Partner David Markson on Non-Traditional Buyers in the Secondary Market

When it comes to buyers, is the secondary market changing?

DAVID MARKSON: It's shifting dramatically, with the universe of buyers diversifying quickly. For the traditional bread and butter deals of the marketplace - straightforward fund stake sales - an increasing number of winning buyers are non-specialists, who were much less present in secondaries five years ago. These buyers include family offices, insurance companies, sovereign wealth funds, endowments, foundations and pension funds and they account for a significant, rapidly growing share of the market. Frequently they buy interests in funds that they know and like from primary market fundraisings, whether or not they've already committed capital to them. That familiarity and confidence means that when they make an offer they are frequently among the highest bidders. Traditional buyers, meaning secondary specialists and funds-of-funds, increasingly look for more complex transactions or very large deals where there are likely to be fewer non-specialist buyers.

Have non-traditional buyers had a big impact on pricing?

DM: They are one of the two key catalysts behind the secondary market's record pricing today. The other main driver of higher prices is the use of structuring in deals. Structuring, including various forms of leverage, is an element that was largely absent from the marketplace five years ago. Some leverage providers are even acting as counselors to non-traditional buyers, pitching them, and then helping them win, more complex deals. For less complex deals involving, say, just one big, well-known fund, the arrival of non-traditional buyers has noticeably increased competition. We see double-digit-premiums on many of these deals because new buyers are applying a longer-term, primary investment mindset. Their focus is on final upside potential. Traditional buyers look much more at current net asset value, near term liquidity and markups; they also buy at discount whenever possible.

What do the high prices mean for secondary returns?

DM: For straight-forward deals, returns are starting to compress as a result of the competition from non-traditional buyers. You're not likely to get the home runs and high upside multiple that investing in a primary fundraising can yield, but you're still often getting very nice returns with shorter duration. You're also benefiting from immediate visibility into portfolio companies and diversification. For assets considered low risk, say solid buyout funds, unlevered returns are typically 8 percent to 10 percent. Those returns can rise to the mid-teens when using structuring or leverage.

How is the arrival of non-traditional buyers affecting secondary market volume?

DM: It's contributing to major growth. People don't invest in a PE fund with the idea of holding it and then arbitraging it against another fund, the way they do with stocks. Investors buy private equity with the idea of holding until liquidation. But investors will sell non-core funds and actively prune their portfolio when pricing is attractive, as it is now. That, and steadily growing fund sizes managed by specialists, should lead to new annual volume records.

How does Triago view its role in the secondary market?

DM: Though we only represent secondary sellers, we spend a lot of time with potential buyers of all types, taking the measure of their interests, whether they're new primary-minded investors or traditional specialists. We also introduce a lot of primary-minded buyers to the secondary market. Our primary fundraising mandates facilitate that, giving us knowledge of the tastes and inclinations of a wide universe of investors. Moreover, to get the best bids from the most appropriate buyers, whether specialist or non-traditional, we follow the principles of auction theory. By that, I mean we offer funds to a select list of qualified investors that we know have heightened interest in a given offering. What we definitely don't do is engage in mass mailings. When potential buyers know they're on a carefully selected short list, they take the time to dig into fund specifics. Overwhelmingly, that leads to greater conviction and focus and, ultimately, better offers.