
Navigating the secondary market for private equity

Understand discounts, know your intermediary and more in secondary markets.

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1. Welcome

Traditionally, private equity (PE) has been treated like a double-decker bus on a NASCAR track: an asset class that moves at its own pace, isn't readily maneuverable, and which the rest of the portfolio must be maneuvered around (not vice versa). Increasingly, PE is becoming a more steerable asset class, thanks in large part to the speed at which secondary markets are evolving.¹ Over the past decade, the secondary market for PE has expanded sixfold to reach a total of \$150 billion transacted in 2021.^{2,3,4} This growth makes buying/selling PE shares more realizable than ever.⁵ The result for investors is the potential to more actively manage their PE holdings by having finer, more fluid control over:

- Risk exposure;⁶
- Cash flows;
- Timing of when returns are realized; and
- How well their PE holdings complement the rest of their portfolio.⁷

¹ The secondary market for PE is a bit like the used car market. When a new PE fund is launched, it sells shares to limited partners (LPs). Buying shares in a new fund is like purchasing a new car from its manufacturer. (This first issuance of LP shares is sometimes referred to as the *primary* PE market.) Manufacturers rarely buy their cars back, and the same is true of general partners (GPs) and shares in their funds; so, when a LP wishes to sell its stake, it must do so on the secondary market. (Note however, that car manufacturers oftentimes franchise used-car dealerships that specialize in buying vehicles of that manufacturer's own make: this is similar to GPs that set up *continuation funds*, which purchase shares in that GP's previous funds, directly from LPs.)

² See: <https://www.collercapital.com/about-secondaries/history-secondaries>. There were at least 2,300 recorded secondary PE transactions in 2021, with an average deal size of around \$60mm [Setter 2022].

³ All price values in this Primer are in \$USD.

⁴ This compares to a \$4.5 trillion market in assets under management for PE overall [McKinsey 2021].

⁵ "Shares" can be entire limited partner's (LP) stakes in a PE fund, or stakes in specific assets owned by that fund.

⁶ To give just two examples among many: 1) selling out of assets that have undesirable ESG characteristics, without exiting a LP stake entirely; and 2) buying into a fund partway through its life, to avoid capital-call risk and uncertainty over portfolio composition.

⁷ For example, if risk exposure elsewhere in the portfolio has changed, the PE portion of the portfolio might be partly 'rebalanced' to better handle that changed exposure.



And even if investors aren't seeking to more actively manage their PE positions, the secondary market still offers novel benefits, especially when it comes to handling liquidity, running an evergreening program for PE and conducting whole-of-portfolio management.⁸

Our interest in PE secondaries has been fueled by studying the portfolio data of Addepar's clients, and by conversations with the clients themselves, including those who've sold PE shares on the secondary market via Marketplace, offered through Addepar's subsidiary broker-dealer Acervus Securities, Inc., member FINRA/SIPC. Many clients are limited partners (LPs) in PE funds that are approaching the end of their intended lifespan (10 years). In related work, we've found that incremental expected returns from PE funds tend to fall drastically near the end of a PE fund's life (around year 8). Hence, clients may be incurring an opportunity cost by not selling some long-in-the-tooth positions on the secondary market (and putting the proceeds to more productive use, either in new PE funds or elsewhere).

The objective of this Primer is to help readers better understand the PE secondary market, thus unlocking greater flexibility and capability in how they invest in the asset class. We prioritize two topics in particular: discounts at which transactions in the secondary market typically trade; and why 'knowing your intermediary' (KYI) is imperative to secondary success. Throughout, we try to give practical examples of how investors might make best use of these topics; by means of illustration, we also include a case study of a recent sale of an LP stake into the secondary market, which was facilitated by Addepar for one of its single-family office clients.

In Section 2 of the Primer, we summarize the key takeaways - things readers 'need to know' about the secondary market for PE. In Section 3, we discuss the opportunities that the secondary market opens up for both buyers and sellers, along with prospective motives for transacting. In Section 4 we conduct a whirlwind tour of the secondary market in terms of its mechanics, its main players and how all of this drives deal pricing. Section 5 offers some details on our methodology. Section 6 offers a case study. Section 7 offers some thoughts on how investors might embark as participants in the secondary market, and Section 8 concludes.

⁸ Regarding PE evergreening, secondary markets can help an investor achieve vintage diversification more quickly than would be feasible by buying into funds only at their launch dates.



2. NTK

Here is the “need-to-know” from this Primer:

- **Increasingly Multifunctional.** Unlike in bygone decades, the secondary PE market has far more to offer than just liquidity for sellers and discounted assets for buyers.⁹ Investors should closely examine their reasons for transacting or not in the secondary market and consider deal structures that may serve multiple goals, even unconventional ones.
- **Savvy Discounting.** Most secondary deals are priced at discounts to net asset value and the size of these discounts is a big determinant of success in the secondary market, particularly for buyers.¹⁰ It’s a best practice to analyze what forces drive the discounts behind a given transaction, and assess whether they’re fair and rationalizable.
- **Responsible Intermediation.** About 80% of secondary deals are intermediated by specialists.¹¹ Knowing your intermediary—and ensuring their interests align with yours—is a best practice for any investor looking to reap the most value from a secondary transaction.

3. Significance

Any negative reputation the PE secondary market may have had is definitely not justified today. The secondary market has come to serve a crucial role in PE, and the opportunities for buying and selling assets are nearly as diverse as the assets themselves.

For sellers, there are many reasons why secondaries may be attractive:

- **Liquidity:** About half of secondary transactions involve stakes in PE funds. Rather than having capital tied up for a decade (often longer if a fund takes many years to wind down), a secondary sale means LPs can

⁹ Moreover, secondary markets have historically been a province for institutional investors only. But that’s changing now, as the character of buyers and sellers becomes more inclusive (and creative!).

¹⁰ Customarily, discounts are usually taken with respect to the assessed net asset value (NAV) of the asset for sale.

¹¹ The percentage of intermediated deals also seems to be increasing: it was estimated that 65% of deals in secondary markets involved intermediaries during FY 2020, vs. 80% in 2021 [Setter 2022].



exit at a time of their choosing, giving them more flexibility in meeting liabilities or obligations inside or outside their portfolios.

- **Regulatory change/shareholder pressure:** A lot can happen over the lifetime of a private asset, and owners of PE stakes may encounter unforeseen changes in the course of ownership, e.g., a sudden need to offload assets with weak ESG characteristics.
- **Rebalancing, refocusing or risk-shifting:** Successful investing entails managing assets at the portfolio level. Over time, a specific asset may become a poor fit for a portfolio, even if the asset itself performs according to plan.¹² For instance: a portfolio might need extensive rebalancing; a newly hired CIO/CFO might wish to streamline private holdings; or there might arise a need to insulate against a surprise source of risk like COVID-19. Liquidating a private asset before it fully ripens can be enormously valuable for total portfolio management.
- **Locking-in returns:** Investors may need to convert paper gains into, simply, realized gains.
- **Changed outlooks:** Sometimes it becomes clear that an asset won't hit expectations or that capital could be productively deployed elsewhere. It can be rational to sell out of a private, illiquid position at a discount and reallocate the proceeds to more effective ends.
- **Conflicts with leadership:** Occasionally, irreconcilable differences arise between investors and an external manager where the latter is the general partner of a PE fund, or the manager of a private company in which the investor owns direct stakes. If firing that manager isn't feasible, the investor and manager may part ways via a sale, rather than toughing-out the remainder of the contractual relationship.

For buyers, the opportunities from transacting in the secondary market are just as plentiful, including:

¹² As an example, consider a hypothetical (but realistic) investor that has an overall target allocation to PE, and that is unwilling to exceed that target (due to regulation, risk management, or both). If sufficient cash cannot be shifted into public equities, then our hypothetical investor may face unavoidable pressure to sell some of its PE portfolio.



- **Shortened duration:** With suitable discounts, buyers can earn traditional PE returns but with abbreviated holding periods. This helps investors move along the J curve in a typical PE portfolio, generating cash returns fast(er).
- **Decreased uncertainty:** Buyers in the secondary market often enjoy greater certainty than they would in the primary market, e.g., buying into a fund at inception.¹³ This may come from knowing the companies or assets a fund will purchase or having greater clarity on when capital is likely to be called. For direct holdings, uncertainty mitigation may come from knowing whether a levered asset can service its debt or that a startup has hit key milestones.
- **Downside protection/return purity:** For many secondary buyers, a significant fraction of their return comes by way of discounted purchase prices, which lessens some of the risk they'd otherwise face if returns relied chiefly on cost of leverage or company growth, as is typically the case for primary PE stakes.
- **Diversification:** Investors can reduce risk in PE investing by averaging into the asset class over time, though it can take many years to implement this if building a portfolio from scratch.¹⁴ The secondary PE market can enable buyers to perform vintage diversification in far less time than would otherwise be possible. The same is true for diversification across GPs and fund strategies, e.g., achieving a mix of VC, LBO, infrastructure funds, etc.
- **Improved access:** Often, GPs grant their current LPs a right-of-first-refusal to participate in subsequent funds. Buying an LP stake on the secondary market may allow investors access to future opportunities that otherwise wouldn't be extended to them, e.g., if subsequent funds are likely to be oversubscribed.

¹³ One manifestation of this decreased uncertainty is mitigation of the 'J-curve' (e.g., shifting it forward in time or changing its steepness). See Pitchbook [2017].

¹⁴ Vintage diversification is the practice of spreading capital allocations to PE funds across funds with different starting dates in the hope that this mitigates some of the risk due to business and credit cycles, along with other time-fluctuating variables.



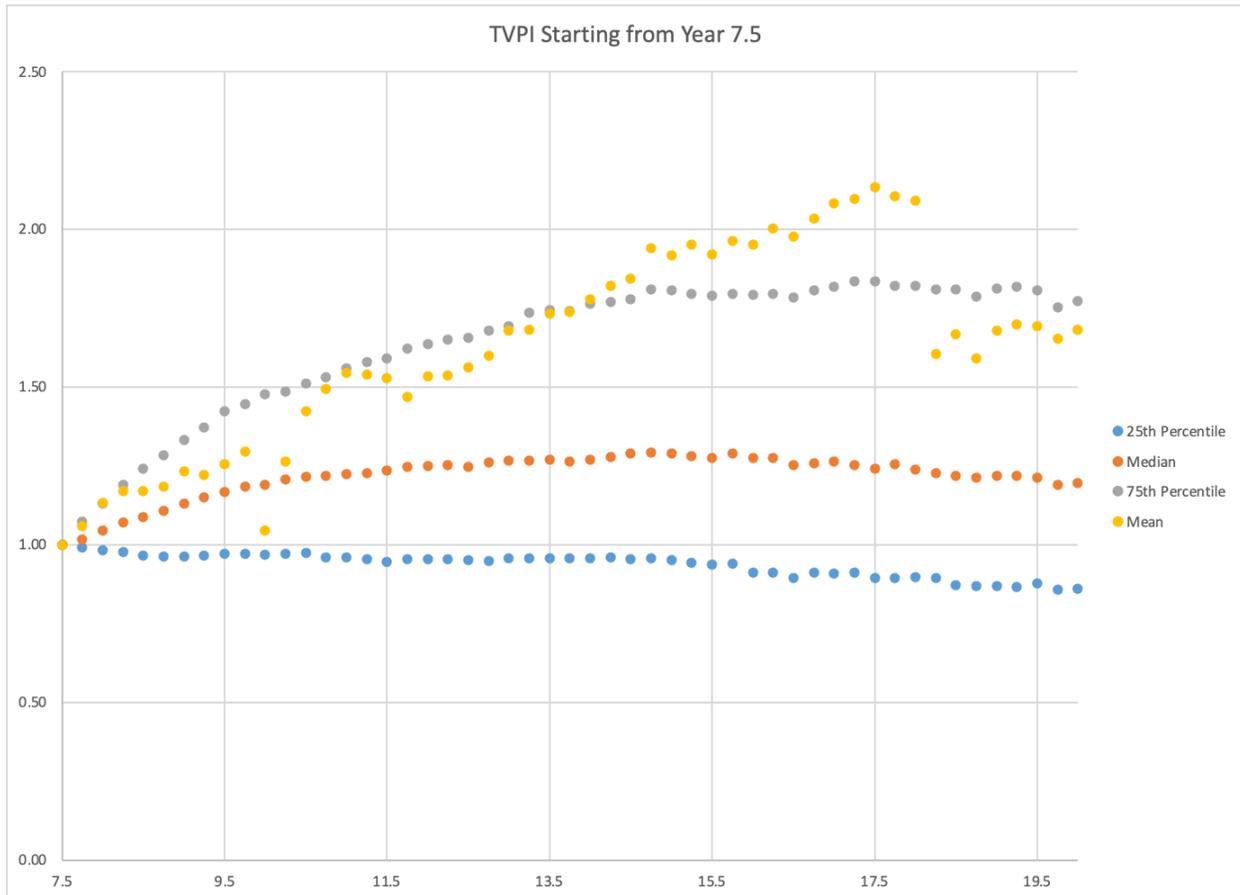
- **Customization:** Being able to buy selectively—and purchase specific private assets from particular funds—can allow investors to construct bespoke, choose-your-own-adventure PE portfolios that wouldn't have been available from any one GP on its own.

These opportunities and motives are just some of the reasons why the secondary market for PE has increased in popularity over the past few years. There are other reasons, however, that are less publicized. One of these can be shown from our own research (utilizing data available from Preqin), which is encapsulated in Figure 1 below. This figure summarizes statistics on total value paid in (TVPI) values for over 5600 PE funds over the past 30 years, beginning at year 7.5 of the fund's life. A TVPI greater than 1.0 indicates an increase in the value of an LP position, whereas a TVPI less than 1.0 marks a decline in value. It's plain to see that many funds fail to deliver significant value in their final years and more than 25% of funds actually *destroy* value!¹⁵ These large-sample statistics serve as robust evidence of the usefulness of the secondary market to investors: secondaries allow investors to exit positions that may earn next to nothing for a dozen quarters or more.

¹⁵ In related, soon-to-be-available work, we'll uncover the dynamics of performance over the lifetime of PE funds. There, we'll demonstrate that there indeed are many possible ways to more actively manage PE investments, not just in their senescence, but through all stages of fund life.

Figure 1

Total Value Paid In (TVPI) of PE Funds in Later Life



Source: Addepar Research (based on Preqin data).

So, what are the mechanics of the secondary market for PE, and how do investors go about maximizing the value they can get from transacting in that market?

4. Context

Here we give a curated walk-through of how a typical secondary transaction works, as well as an examination of the major players involved: buyers, sellers and intermediaries. From there, we'll offer insights on how different factors affect discounts at which PE shares usually trade in the



secondary market. While there is no single equation for determining the discount of any particular secondary deal, we find it to be best practice for investors to identify what factors are likely to be the most significant in their specific transaction. Intermediaries can be substantially helpful to that end. If you're going to be an investor in the PE secondary market (whether buyer or seller), it's vital to know your intermediary and make sure their interests are properly aligned with your own. We conclude this section with a case study of an actual, recent secondary deal that Addepar facilitated for one of its single-family office clients.

Secondary PE transactions aren't all quick-and-simple. Instead, the usual transaction is more like selling/buying a home, a transaction that takes time, as it requires various inspections, appraisals, arrangement of financing, etc.¹⁶ As with home sales, speedy and straightforward transactions very much can and do occur; but all parties are best off going into a deal with the expectation that it could take some time—perhaps a month, perhaps several—to close.¹⁷

Usually, the sales process for a PE secondary has four stages (some of which may blend together)¹⁸:

1. **Analysis:** Potential buyers are sought and vetted; the type of auction or other sales mechanism is decided; sell-side valuations are conducted.¹⁹
2. **Preparation:** Prospective buyers perform diligence on the assets for sale; buyers prepare and submit their offers.²⁰
3. **Execution:** A buyer is chosen, and the transfer steps are initiated.²¹ If an asset is being divided, e.g., an LP stake in a fund is to be divided into the companies it

¹⁶ Here we should note that “typical transactions” are something of a *rara avis*: given the many factors that go into each secondary deal, it's challenging to say that any two transactions are very closely alike. So for the purposes of our discussion, just recognize that a typical transaction is a byword for a plurality of recent-ish transactions.

¹⁷ Both sides of a deal can sometimes accelerate it, if they're prepared to compromise enough on certain terms (usually price)—although usually it's sellers that can accelerate the process more so than buyers.

¹⁸ The sales process is quite similar for both fund stakes and direct holdings. In recent years, there's been a marked rise in the number of single-holding transactions [Dawn and Rohloff 2021].

¹⁹ It's highly important for an investor to be fully aware of the ability to transact—both for themselves and their counterparties—and the sooner in the deal process, the better. A worthy intermediary should help screen for whether either side of the transaction won't be able to close due to issues such as restrictions by the GP, contractual obstacles, SEC eligibility, etc. Working with or as an ineligible counterparty is a waste of time that must be avoided if possible.

²⁰ Mutual anonymity is customary both before and during the auction—buyers and sellers aren't aware of anyone else's identity, just the identities of certain intermediaries. That doesn't mean either side of the deal shouldn't try to guess who the other participants are, nor their motives. Transparency is a strategic asset—one that extends to the for-sale asset as well. Buyers should discount their bids to the extent that they believe they know less about what they're purchasing than the seller. They must also account for what the seller itself might not know, such as; the timing of any remaining capital calls or distributions, the ability of the asset to service its debt, the ability of startups to hit their milestones, etc.

²¹ Financing terms are often key considerations in bids by buyers. Most deals are all cash—some include deferred payments (e.g., a portion at close, and the balance paid on contingencies at some future date), preferred equity, or some degree of upside participation by the seller. Relatedly, buyers may write various contingencies into their bids. As a general rule, sellers should retain the sole and absolute right to reject any and all offers, except under special circumstances.



contains and stakes in those companies sold individually, the same process applies to multiple buyers.

4. **Closing:** Transfer of ownership (including payment, retitling, etc.) is finalized.

Secondary deals can and do come unglued at any stage in the sales process and completing each stage isn't just about 'getting the deal done'.²² Instead, at each step, buyers and sellers should both be gaining confidence in the transaction as well as seeing increasing proof that their respective intermediaries are serving their needs. Asking for this proof is best practice. An intermediary should always be willing and able to furnish evidence that it's maximizing value for its client, whether that client is a buyer or seller.

In any transaction, there's clearly at least one buyer and one seller, although some transactions have more than one of each. A majority of deals do feature multiple prospective bidders because that tends to help maximize value for the seller. Here are some frequent cases in which more than one buyer or seller can participate in a transaction:

- **Multiple buyers, one seller:** a seller offers stakes in multiple PE funds, and different buyers purchase those stakes separately, as part of a single sales process. Or, a seller may sell a single stake in one PE fund to multiple buyers by selling shares in the underlying assets to different buyers (e.g., buyer A gets the seller's shares in company X in the PE fund's portfolio, buyer B gets the seller's shares in company Y, etc.). Or, a seller may sell multiple direct holdings in private companies to separate buyers.
- **Multiple sellers, multiple buyers:** same as above, except with more than one seller in the same sales process. This happens when the sellers are all offloading stakes in the same PE fund (and may be facilitated by the GP of that fund).
- **Multiple sellers, one buyer:** this happens most often when the sellers are all offering their stakes in a single PE fund as a block and that block is bought by a single buyer.

²² The most frequent cause of deals falling apart is sellers deciding not to sell (which accounts for 50% of deal failures), followed by adverse conditions encountered by the buyer during diligence (around 10% of deal failures) [Setter 2022].



Let's take a look at the characteristics of sellers and buyers, respectively.

Sellers can be classified by not only who they are, but what they're selling: LP stakes in PE funds or direct holdings in private companies.²³ For sales of fund stakes, positions in leveraged buyout funds are the most popular assets to sell (about 75% of sales in LP stakes in 2021 were for LBO funds), followed by LP positions in venture capital funds (about 15%) [Setter 2022]. The average age of a fund position sold on the secondary market was between 5 and 6 years (see Figure 2 below). Note the distribution of ages across the fund lifecycle isn't heavily peaked: there's significant transaction volume at all stages of a fund's life, which points to the diverse reasons why sellers choose to exit their LP positions.

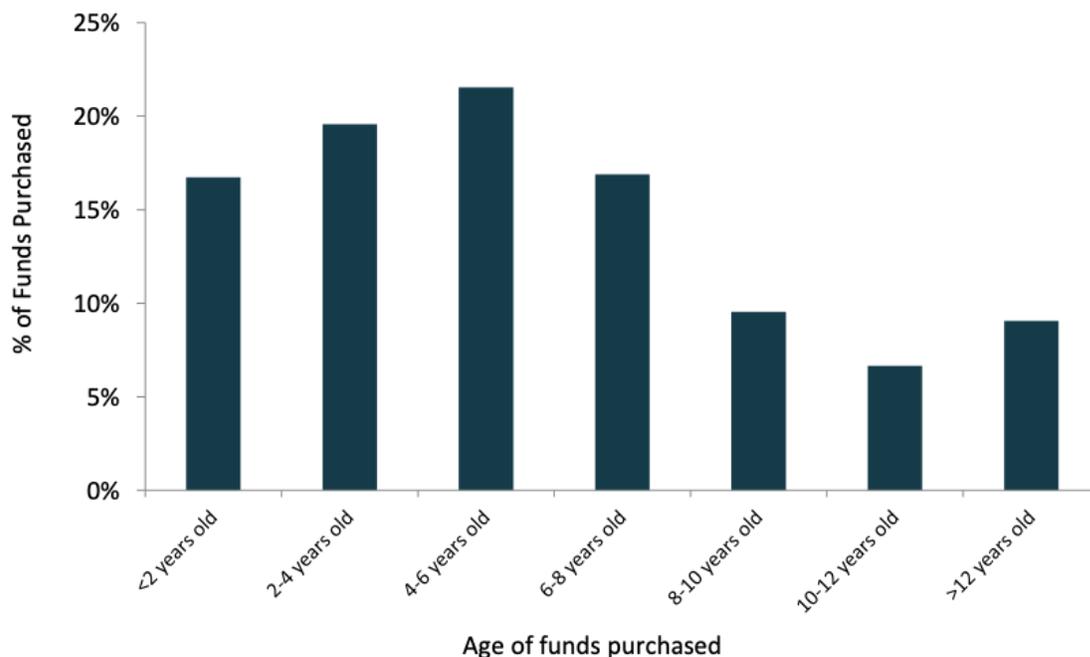
Sellers themselves are also diverse, although institutional sellers (pension funds, sovereign wealth funds, etc.) are most prevalent. About a third of all secondary deal volume is GP-led, meaning the general partners in a PE fund help coordinate the voluntary sale of fund assets, whether this is for single companies in the fund's portfolio or for an LP's entire stake in the fund [McKinsey 2021].²⁴

²³ There's a roughly equal split in terms of the number of sales that are fund stakes and number that are directs [McKinsey 2021; Setter 2022].

²⁴ The number of GP-led secondaries for single assets is about the same as that for full LP positions [Triago 2021]. GP-led secondaries have become increasingly popular since the Global Financial Crisis of 2007-2009, before which they were relatively uncommon [McKinsey 2021].

Figure 2

Age Distribution of PE Fund Shares Purchased on Secondary Markets for 2021



Source: Setter Capital [2022].

As far as buyers go, there are many types, some of which include:

- **Latecomer LPs:** buyers who prefer less risk, seek diversification or for some reason couldn't join a fund at the time it closed;
- **Choosy FoFs:** funds-of-funds who have dedicated allocations for secondary purchases, either for the sake of risk management, bargain-seeking or both;
- **One-off opportunists:** hedge funds or other investors who are mainly concerned with very specific deals;
- **Dedicated secondary funds:** buyers (including many continuation funds by GPs) that are exclusively interested in secondary purchases.



In terms of buyer activity, specialized secondary funds account for most of the total deal value in PE secondaries (about 88% in 2021), with funds-of-funds (FoFs) accounting for a further 10% of activity [Triago 2021]. The amount of dry powder available for secondary purchases is rapidly growing, with an estimated \$240 billion intended for secondaries in 2022 [Triago 2021], much of it controlled by FoFs. But this capital is concentrated, and controlled by a small number of buyers. Indeed, concentration of buyers is a characteristic of the PE secondary market in general: in 2021, the 25 largest buyers in the market accounted for >75% of overall deal volume (each of these buyers did >\$1bn in transactions for the year, with the top three buyers accounting for >40% of total deal volume) [Setter 2022]. Yet, despite this concentration, smaller deals can and do flourish.

In 2021:

- Over 70 medium-sized buyers (who deployed between \$100mm and \$1bn in secondary markets for the year) closed over 1100 transactions, with a mean deal size of \$25.8mm; and
- Over 30 small-sized buyers (who deployed less than \$100mm in secondary markets for the year) closed over 240 transactions, with a mean deal size of \$6.8mm [Setter 2022].²⁵

Diversity is the name of the game in PE secondary markets in terms of buyer and seller motivations and preferences—yet deals and deal terms are surprisingly heterogeneous. It's also useful to realize that buyers' appetites will be fueled not only by the particular assets for sale in a given deal, but also by what other assets are circulating in the secondary market, along with the current state of the PE market overall (especially the primary market). Viewing a secondary deal from an ecosystem perspective is vital for understanding not only who's likely to participate in a sales process, but also the amounts that competitive buyers might willingly pay. Intermediaries can help both buyers and sellers in this respect, which is one of many reasons why most secondary PE transactions are intermediated. There are different species of intermediary, and we'll touch on these shortly.

Some transactions are more heavily intermediated than others, and it's important for both buyers and sellers to be aware of:

²⁵ Given the rapid expansion of the PE secondary market, it's highly likely that the activity volumes of small-to-medium-sized buyers will only increase (if not in total market-share, then at least in absolute number of deals done).



- Whose interests (the buyer's or seller's) are being represented by which intermediaries—rarely, if ever, should a single intermediary represent both buyer and seller; and
- What those various intermediaries are or aren't willing or able to do.

The most powerful intermediary is often the transaction manager that helps the seller find suitable buyers. In many situations, this transaction manager also helps: facilitate buyer diligence (e.g., by setting up a secure digital data room); communicating with GPs; and running auctions. Because transactions in this market are very heterogeneous, it's not uncommon for the same intermediaries to play different roles in different transactions. What's most crucial is that every investor ought to KYI: know your intermediary, in terms of what that intermediary's obligations, incentives and capabilities are for your particular transaction.

To use a dinner analogy, the ideal intermediary should be well-positioned to help investors get the most from their meal: from navigating the guest list, to enforcing good dinner etiquette, to making sure the party they're representing (usually the seller) is obtaining the best price. There are many species of intermediaries that can perform these functions, but the three main ones are:²⁶

- Consultants/deal advisors who provide valuation, diligence and other appraisal services;
- Sales agents who help organize auctions, vet buyers and guide transactions; and
- Legal specialists who help structure contracts and navigate fiduciary responsibilities.

These roles can be interchangeable as sales agents assist in diligence and deal advisors may engage in some matchmaking, but rarely will only a single intermediary be involved in any one transaction. In general, the sales agent in a secondary transaction will control most of the process, and it's typical that they will represent only the seller. Buyers interact with this agent exclusively before being introduced to the seller, and often after an auction is concluded - though this can

²⁶ This list is not exhaustive, and there are other roles that intermediaries can play in secondary PE transactions. Yet this list covers the primary functions needed to execute most transactions.



differ from one transaction to the next.²⁷ It's crucial for any investor who engages an intermediary to ensure the intermediary is representing their best interests, e.g., a seller's agent shouldn't be collecting fees from buyers for special privileges that might reduce the price the seller ultimately receives. Investors should prefer intermediaries that operate on exclusive mandates to avoid conflicts of interest, as doing so is the best guarantee that any eventual deal terms will be fair.²⁸

It's imperative to discuss discounts because most deals in the PE secondary market are done as discounts to the net values (NAVs) of assets in the transaction. Discounts in the secondary market are highly variable, and this variability exists both across time (discounts can be significantly different from quarter to quarter) and across seemingly similar assets. What's important to understand is that the final discount that's reached in a secondary deal is a function of many distinct factors, and there's no set formula for calculating it.²⁹

What investors must do then—and what should be seen as a best practice—is to consider the major factors individually and assess how they might combine into the final discount that's reflected in the offers made by buyers. Below, we cover what those major factors are as well as how they tend to affect deal pricing.

Figure 3 depicts average discounts from deals in the PE secondary market, for fund-stakes of various types, as a percentage of NAV. At least two features jump out from this chart:

- There are wide gaps in average discount levels between different types of PE fund—from >40%, all the way down to slightly negative discounts, i.e., premia.
- The average discount levels themselves, even within a fund type, are heavily variable over time.

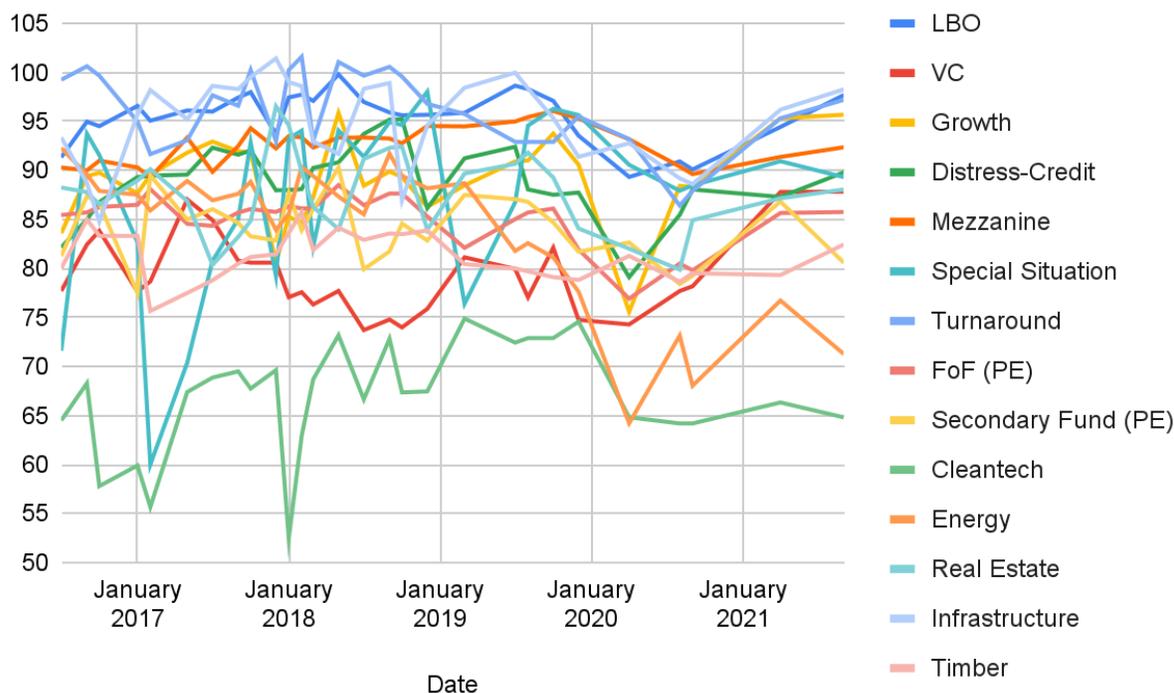
²⁷ For their services, sales agents routinely charge a fee of 1-2% of the NAV of the transacted asset, and this fee may be paid directly by the buyer or subtracted from the seller's net proceeds (this can vary from deal to deal). Some examples of the most popular sales agents (and, in many instances, consultants and deal advisors as well) include Melting Point Solutions, Setter Capital, Evercore, Campbell Lutyens, Green Hill, and Park Hill.

²⁸ See the paper "Seeking to Sell Alternative Assets in the Secondary Market?" by Melting Point Liquidity Solutions.

²⁹ Ideally, the discount gets optimally priced by a well-run auction. This is why it's so important to know your intermediary (KYI) and understand if they're able to run an efficient and effective auction.

Figure 3

Prices of PE Secondary Transactions over Time (Fund-Stakes as % of NAV)



Source: Setter Capital price reports, 2017-2021.

These properties are reflective of the secondary market in general as discounts vary substantially across types of PE asset, as well as across individual assets. And, these discounts are substantially 'bouncy' over time.³⁰ Let's dissect some of the factors driving this variability.

- Condition:** Undoubtedly, the condition of for-sale assets matters to discounts. For instance, profitability of companies in a portfolio, their level of maturity and their ability to service debt can all get baked into a discount. Yet, asset condition is often as much a decider of deal structure as discount levels: an LP stake that's a mixed bag of asset quality might be structured so that buyers can bid on positions in specific assets, rather than the position overall.

³⁰ On the former point, it should be borne in mind that the figures in Figure 3 are average prices, and that there is meaningful dispersion of discounts within each type of PE asset in the sample.



- **Transparency:** In many sales, buyers are permitted to conduct extensive diligence, which narrows the information gap between buyer and seller. But full transparency is far from universal, and even if a buyer possesses as much information as the seller, there can still be uncertainties about the asset, e.g., timing of calls for undrawn capital commitments that prompt a reduction in the sale price. Degree of transparency is a significant driver of discounts.
- **Deal-specific factors:** “Every deal is different” is a common saying in the PE secondary market. Not only is it true, it also reflects why the discounts that appear in deals vary so widely. Apart from differences in motivations and preferences among buyers and sellers, there are other factors that have a strong influence on deal mechanics. Perhaps foremost among these are the degree of anonymity among deal participants, and whether reasonable deal comps are available. If managed appropriately, keeping oneself anonymous (including keeping one’s identity relatively un-guessable) is an advantage for swinging the discount in your favor. Likewise, highlighting particular comparable deals in a strategic way can steer discounts favorably.
- **Market-level characteristics:** Deals occur within broader macroeconomic and socio-political settings, and marketwide conditions can and do affect deal terms. Among the most crucial of these conditions is the health of public equity markets—specifically, how strong the IPO market is, and whether public-equity buys look more promising than opportunities in private markets. Additionally, the amount of dry powder that’s available across PE funds can have a serious impact on buyer competitiveness, as can regulatory or tax-law changes.
- **Clock-factor:** The timing of a transaction can meaningfully impact the discount it sees, and there are multiple clocks that exist for any deal. For fund deals (whether led by an LP or GP), the time remaining in the fund’s life has an impact on the size of discount—though this impact isn’t strictly linear. In general, stakes in younger funds are likely to trade at steeper discounts to more mature funds. Another important clock is the tax clock, as some sellers or buyers may be motivated to get the



deal completed before a tax year ends, and so accept a discount that's more favorable to the counterparty.

- **Blockers:** While many GPs take a tolerant to favorable view of secondary sales, not all GPs are likely to approve of all buyers. Although a GP may not always be able to block a sale to a particular buyer, their resistance may encourage the buyer to submit a lower bid for the asset. In general, a GP's stance on a sale can affect the degree of discount and whether a deal succeeds at all.
- **Permissibility:** Both sellers and buyers can be enticed by deals that are quick and easy to execute. But they often won't be enticed to the same degree. The party that's more incentivized to get the deal done efficiently—with high speed or low complexity, or both—may be willing to cede more ground on the discount. It's crucial to manage perceptions about efficiency, and this can be done in several ways by sellers and their intermediaries, including the degree of diligence that's completed in advance for buyers and parameters for the sale process, e.g., what type of auction is run.

A good intermediary should help an investor navigate the foregoing factors, helping their client to not only understand them but also to advantageously manage them, to the extent possible. Indeed, the intermediary's competency may be the biggest factor of all in dictating the discount for a particular deal, which further underscores the need to KYI: *know your intermediaries*.

As a capstone to all we've covered in this section, let's take a glimpse at a recent secondary transaction that Addepar facilitated for a client. For confidentiality, we omit both the name of the client and the PE fund in which the client sought to sell its LP stake. Note that Addepar didn't act as the intermediary in this deal per se, but was instrumental in introducing the seller to a respected intermediary, Melting Point Solutions (MPS).



5. Approach

In order to better illustrate the motivation for, and implementation of, PE secondaries, we've chosen to provide a case study of an investor prosecuting a PE secondary transaction. The goal of the case study is to learn the path through one of these complex deals. In this case, we examined a single-family office selling a \$2mm LP stake. The case selection and data analysis follow guidelines from Flyvbjerg (2006).

6. Findings

In order to demonstrate the secondary market 'in action', we conducted a case study of a single-family office selling an LP stake.

- In 2021, a single-family office (SFO) client of Addepar's held an LP stake in a US-based, mid-sized PE fund (approx. \$2 billion under management), which was focused on growth opportunities, primarily in the technology sector.
- The SFO was no longer in favor of the fund's GP. At the time of the fund's launch in 2014, the SFO had committed \$3.5 million but the net value of its position had fallen to just over \$2 million by Q3 2020. Hence, the SFO sought to sell out of its LP stake and recommit the proceeds to more promising opportunities.
- In mid-February 2021, in consultation with the SFO, Addepar initiated the sale process by contacting Melting Point Solutions, a specialist intermediary that represents sellers in secondary PE transactions.
- Melting Point immediately launched a competitive sale process, in which it represented only the SFO client's interests. It contacted 72 prospective buyers that it knew from experience might be interested in the LP stake. These prospects included many known buyers of secondary stakes, and included other family offices, endowments, foundations, dedicated secondary funds and fund-of-funds and insurance companies, along with other LPs in the fund.
- Of these 72 contacts, 20 requested diligence materials and all 20 had enough interest in the asset to sign the fund GP's non-disclosure agreement. Of those 20, eight parties ultimately submitted auction bids. Throughout this process, Melting Point hosted many diligence calls between prospects and the fund GP, all while keeping the seller's identity confidential.



- The auction closed in early March 2021, just two weeks after Addepar initiated the sale process. The winning bid was for 80.2% of the stake's NAV (per its most recent valuation), which was in line with growth-fund secondaries at the time.
- The sale concluded in mid-April, less than two months after the process began. For its efforts, Melting Point Solutions collected a 2% fee (based on NAV).
- The SFO client expressed strong satisfaction with the outcome, as well as the process itself, describing it as “very smooth.”

To sum up, a seller desired to sell an underperforming LP stake and aimed for expediency in doing so. A competitive auction then ensued, thanks to a respected intermediary whose interests were aligned with the seller's. As a result, a timely and smooth sale occurred at what the seller considered to be a fair price. This all goes to demonstrate that, with an understanding of the factors that drive secondary-market pricing and a capable intermediary, investors large and small can succeed in the secondary market for PE.

7. The ARB-itrage

For investors considering getting involved in the PE secondary market, we've identified some best practices that investors should retain:

- **Experts:** Use PE secondary markets as a tool for the active management of private equity, but use it responsibly. Just like leverage and derivatives, using secondary transactions judiciously can be an efficient way to do things that ordinarily might not be feasible. But, when used improperly, they can destroy hard-earned value. Feeling well-informed and comfortable with a transaction should be a primary concern for investors—as with exotic derivatives, you don't want any confusing deal mechanics or terms.
- **Trust:** Think of selling and buying in secondary markets as being like selling or buying a home—it's a transaction that can serve multiple ends including diversification, a toehold with a top-notch GP, liquidity/cash-flow management and more. It's invaluable to take the time to find the right intermediary, educate yourself and try not to see value (in specific, discounts) too narrowly.



- **Network:** Reach out to other investors to learn more, not just on deal mechanics but also on their experiences with particular intermediaries, novel deal structures they've encountered and what discounts they're seeing. For all its evolution in recent years, visibility is far from perfect in the PE secondary market, and sharing experiences and information can be a great way to increase the odds of a successful transaction.

8. Coda

Secondary markets for PE present many exciting new possibilities for how investors manage illiquid assets. Studying this topic—namely, how investors can more actively run their PE portfolios—is a core research endeavor for us. We're currently using Addepar's unique dataset to uncover more best practices in this area: from when might be the best time to sell a stake in a PE fund, to how secondary markets might be used for improving portfolio resilience.

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