfolios. Primarily this is due to liquidity needs and portfolio rebalancing by institutional investors. This evolution has significant implications for fund performance, pricing, and market dynamics, providing private equity investors with new avenues for both entry and exit.

1. Market Growth: Secondary market transaction volumes are on track to reach a new high of over \$140 billion by the end of 2024, driven by LP liquidity needs and increased GP activity in continuation vehicles. GP-led transactions, supported by continuation

funds, reached over \$50 billion in 2023. Pension funds, endowments, and insurance companies represent a significant portion of secondary market transactions due to their frequent need for liquidity and portfolio rebalancing. An estimated 45% of LPs engaging in secondary transactions are first-time sellers, highlighting an increasing acceptance of secondary transactions as part of portfolio management:

The secondary private equity market has seen substantial growth, reaching ~\$110 billion in transaction volume (2023). This expansion was driven by institutional investors seeking liquidity in the face of tightening interest rates and economic uncertainty. Notably, LPs are utilizing secondaries to rebalance portfolios, and GPs are leveraging them to extend asset holding periods, creating liquidity options when IPO and M&A exits are less available.

- Liquidity Needs of Institutional Investors: Traditionally, private equity is an illiquid asset class, locking up investor capital for many years, sometimes for over a decade, . However, many LPs, such as pension funds, endowments, and insurance companies, require liquidity to meet liabilities or rebalance portfolios. Secondary markets offer these LPs a means to monetize their holdings, enabling more dynamic asset liability management.
- Mature Portfolio Exits: As private equity portfolios mature, investors are
 increasingly looking to exit positions that may have longer holding periods
 than initially expected. Secondary transactions provide an exit route
 without needing the underlying assets to reach full liquidity events.
- Rising Volumes of Dry Powder. Secondary funds have accumulated a substantial amount of dry powder, as investor interest in private equity has surged in recent years. This capital has created competition among secondary buyers, increasing demand and liquidity for secondary transactions
- **2. Pricing Trends:** Discounts in the LP-led secondary market have narrowed somewhat in recent years, with pricing at ~80% of NAV, reflecting increased competition and stabilizing economic conditions. However, this is surely going to evolve over the near term as during economic downturns, average discounts to NAV widen as sellers seek liquidity, while buyers leverage the opportunity to acquire assets at attractive valuations:
 - **Pricing:** Historically, LPs had to accept significant discounts to net asset value (NAV), but today, pricing for secondary transactions has become more competitive, especially for high-quality assets and top-tier GPs. However, in the venture capital secondary market, discounts are typically greater, averaging around 70% of NAV due to perceived higher risk exposure, especially in earlier-stage funds.
 - Sector and Asset Class Variances: Secondary pricing varies across sectors and asset classes. For example, funds with high exposure to resilient sectors like technology or healthcare tend to command better pricing than those heavily exposed to cyclical industries. Additionally, primary versus secondary asset classes—like venture capital, buyout, or growth equity—can influence price discrepancies.

COPYRIGHT 2024 2

Secondary market pricing discounts to NAV reached around 84% on average as of mid-2023. Variations exist by asset class, with higher demand for assets in sectors like technology and healthcare, which often

fetch premiums.

- **3. Deal Structures:** Buyers and sellers now have more options for structuring deals, including partial sales, preferred equity investments, and structured liquidity solutions. These structures provide flexibility but also add complexity to pricing as investors seek to balance risk and return:
 - **GP-Led Secondary Transactions:** One of the most notable trends is the rise of GP-led secondary transactions, where the GP initiates the sale of assets to a continuation fund. This structure provides liquidity to existing LPs while allowing the GP to continue managing promising assets. GP-led deals have gained popularity, especially as exit markets slow down, enabling GPs to hold onto assets with potential for further value creation.
 - **Deferred Consideration:** Deferred consideration is a payment structure where part of the transaction's purchase price is paid later, often contingent upon the performance or milestones of the assets. In continuation transactions, deferred consideration helps align interests between the seller (usually the original LPs) and the buyer (often
 - secondary investors), who may have differing expectations on valuation and future returns. Deferred consideration reduces immediate capital requirements for the buyer and provides an incentive for both parties to maximize asset value over time. For sellers, it offers potential upside based on asset performance, which is particularly beneficial when selling into a GP-led continuation fund where the GP retains control of the asset. This structure mitigates risk for the buyer, especially if the underlying assets have strong growth potential but have not yet achieved full value realization. Deferred consideration provides flexibility, allowing GPs to continue managing and growing the asset before a portion of the value is finalized.
 - Preferred Equity: Preferred equity structures involve creating a class of equity that has priority in receiving returns before common equity holders. In continuation transactions, preferred equity can be used as a means of providing downside protection

The secondary market has seen a surge in GP-led transactions. These deals allow GPs to retain promising assets beyond the typical fund term while providing liquidity to existing LPs. For buyers, GP-led deals can offer attractive returns, with nearly 62% of investors targeting net internal rates of return above 20%. GP-led continuation funds now account for about 80% of GP-led market volume, offering GPs a way to retain valuable assets while giving LPs a chance to exit or roll over their investments.

- for new investors while still allowing existing LPs and the GP to benefit from additional value creation. Preferred equity holders typically receive a fixed return on their investment, often through a "preferred return" or minimum hurdle rate that needs to be met before other stakeholders (like existing LPs or GPs) can access the remaining returns. This structure provides stability to new investors entering a continuation fund, as it offers a first claim on distributions and priority during exit scenarios. For existing LPs, preferred equity structures can be attractive as they help bring in capital without diluting their potential returns if the asset performs well. Preferred equity is especially appealing in continuation transactions where assets may require additional capital to reach their full potential, such as in infrastructure, real estate, or buyout sectors. By offering downside protection, preferred equity can attract secondary investors who may otherwise be hesitant due to market uncertainties or asset volatility.
- **4. Challenges and Considerations:** A challenge in the secondary market is balancing the bid-ask spread, as sellers often seek minimal discounts while buyers aim for attractive pricing, leading to extended negotiations and slower deal closures. In addition, due diligence can be a lengthy and time-consuming process, as transactions involve assessing mature portfolios with complex risk factors requiring careful analysis.
 - Transparency and Due Diligence: The secondary market involves unique due diligence challenges, as secondary

Continuation funds have become prominent at some large private equity firms. Blackstone and KKR have created entire strategies around them highlighting the shift toward extended ownership over traditional exits in private equity.

- buyers may face limited visibility into the underlying assets compared to primary investors. This creates a need for innovative due diligence practices and greater transparency from GPs to attract sophisticated secondary buyers.
- Market Cyclicality and Exit Opportunities: The secondary market is sensitive
 to economic cycles. During periods of economic uncertainty, pricing tends
 to be more volatile as discounts to NAV widen as exit opportunities become
 scarcer. Understanding and managing this cyclicality is essential for buyers
 and sellers.

COPYRIGHT 2024

- **Regulatory and Tax Considerations:** Secondary transactions often involve complex regulatory and tax implications, especially for international investors. The need to navigate jurisdictional tax regulations, transfer restrictions, and compliance requirements adds an additional layer of complexity to secondary transactions.
- **5. Continuation Best Practices**: To avoid conflicts of interest in continuation funds, GPs should follow practices to ensure transparency, fairness, and alignment with LPs.
 - Fairness Opinion: Engage a valuation firm to assess the assets being rolled into the continuation fund and provide an opinion as to the fairness of the pricing, structure and terms. This can help support that the transaction took place on a fair basis and provide LPs confidence that it was unbiased.
 - Clear Disclosure of Fees and Terms: Full transparency around fees, carried interest, and other terms associated with the continuation fund is essential. GPs should avoid charging duplicative fees and ensure that terms align with industry standards to prevent potential conflicts with LPs.
 - Offer Roll and Cash Options: Provide existing LPs with options. They should be able to either "roll" their investment into the new vehicle if they wish to stay invested or "cash out" to realize full or partial liquidity.
 - Fair Allocation of Management Time and Resources: Ensure that GPs allocate appropriate resources and attention to the assets in the continuation fund without compromising other existing fund investments.
 - Periodic Performance Reviews and Reporting: Commit to regular reporting and performance reviews to ensure that LPs in the continuation fund receive consistent updates on asset performance, risks, and potential exit opportunities. Transparent communication helps maintain trust and accountability.
 - Independent Leal Counsel: Ensure the vending fund and the continuing fund have independent legal counsel.
 - Ensure Alignment of Interests with New Investors: For secondary buyers entering the continuation fund, the GP should structure terms that align new investor incentives with existing LPs. Terms like the preferred return or carry structure should be consistent across all investors to maintain fairness.

6. Outlook: By 2030, secondary market volumes could reach \$500 billion, driven by sustained demand for liquidity solutions, the maturation of large primary portfolios and as institutional investors increasingly adopt secondary transactions for portfolio diversification.

Growth in the secondary market is expected to continue. As private equity AUM is projected to grow from \$9.3 trillion to \$18.3 trillion by 2027, the secondary market will play a crucial role in enabling liquidity and diversification for this expanding investor base.

• Institutional Participation: The secondary market is becoming increasingly mainstream, with more institutional investors participating. This shift is expected to drive higher volumes and more innovation in deal structures and pricing mechanisms.

Over 80% of GP-led continuation

transactions (2023) in the U.S. and Europe involve third-party

valuations/fairness opinions to

mitigate conflicts of interest,

acceptance as a best practice.

disclosed detailed fee structures

underscoring its industry

Approximately 90% of GPs

(including management and

• Role of Secondary Funds in Portfolio Diversification: Secondary funds provide LPs with unique diversification opportunities by allowing them to acquire seasoned private equity assets with shorter durations, enhancing portfolio diversification and potentially reducing risk.

CONCLUSION:

The secondary and continuation fund market is no longer a niche but is now a critical component of the ecosystem, reshaping how investors approach liquidity, portfolio management, and value creation. For LPs, GPs, and secondary buyers alike, this market evolution presents both opportunities and challenges that are likely to influence private equity strategies and portfolio management for years to come.

COPYRIGHT 2024

SOURCES:

- 1. Bain & Company, "Private Equity Outlook 2024: The Liquidity Imperative"
- 2. J.P. Morgan, "The rising tide of secondaries: investors seek private market liquidity"
- 3. Morgan Stanley, "Private Investments in the Secondary Market"
- 4. Private Equity List, "Private Equity Secondaries: What You Need to Know About the Secondary Market"
- 5. Morgan Stanley, "Secondaries in Private Equity: Opportunities"
- 6. PineBridge Investments, "Could the Private Equity Secondary Market Triple in 5 Years?"
- 7. Moonfare, "Private equity secondaries on the upswing: What's driving the growth?"

APPENDIX:

Sample list of recent continuation funds

- KKR Envision Healthcare, 2022, healthcare solutions provider
- Blackstone BioMed Realty, 2021, life sciences real estate
- Insight Partners Veeam, 2021, data protection and cloud management solutions
- Hellman & Friedman Genesys & Renaissance Learning, 2022, customer experience and education software
- TPG Biolife Sciences, 2023, regenerative medicine company
- Thomas Bravo RealPage, 2022, property management software
- Carlyle Group Addison Lee, 2021, UK-based transportation and logistics
- Vista Equity Partners Aptean, 2022, enterprise software provider
- Advent International INNIO Group, 2022, power generation
- Warburg Pincus Allied Universal, 2021, security services provider
- General Atlantic Argus Media, 2023, energy and commodities price reporting
- Silver Lake Global Blue, 2021, technology and payments for the tourism sector
- Apax Partners TietoEVRY, 2022, Nordic digital services and software
- EQT Cerba HealthCare, 2023, medical diagnostics provider
- Permira Allegro, 2021, Poland's leading online marketplace
- Providence Equity Partners DoubleVerify, 2020, digital media measurement
- Ardian Biofarma, 2022, pharmaceutical contract manufacturing
- Summit Partners WildBrain Spark, 2023, kids' digital media network
- CVC Capital Partners Recordati, 2021, pharmaceuticals and healthcare
- Bain Capital Zelis & RedCard, 2020, healthcare payments solutions
- Audax Group 2023 assets from 2012 Audax Private Equity Fund IV

COPYRIGHT 2024 5



Toronto Office: TD Canada Trust Tower, 161 Bay St. 27th Floor, P.O. Box 508 Toronto, ON, M5J 2S1

Calgary Office: Suite 300, 4954 Richard Road SW Calgary, AB, T3E 6L1

www.omnigenceam.com



Our reports, including this paper, express our opinions which have been based, in part, upon generally available public information and research as well as upon inferences and deductions made through our due diligence, research and analytical process. The information contained in this paper includes information from, or data derived from, public thirdparty sources including industry publications, reports and research papers. Although this third-party information and data is believed to be reliable, neither Omnigence Asset Management nor its agents (collectively "Omnigence") have independently verified the accuracy, currency or completeness of any of the information and data contained in this paper which is derived from such third party sources and, therefore, there is no assurance or guarantee as to the accuracy or completeness of such included information and data. Omnigence and its agents hereby disclaim any liability whatsoever in respect of any third-party information or data, and the results derived from our utilization of that data in our analysis. While we have a good-faith belief in the accuracy of what we write, all such information is presented "as is," without warranty of any kind, whether express or implied. The use made of the information and conclusions set forth in this paper is solely at the risk of the user of this information. This paper is intended only as general information presented for the convenience of the reader and should not in any way be construed as investment or other advice whatsoever. Omnigence is not registered as an investment dealer or advisor in any jurisdiction and this report does not represent investment advice of any kind. The reader should seek the advice of relevant professionals (including a registered investment professional) before making any investment decisions. The opinions and views expressed in this paper are subject to change or modification without notice, and Omnigence does not undertake to update or supplement this or any other of its reports or papers as a result of a change in opinion stated herein or otherwise.