KEYNOTE INTERVIEW

The draw of the mid-market

The breadth of GPs and resilient businesses to be found in the mid-market makes for highly compelling single-asset deals, says Hayfin's Mirja Lehmler-Brown

Q How has the single-asset GP-led secondaries market developed over the last few years?

The single-asset GP-led market has seen tremendous growth, outstripping some of the more mature segments within the secondaries industry. In 2023, the global market for single-asset GP-led secondaries reached around $19 billion, out of approximately $109 billion in transaction volume for the secondaries industry as a whole.

At Hayfin, we focus exclusively on single-asset GP-led transactions in Europe, and we expect this market to double if not triple in size over the next three to five years, capturing 4-8 percent of all European sponsor exits.

SPONSOR
HAYFIN

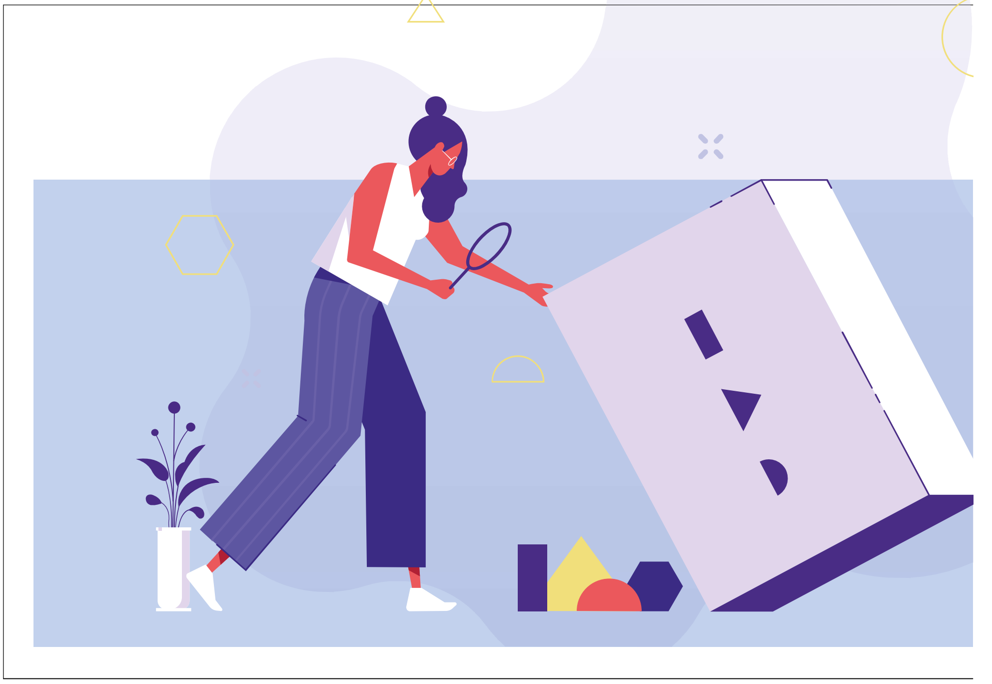
Q What is so attractive about single-asset GP-led deals within the secondaries market?

It's worth noting that the LP stakes secondaries market is significantly more mature than the GP-led market, and the large players in that space have built extensive teams around a very particular skill set. The emphasis there is on diversification, and pricing is based on cashflows. That is not where we are looking to play.

Single-asset deals are about high-conviction, concentrated investments, typically in trophy assets, hence we very much have a stock picking mindset. The way we have shaped our processes and our knowledge about sectors is more akin to a general partner than a limited partner.

In addition to having the fundamental business selection filters, it is about building relationships with GPs – and in the mid-market, where we operate, there are several hundred of them – and then gaining a true understanding of fit and alignment. We have been having conversations with mid-market GPs about which assets would be optimal for a GP-led transaction over many years and are now actively tracking these assets so that when a transaction arises, we have knowledge and conviction of the asset and its fit with the GP.

The multi-asset GP-led market, meanwhile, sits somewhere in between LP stakes secondaries and single-asset GP-leds, but the majority of capital flows in that space are still coming from the traditional secondaries industry. That added layer of diversification enables those players to get more comfortable with pricing the assets, but you still need to mix high-performing businesses with some of the GP's less successful bets.



Q Why do you believe the mid-market offers the most compelling investment proposition?

Just as in the direct buyout world, the mid-market offers a far richer seam of opportunities – there are simply many more mid-market companies than there are at the larger end of the spectrum and that means you can be more disciplined in the companies you choose to work with.

We are industry focused. We prefer to work with technology and healthcare services businesses, as well as other areas of business services that mirror that same level of resilience. We look for durable, preferably double-digit organic growth and 20 percent-plus EBITDA margins. The mid-market segment offers a broader selection of opportunities with these fundamental characteristics, but also features fragmented end markets where companies with established business infrastructure can create significant value via M&A.

Finally, the exit market is more attractive in this segment, particularly in the current environment, where IPOs are extremely challenging, and it is hard to access debt financing. Generally, we find that there is far more exit liquidity in the mid-market. There is a broader set of buyers, including highly acquisitive PE-backed platforms, so when compared to the upper end of the market, where if the IPO window is closed, alternatives are just more limited.

"Just as in the direct buyout world, the mid-market offers a far richer seam of opportunities"

Q What does diligence involve today, both in terms of the underlying asset and the manager?

It is very much the combination of the two that is important. In addition to the core asset diligence, you need to be able to have a trust-based dialogue with the GP in order to really understand the motivation for the transaction and to ensure that the appropriate alignment is in place. Accumulating this knowledge and relationships takes a long time, especially in the fragmented European mid-market.

Today, single-asset GP-led processes often involve trophy assets. The opportunity to get access to these companies, via managers that already know the company intimately, is precisely why we believe concentrated GP-led secondaries represent the most attractive part of the private equity industry today. But not all the GP-led deals that come to market have these ingredients in place.

It is imperative, therefore, to build conviction over time and to only focus on high-alignment situations, where the management team and the GP are rolling over a significant part of their proceeds into the continuation vehicle and in many cases also investing capital from their flagship fund. That understanding of the partner fit is just as important as the analysis of the asset itself.

Meanwhile, when it comes to underwriting the asset, our approach is to

Q Is the single-asset GP-led market primarily made up of continuation vehicles, or is the opportunity set broader than that?

In order to be able to generate an interesting risk return profile, and in order to deliver solutions that really work for the GP, it is important to be able to tailor deals to meet the specific requirements of the situation, and we are therefore flexible when it comes to how a transaction is structured.

If it makes sense for the GP to move the whole asset into a single-asset continuation vehicle and to start again from scratch, then that is something we are happy to do. However, we also come across situations where the GP has owned the asset for a year or so, but the buy-and-build capital needed to fulfil the growth strategy is outstripping what the fund can accommodate. In these situations, we can tailor a top-up vehicle with the specific purpose of providing that additional capital. Moreover, we come across situations where a GP is looking for a minority liquidity solution.

We believe that being able to offer broader and more tailored solutions to fit a particular situation is more valuable than simply lifting an asset out of its existing home and putting it into a continuation vehicle, which is what people generally think of when talking about single-asset GP-led secondaries.

"Management teams also value these transactions. They do not necessarily want to exit their relationship with a fund after a few years"

act like a GP. The materials prepared for a continuation vehicle today are generally similar to those prepared for a normal M&A process, and that is our starting point for building conviction. Our pricing philosophy is not anchored by the GP's holding NAV, but rather by fundamental value. This helps us provide credibility as a true third-party buyer, rather than just validating book valuation.

Q Does that mean that the concept of discounts and premiums is irrelevant in this space?

No, it is not irrelevant because the advisers preparing these deals will often be doing so with traditional secondaries buyers in mind, and discounts and premiums are important metrics for those players. We would also always keep an eye on NAV, as this guides the ability to deliver a solution that is attractive for selling LPs.

Q What value does your broader platform bring to operating in the GP-led market?

It is essential; unlike traditional co-investment and secondaries strategies, where a key platform advantage can be created through primary fund investing capabilities, for concentrated deals a long track record of individual business selection is key.

Hayfin is predominantly a credit platform, with more than $30 billion in assets under management. That means that we have reviewed thousands of businesses since we launched in 2009, and all that intelligence around business models and sectors exists within the firm.

In addition, there have been a number of situations where we have been able to involve our colleagues on the credit side to create tailored solutions spanning both equity and debt.

Q How do you see the single-asset GP-led market evolving in the future?

We are extremely excited about what is to come. We have relationships with more than 300 mid-market GPs, and there isn't a single one of them that is not at least considering a GP-led transaction. This is a fantastic market. We believe it is the best place to be in private equity. You don't have to buy the whole fund anymore. You can handpick companies and construct portfolios for end clients that are the most compelling in the asset class by some margin.

These deals also make sense for GPs. It can be hard to find quality assets and so having the opportunity to continue to back your best companies is a no-brainer. It is a win for the new LPs coming in, who have the chance to invest in these trophy assets, and it is a win for the existing LPs, who can generate the liquidity they need.

I would add that management teams also value these transactions. They do not necessarily want to exit their relationship with a fund after a few years if they can see another stretch of value creation ahead of them. Indeed, we tend to see management teams rolling over proceeds aggressively. All of this is why we expect to see the GP-led market double or treble in size over the next three to five years. ■

Mirja Lehmler-Brown is a managing director within the private equity solutions investment team at Hayfin