KEYNOTE INTERVIEW

Volatility buoys co-investing and secondaries

The challenging economic environment is expected to continue to generate compelling opportunities for both co-investment and secondaries strategies, say David Brett and Jeff Akers at Adams Street Partners

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Q How would you describe the current valuation environment, and what opportunities is that creating for co-investment and secondaries?

David Brett: Valuations remain high, despite pervasive volatility, increased interest rates, tougher exit markets and reduced availability of credit – all factors that you imagine would push valuations down. This is likely because the deals still transacting in this environment typically involve high-quality companies, which offsets downward pressures.

At Adams Street, we focus on co-investment opportunities with GPs that demonstrate a strong record of executing on detailed and actionable value-creation plans. This is even more important in today's uncertain environment. We prioritise investments where we believe GPs can leverage multiple value-creation levers within their control, while factoring in cushions for unforeseen circumstances. This strategic approach gives us confidence in the current valuations of our portfolio and its long-term potential to generate compelling private equity returns for our clients.

Jeff Akers: We think current valuation dynamics present strong opportunities for secondaries buyers with deep GP relationships and a focus on value arbitrage in high-quality funds. When we analyse current private equity marks as secondaries buyers, several observations arise.

First, public market comparables that are often used to value private companies have clearly been re-rated. Second, the generally strong EBITDA growth of private equity portfolio companies over the past 18 months has not been matched by commensurate mark-ups during this period, meaning that holding multiples have come down for many portfolios.

Finally, valuation policies vary among GPs, so market generalities are not always reflected in every fund manager's marks. This lack of clarity on valuation can create enormous potential for secondaries buyers with deep knowledge of underlying portfolios, enabling them to target and isolate buying opportunities in specific funds.

For example, this can allow managers with better visibility into valuation policies to be comfortable buying at a price that may seem elevated to other secondaries market participants. If an adviser understands that the GP employs a conservative valuation policy, the adviser may be able to buy assets at potentially significant discounts to what they believe to be the intrinsic value of the fund interest.

Q What impact is a more challenging fundraising environment having as you partner with GPs across these two strategies?

JA: The primary driver of the challenging fundraising environment for GPs is overallocation to private equity by LPs. That largely stems from the denominator effect, which has been compounded by the constrained liquidity environment throughout much of 2022 and 2023.

As a remedy, LPs are turning to secondaries sales as the quickest and easiest way to rebalance their portfolios and generate liquidity. A surge of motivated sellers has emerged, leading to a supply/demand imbalance in the secondaries market as the pace of new deals outpaces available capital. This imbalance has led to more attractive pricing for buyers.

Meanwhile, many GPs are also looking to the secondaries market to drive liquidity through GP-led deals, rather than generating liquidity through IPOs or sales to third-party buyers via M&A processes. Using continuation vehicles, GPs create liquidity for existing investors while extending their hold period. GP-led secondaries represented nearly 50 percent of secondaries market volume in 2023 and provided an attractive avenue for secondaries investors to deploy capital.

DB: It is interesting that demand for co-investment capital is increasing, despite an overall decline in buyout activity. This demand is due to the more challenging fundraising environment and the increased cost of debt financing. Our GPs are engaging us more frequently, and at earlier stages of the investment process, to ensure they secure certainty for their equity needs.

Having a dedicated co-investment team, and committed co-investment capital, allows us to collaborate with GPs transparently and efficiently. Despite the considerable decrease in sponsor-backed M&A activity, our recent co-investment dealflow has been

Q Is overallocation to private equity amid public market volatility resulting in any change in LPs' views about commitments to co-investment and secondaries?

DB: LPs recognise that co-investment dealflow remains robust, creating opportunities to collaborate with GPs earlier in the underwriting process, which can strengthen relationships with high-conviction managers. As a result, investor appetite for co-investment products remains strong. This is reinforced by the cost advantage that co-investment has historically offered to LPs.

JA: The secondaries market produces an interesting paradox for investors. Secondaries buying opportunities have often proven to be the most attractive when LPs are overallocated to private equity, because sellers are highly motivated. But there is often less capital available for investment in secondaries funds at precisely the point when commitment to secondaries funds potentially makes most sense.

Despite this phenomenon, private equity secondaries funds raised $99.85 billion in 2023, almost triple the $34 billion total for 2022, according to *Secondaries Investor* data, indicating the appetite for secondaries among well-funded LPs. Most LPs view the tactical opportunity today as highly attractive and are particularly keen to invest with secondaries managers that can build conviction in a market that is full of uncertainty.

as strong as it was at the market peak in 2021.

Q How is the more volatile macroeconomic and geopolitical environment, including challenges such as high interest rates, impacting your existing portfolio and the future opportunity set?

JA: Uncertainty creates motivated sellers and makes investments less predictable for buyers. This dynamic can enable discerning and strategic buyers to find undervalued assets. Our strong GP relationships enable Adams Street to conduct deep due diligence on companies as they navigate this challenging environment.

Higher interest rates, meanwhile, benefit our secondaries strategy by making large, levered portfolios less attractive for buyers. This leads to mosaic sales where we can target specific high-quality assets at what we believe are discounted prices.

Our focus on quality is designed to minimise risk. We combine bottom-up risk mitigation with top-down portfolio construction controls, with the goal of avoiding excessive exposure to any single risk factor, including sector, manager, or company. The approach has historically resulted in very low capital loss rates in our portfolios.

DB: Our current co-investment portfolio is holding up well. Adams Street, as a firm, focuses on the investment themes of growth, innovation, change and dislocation. We emphasise backing managers with resilient investment models. These managers typically specialise in specific sectors or strategies and have repeatable value-creation plans for each business they back. They are not relying on financial engineering, where returns are more reliant on capital markets.

We are not market timers. Adams Street takes a disciplined approach to portfolio construction, most importantly around time diversification, but also industry, geography and target company size. Our focus on growth and value creation, as opposed to financial engineering, enables us to build all-weather portfolios for our clients.

When assessing new opportunities, we rigorously examine and pressure-test the assumptions underlying the lead GP's base case. This involves ensuring that debt capital structures include a sufficient cushion to help safeguard against adverse market forces. We also scrutinise future revenue and cashflow assumptions to ensure that we are well positioned to generate appropriate private equity returns for clients.

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>
> **DAVID BRETT**

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>
> **JEFF AKERS**

Q How do your secondaries and co-investment teams collaborate with other strategies within the firm?

DB: Our investment professionals collaborate across our primary, secondaries, co-investment and private credit teams. This creates an effective flywheel of information and relationship development. We have a systematic approach to GP relationship management via cross-team pods, thus enabling the teams to stay up to date with each of our managers.

JA: Our platform is strategically integrated, with each team responsible for investing capital within their strategies. Each strategy benefits from the firm's collective participation across all strategies. Our organisational design, including our ownership structure and cross-team incentives, promotes a culture of collaboration. This has enabled us to source and diligence investments with a competitive edge.

A good example of our collaborative approach is demonstrated by our relationship with a US mid-market GP with which four of our teams have completed transactions. We have had over 70 interactions with the manager over the past three years alone, leading to 16 distinct transaction opportunities across the platform. The collaboration across investment teams has created opportunities for each investment team while also positioning Adams Street for more partnerships with that GP going forward. ■

David Brett is a partner and head of co-investments at Adams Street Partners and Jeff Akers is a partner and head of secondary investments at the firm