Q&A

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Elm Capital's Etienne Deshormes explains how placement agents no longer just advise on fundraising, but also on a multitude of liquidity options combining primary and secondary elements.

By *Talya Misiri*

As the asset class has evolved, what has led to the cohesion of primary and secondary advisory in private equity?
In the past, GPs typically worked with placement agents who gave them access to long-term investors. Also, LPs worked with secondary advisors to sell their positions and those advisors mainly gave them access to secondary funds. There is a bit of an overlap between the two investors categories, but long-term investors who invest in the primary and secondary markets usually do so through different teams. As a result, primary and secondary markets are relatively segmented.

In today's market, however, GPs are not just interested in fundraising anymore, but are also tapping into the secondary market to organise asset sales or tender offers for their LPs' interests.

We did our first GP-led in 2007 with an Italian fund called Aksia where they sold three assets from fund II to fund III and we then raised €150m with a syndicate of c.10-12 investors to invest in fund III.

How can GPs and LPs benefit in transactions combining primary fundraising and secondary market elements?
For GPs, the secondary market today can help them to replace LPs that are not going to support the fund in the long term, or to offer liquidity to all their LPs by doing a tender offer. It can also help to sell assets left in older vintages into a continuation vehicle and distribute money back to their LPs. These transactions are often stapled with a primary commitment to a new fund, thereby facilitating fundraising for the GP.

LPs can be weary of investing in a new fund if the GP isn't a brand name, so they like to invest in a secondary combined with a primary as this reduces the blind pool risk and allows them to better assess part of the investment.

How else can primary fundraising be supplemented in this market? Are LPs still keen to co-invest?
Co-investments are also a way for investors to reduce blind pool risk. They can invest in a fund and a deal at the same time, so part of their commitment is deployed in an asset that they have been able to analyse.

We did a fundraising recently whereby we brought four investors who acquired stakes in the previous fund and committed to the new fund, and brought an additional investor in the fund who co-invested in the first deal of the new fund. We were able to combine fundraising, secondaries and co-investment in one single transaction.

The role of the placement agent is no longer limited to advising on fundraising, how has the role evolved and what more can GPs be assisted with?
Traditionally a placement agent raised funds and that was it. As far as we are concerned, every time we engage on a new mandate, we look at whether people are going to re-up, and if not, we look at whether we can generate a sale to someone who will buy their stake in the old fund and invest in the new fund. We look at the entire investor base, and if investors are able to get an attractive multiple by selling the older funds, we can organise a tender offer for all LPs to exit and then bring new investors in who would also commit to the new fund.

We also discuss the GP's plans for old assets. There are many situations where GPs have a number of tail-end assets that they need to find solutions for. So, we look at generating liquidity for some of their portfolio companies by selling them into a continuation vehicle. We can also work with GPs to organise preferred equity solutions whereby liquidity is provided to the fund.

There are many hats that advisors wear today and it is a critical part of our role to be able to analyse all options available. The advisor is expected to understand what the market can offer and have extensive knowledge of the various market players. A team that combines primary and secondary expertise is best placed to provide objective advice and to tap into the right investor base.

It is beneficial to have one team covering all services for the GP, as it will not push one solution over another and will have the right contacts with long-term LPs and more transaction-based secondary players.

It also makes the role more varied and interesting for the placement agent.

Debt has become an alternative liquidity source to LP equity replacement, what options are available?
If you need liquidity there are three ways to do it as a GP. You can either sell assets to the private equity market, or you can raise money through preferred equity where investors would give you cash up front and they would take priority in the waterfall. Or thirdly, you can go to the lending market to get a party to lend money to the fund against the portfolios' NAV.

These structures require different processes and come with different risks. The more cost effective solutions have the most constraints. Some of these facilities can conflict with each other, for instance, the terms of an existing capital call facility might limit the ability to enter into a NAV based facility.

The adviser needs to be able to navigate through these different products, to advise clients on the costs and benefits of each strategy, and to provide seamless execution of the process.

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Montefiore Investment V Co-investment

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