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PER GUIDE TO A CAREER IN **SECONDARIES**

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TABLE OF CONTENTS

Introduction

The private equity secondaries market is large and growing. Conservative estimates say the UK market will hit £100bn by 2023. It offers an exciting place to build a private equity career, but is often not well understood. As a result, we have prepared this guide to help you understand this part of the market and be better prepared to interview with secondaries funds. We'll give you a practical perspective on what it's like to join a secondaries team and help you understand whether the secondaries market is something you'd enjoy and thrive in.

We've spoken to analysts and associates in a number of secondaries funds, and have combined their opinions to give an overview of what you can expect.

What are secondaries?

Private equity secondaries refers to the acquisition of existing investor, or Limited Partner (LP), commitments in one or more private equity funds managed by General Partners (GPs). The buyer of the commitment will replace the selling LP in the fund and take over any remaining commitments. Consequently, when a vendor sells their interests in a fund, the secondaries investor will have to value the underlying investments already in that fund and evaluate the GP as there may be some unfunded commitments that will need to be provided at a later date.

The secondaries market emerged to provide liquidity to LPs who had invested in private equity funds and had their capital tied up for the life of the fund, which could be ten years or more. They wanted to crystallise their interest in that fund early. The reasons an LP might want to sell their stake vary. It could be strategic, to adjust their allocation to that particular asset class, or it could be due to a need for liquidity.

In the last decade, significant funds have been raised and committed to dedicated secondary investors. The asset class has matured and pricing reflects this. In the early days of secondaries, most transactions took place at significant discounts to cost and were driven by distressed sellers. At the peak of the market, when appetite for private equity as an asset class was buoyant, secondary prices were at or above book values.

Today the secondaries market has a larger supply of vendors and since there is more capital the volume of deals has increased to the point where secondaries is probably the fastest-growing segment of the private equity industry and it has matured into more complex transactions and structures to suit the vendor's requirements. Today's secondary transactions can be financed with leverage just like direct investments and new structures to meet vendors needs are being developed all the time.

Secondaries investors

Secondaries investors with strong market positions include:

- Adams Street Partners
- Ardian
- Coller Capital
- Carlyle, via their purchase of Alpinvest
- Goldman Sachs
- HarbourVest
- Lexington
- Pantheon

Secondary advisory platforms are often involved in intermediating these deals, high quality names in this space include:

- Lazard
- Credit Suisse
- Campbell Lutyens
- Greenhill Cogent
- UBS

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Types of secondaries transactions

Broadly speaking, secondaries can be divided into LP and GP led transactions. LP led secondaries arise when an institutional investor e.g. a pension fund / sovereign wealth fund etc, sells a portfolio of private equity fund commitments. The portfolio can be highly varied in terms of the size of the underlying funds, their investment strategies, their geographic / sector coverages and their vintages.

Examples of LP-led secondaries would include:

PLAIN VANILLA SECONDARIES	These are secondary investments in funds where the majority of the original commitment has been invested. When the secondaries market started, investors looked to buy from LPs where a majority of the committed capital had been drawn down, leading to more rapid realisations. As a result, the holding period of a plain vanilla secondaries investment may be three to five years. Considerably less than the ten years plus when investing at the start of a fund.
EARLY SECONDARIES	Early secondaries invest in funds at an early stage of their investment cycle where they have invested less than 50% of the committed capital. Traditionally, early secondaries weren't attractive to mainstream secondary players, who usually looked for situations with greater visibility on the likely fund composition and performance of the underlying funds. Consequently, these opportunities usually arose when distressed LPs needed to free themselves from the liabilities of unfunded commitments in relatively new funds, and prices were at a significant discount. However, as the market has become more liquid and competitive, early secondaries are no longer limited to distressed vendors and take place more often.
STRUCTURED SECONDARIES	In a structured secondary the vendor keeps some or all of the fund interests on its balance sheet but the buyer agrees to fund some or all future capital commitments of the vendor's portfolio in exchange for a preferred return secured against future distributions from the portfolio. These types of secondary transactions have become increasingly common as some sellers don't want to crystallise any losses through a straight sale of their portfolio at a steep discount but instead are ready to abandon some of the future upside in exchange for reducing the uncalled capital commitments.
SECONDARY DIRECTS	Secondary directs involve the sale of one or a portfolio of direct investments to a secondary buyer of those investments. In these cases, the buyer takes over the management of the realisation programme.
TAIL-END SECONDARIES	Tail-end secondaries are investments made when a private equity fund is approaching the end of its life and the LP wants to sell its remaining 'tail end' positions in order to re-invest capital in new funds.

GP-led secondaries take place when the private equity fund itself comes to the secondary market in search of a solution for a particular situation the fund is in. There are a number of reasons GPs may look to use the secondaries market as a tool. For example, it could be related to a vehicle that is reaching the end of its life cycle, in which there are still assets with some value, but which are not ready for exit. Alternatively, it could be driven by a desire to give its own LPs the chance to access liquidity and crystallise returns. Some examples of GP led secondaries include:

SECONDARY DIRECTS	Secondary directs involve the sale of one or a portfolio of direct investments to a secondary buyer of those investments. In these cases, the buyer takes over the management of the realisation programme.
WHOLESALE RESTRUCTURINGS	Often driven by funds reaching the end of their life cycle, wholesale fund restructurings regularly feature the creation of a new, special purpose, continuation vehicle that will hold the remaining portfolio of operating companies. Typically, the team who made those investments is then incentivised with a new long-term incentive scheme in order to maximise the returns of the new vehicle. LPs in the original fund tend to be given the opportunity either sell or roll over into the new structure, depending on their need for liquidity / appetite to realise the full face-value of their original investment. These restructurings can also be driven by 'spin outs' – either of captive private equity funds that are currently situated inside larger financial institutions, or by individual teams that operate semi-independently from the parent organisation.
STAPLED SECONDARIES	Stapled secondaries are the acquisition of an existing pool of private equity assets while simultaneously making a new, primary capital commitment to a newer fund. This activity could serve to replace one of the original LPs who will not commit to future funds. In this case, the secondary investor would acquire the original LP's interests and commit to invest in the future fund. Alternatively, it could be a straightforward commitment to investing in the GP's next vehicle in order to gain access to the secondary opportunities afforded by existing funds. These transactions can also involve the replacement of cornerstone LPs who have taken large positions in a first fund.

What to expect from a role in secondaries

Everyone that makes it into secondaries is intelligent, thorough and proactive and this makes for a stimulating environment. The structures are flat and partners and principals actively seek your thoughts. Everyone has a slightly different perspective on the same issue and each view is valid and adds depth to the decision making. It's encouraged and expected that you express an opinion. You'll need to think about what's going on and add value to the analysis. Your opinions will be sought and will count.

The working environment is less stressful than in banking. One of the main factors contributing to this is that you'll work with the same people all the time, so teams have time to gel and work well together. During the recruitment process you'll get the opportunity to meet team members and assess the fit.

Most associates joining secondaries firms come from large investment banks or the Big Four professional services firms, so their first impression is the difference in size of the organisation and the variety of people. In one London team, for example, everyone has a different mother tongue. Secondaries teams are usually described as approachable and genuinely friendly places to work.

You'll meet everyone within the first few weeks and start building your own internal network. You might join a secondary team as small as three people or as large as 40 in one location. A global secondaries team might have 50 – 100 professionals across four or five cities. With time, you'll work with many of the professionals in the firm and get to know them. Most teams have a weekly global conference call or meeting where everyone participates and gives their input.

Investment Committee will usually comprise the partners from each office. In some firms, the junior team members working on the investments being presented will participate in the investment committee discussion as well.

The key to your success in secondaries is being able to make a judgement call on how quickly, and with what degree of certainty, you expect each company in the portfolio to be realised. You'll need to think about business performance and make commercial assumptions in your model.

Deal flow is sourced globally and staffing on investments may involve team members from multiple offices. Like banking, secondaries is a 'lumpy business', because it's deal oriented. You'll jump straight into the deal flow on joining and you'll have busy periods where you're working a 90-hour week and others where you'll have much more free time.

The due diligence required on each underlying investment in a portfolio is at a fairly high level and you won't be digging down into the details in the way that you might on a single direct investment. You'll focus on those with the highest values or largest risks. You'll need a good economic view because a fund can have dozens of underlying companies you cannot value comprehensively as individual investments. So you have to be confident in taking a view on how the macroeconomic environment will impact the investments over the holding period.

The financial modelling that secondaries firms complete can be complicated and technically demanding, but the skills developed in investment banking and other corporate finance advisory positions means you should already possess the skills required. As with all investment roles, the quality of your thinking and assumptions is key. All firms will have a template model already built. The exception is on the secondary directs, where the due diligence is necessarily much deeper. In these cases, you'll need to build a full LBO model, often from scratch, and talk extensively to management about detailed cash flow assumptions.

Since most secondaries teams are developing quickly, they're continually trying to improve their internal procedures and due diligence processes. You'll be an active participant in making the business better and more efficient.

On-the-job training

If you're hired into secondaries, you'll probably have all the modelling skills required, so much of the ongoing training is 'on the job'. Specifically, you will learn the techniques of secondary valuations, how to carry out due diligence and how to represent your firm in front of vendors and advisors. The partners will coach you on how to approach investments and provide insight into the different elements of the transaction and the variety of structuring techniques.

If it's a large team, you may be part of a training program with a number of other associates. One global team offers a three-week training course in New York where the majority of the partners participate. You'll be taught using investment case studies and you'll study the investment opportunity and the portfolio positions, value the investment, assess the risks and opportunities, structure the investment and prepare an investment proposal.

The role itself

DEAL EVALUATION AND TRANSACTION WORK	One of the most exciting aspects of working in secondaries is that you'll see many more completed transactions than in buyouts or other direct investment environments. You could work on two to four completed transactions in your first couple of years. You'll be looking at a variety of industries and geographies and will need to think about the value drivers and risks in each. You may also be looking at

investments from infrastructure, growth, real estate and debt funds as well as buyouts.

Transaction work involves due diligence, financial modelling and structuring, conference calls and GP and LP meetings. Half of your time, or more, will involve the modelling or valuation of the transaction. This includes significant time working in Excel, as well as gathering the information and back-up data to make comparable analyses, undertaking due diligence on sectors and individual companies and reviewing your assumptions and all the underlying information.

For any portfolio, the model may be large. Secondaries funds often revisit investment opportunities, rolling forward existing valuation models with updated assumptions. You will rarely find yourself building a model from scratch except on structured deals and directs. On a fund portfolio investment the model involves a balance sheet debt commitments and debt pay down and current NAVs.

To aggregate valuations of underlying investments you will make your own assumptions on the timing and value of exiting each underlying company or security. This involves forecasting growth in the context of economic and sector research; leverage; valuation multiples based on trading comparables and comparable transactions; uncalled commitments (and assumptions on when they will be committed and the returns); commitments; carry; fee stream; and the deal structure

To start your valuation, you'll have information on the companies and how the GP looks at them. In the due diligence process, you'll meet with the managers of the significant investments to develop your assumptions.

If the transaction involves investment in 10 funds of which each has ownership of 10 companies, your model will include 100 underlying companies. So you'll have to make assumptions on 100 companies in different industries and geographies to derive a valuation for that portfolio.

You'll have to forecast earnings by company by talking to the GPs, looking at trading comparables and brokers notes on the sector and, for the largest companies, you'll talk to management teams and review the accounts, the financing and the exit potential of that investment. It's a company-by-company exercise. But you won't have time to do a full LBO and DCF on all 100 companies. You'll focus on those with the most significant effect on overall portfolio value and will have to use your judgement.

The other major components to transaction work are the structuring, negotiation and documentation and completion processes.

PORTFOLIO WORK

In a tough economic climate, this involves understanding what's going on with each current investment and reassuring your investors that you're aware of the risks. Keep in mind that it will be the GPs who will manage the portfolio companies, so you'll be one-step removed. Your role is to analyse the situation from a bird's eye view and gauge the performance and risks. You'll also take a broad perspective on the economy.

ORIGINATION	You'll dedicate time to market and economic research, talking to partners, researching potential vendors and likely markets. You'll also network within the investor community to develop relationships that in turn will drive future deal flow. Most secondaries teams like to source their own transactions 'off-market' where they can avoid competition and the higher prices that auctions imply, so building a strong, private network for proprietary origination is an important task.

Knowledge and experience required

Secondaries investors tend to favour people who have mathematics, science or finance degrees with excellent academic results. They look for the best students with good honours degrees. Work experience could be from a wide variety of corporate finance disciplines including M&A, leveraged finance or private equity as well as valuations and modelling teams in professional services firms.

The main skills and experience you will need include:

- Financial analysis and valuation modelling experience
- Experience of analysing companies and industries
- A good macro-economic perspective
- Some exposure to investment structuring and legal documentation
- Transaction and negotiation exposure
- Good communication skills, written and verbal
- IT literacy, in particular familiarity with Microsoft applications such as Excel, Word and PowerPoint
- Ability to work to tight deadlines and under pressure with minimum supervision

In addition, culture is critical so it's important that you're seen to 'fit in', in particular:

- Ability to work well in a team
- Personable
- High level of professionalism, confidentiality, discretion and judgement
- Strong problem-solving, influencing and relationship-building skills
- Some secondaries teams say they only hire you if you have partner potential, which includes networking and relationship skills so that you can ultimately source investments.

Skills needed to develop within the role

The path to partner is not as structured as in a bank. Strong performers will be promoted earlier, so progression will differ among your peers. If you want to progress quickly, there are four main skill sets you need to demonstrate.

TEAMWORK	Win the support and trust of your colleagues by contributing to the overall team objective with your work effort and opinions.

TRANSACTION EXPERIENCE	This is key to your career progression so that you're able to take the lead on all aspects of the transaction. For example, when you first join, your focus will be to master the valuation of the investments and as you develop you'll be encouraged to participate and contribute more on the negotiation of the terms, the structuring and the legal documentation. Over time you'll learn to be creative with transaction

	structures. There is no amount of training that will replace working on investments.
COMMERCIAL JUDGEMENT	With experience, you'll build your team's confidence in your judgement and you'll be able to represent your firm on transactions and make your voice heard in a constructive way. To be successful you'll need to review large amounts of information and identify the critical points.
ORIGINATION	From day one you'll develop your network, for example by attending conferences and meetings. You'll get to know many GPs and LPs who might be sellers (or even investors in your next fund). It's key to be proactive in building your network. Once you start sourcing transactions you'll be adding real value to the team and securing your route to promotion. In addition, being able to secure new investors for the firm's future fund raising will be viewed as immensely valuable.

What to expect from the interview process

The interview process can be lengthy – often involving psychometric, numeracy and verbal reasoning tests in addition to the case studies and interviews. You may be asked brain teasers during the interviews and investment questions such as, "How would you approach this investment?" It will show up during the challenging interview process if your interest in secondaries and your motivation to join that firm is not clear.

You'll meet most of the senior team as well as analysts and associates. They'll go over your modelling experience, your numeracy and previous exposure to private equity. You'll have to demonstrate that you understand private equity and have researched the secondaries market in particular. The depth of your understanding of secondaries and your level of interest in the sector will be a major differentiator during the process.

During interviews you'll need to establish and develop your own view – you don't have to be aggressive but you do need to back up each assumption you make. You need to be rational and consistent and able to justify your views in extended discussion with associates and partners.

- Be thoughtful, clear and confident in your answers
- Take a position and present it decisively, backed up by analysis
- Answer the question clearly and succinctly
- Explore it from different angles
- Explain how you got to the answer

Personality fit will be the final and key factor in their decision to hire you. You'll spend more time with the team than with your family so it's absolutely critical that you like each other. During the interviews you'll have to build a rapport with the team; let your personality shine through. They'll see lots of people who tick all the boxes in terms of skills and background, but not all will come across as personable and likeable during this strenuous process. Many will fold, get nervous or tense up.

Bear in mind that, culturally, bankers are often taught to listen and are not so used to speaking up, so this can come across as being on the fence. So have a view, and make sure you stay on the right side of the line between confidence and arrogance.

Conclusion

This is an excellent time to be in secondaries. The market is well established and operates globally but is still growing quickly. It is also constantly evolving, as secondaries investors seek new and innovative ways to deploy capital and identify opportunities to generate returns. Secondaries offers something different to the large buyout funds: a much broader outlook on global investments of every vintage, industry, geography and of a vast number of companies at different stages in their lifecycle. As a secondaries investor, you'll get to see a range of investments from numerous funds within different markets, sizes and sectors. In the role, you'll evaluate large amounts of information within tight time constraints and have to make commercial sense of the assumptions related to the underlying companies.

Secondaries is long-term investment with long-term rewards in the form of carried interest. When you join a team, you'll be compensated with a base salary and bonus and may participate in the carried interest scheme. You'll need to stay for the longer term to enjoy these rewards, so research the strategy, performance, track record and viability of the company you wish to join and explore its team culture and dynamics. Get this right and you'll have a mentally stimulating and financially rewarding long-term role.

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