ACG® New York
Association for Corporate Growth

TresVista

In February, we attended ACG's Monthly Luncheon Meeting. Here are five of our top takeaways from the panel discussion on the 'Impact of the Rising Trend of Secondary Buyouts'

Prepared by TresVista

5 THINGS YOU MISSED –

1 **Secondary Buyouts – Evolution in Deal Sourcing:** Secondary buyouts have witnessed tremendous growth over the past five to seven years, a trend that was very uncommon ten years ago. Evolving market conditions coupled with the substantial amount of dry powder available with the PE firms and changing credit market conditions have contributed to this paradigm shift. To give perspective on this trend, the number of PE platforms have increased by 200-300% over the past ten years, indicating an excellent opportunity for strategics to deploy capital while also earning a premium for the PE firm for an asset that's being well-run and managed. Strategics often look to buy the best companies – companies that are already owned by smaller PE firms – in an attempt to get the best returns.

2 **Filling the Voids in the PE Value Chain:** As secondaries continue to look to buy the best assets, there exists and untouched space of founder-owned assets, which is a tremendous opportunity for early-stage PE firms. Independent sponsors, otherwise known as a fundless sponsors, are part of the PE ecosystem but focus on much smaller opportunities (sub-$100MM in EV). Independent sponsors have a relevant role in identifying and developing relationships with such owners and bringing them to a more institutionalized level. This is a strategy to consolidate smaller platform companies with the aim of creating a big tech-enabled player to be run by big national players. Early-stage PE firms are quite explicit about the fact that they cannot build such smaller-scale companies, thereby creating an opportunity for independent sponsors, all the way down to the bottom of the market.

3 **Cross-Pollinating of LPs; Non-Traditional Avenues of Deal Sourcing:** In a secondary buyout transaction, a probable area of conflict could be at a Limited Partner (LP) level. Typically, with larger funds, there is a disproportionate chance that both participating funds have a common LP, thereby creating a situation where they end up paying the fees twice to re-enter the same asset – an asset whose value has already been extracted. However, there is relatively less probability of conflict in small or middle market funds as these markets are fragmented, and the possibility of overlap in LPs is limited. Gradually, the market is moving to a situation in which PE firms are spending time directly with their peers to understand the businesses well before they decide to exit an investment, giving an edge to the PE buyer. The traditional process of cold-calling for prospects has been shelved and PE funds have shifted their focus towards sponsored-owned businesses because the market has become much more efficient.

4 **Asset Sale to Sponsor and Non-Sponsor:** Despite focusing on building businesses that are relevant to strategic buyers, there exist an equally interesting set of PE firms who are interested in buying the businesses. Such sponsors are more adept and understand the value of the business much better than the strategics, enabling a sponsor to win in a process and sometimes outpace/outrun the strategic. Sponsors tend to move the process much more quickly and provide more certainty around getting into a transaction.

5 **Outlook on the Secondary Market in the Future:** The number of secondary buyout transactions is expected to increase in the future. With fundraising activities at a peak, and PE returns relatively high as compared to public markets, it would be interesting to look at how strategic buyers will continue to evolve over the next five years as they adapt to a more competitive and sophisticated environment.

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