September 2023

The Alternative Investor

Performance

News

Trends

Regulatory updates

The secondary market takes off as it comes of age.

In this edition, **Multiplicity Partners** writes about finding attractive niches in the secondary market, while **Hedgebay** looks at the sector's evolution and its balancing role, **Tyrus Capital** returns to the investment opportunities in the space and what they are seeing, and **PwC** focuses in on third-party transaction valuations.

A Brodie Consulting publication in conjunction with Capricorn Fund Managers and RQC Group.

#27

GUEST ARTICLES (cont.)

Finding niches in the secondary market: six essential factors to consider

Andres Hefti, Partner, Multiplicity Partners

In the realm of secondary market investing, competition is a prevailing force. As per our estimate, dedicated secondary funds currently sit on more than $200 billion of "dry powder". As investors navigate this landscape, the search for less contested opportunities becomes a strategic pursuit. A process of elimination centred around six pivotal factors can guide investors toward such untapped potential.

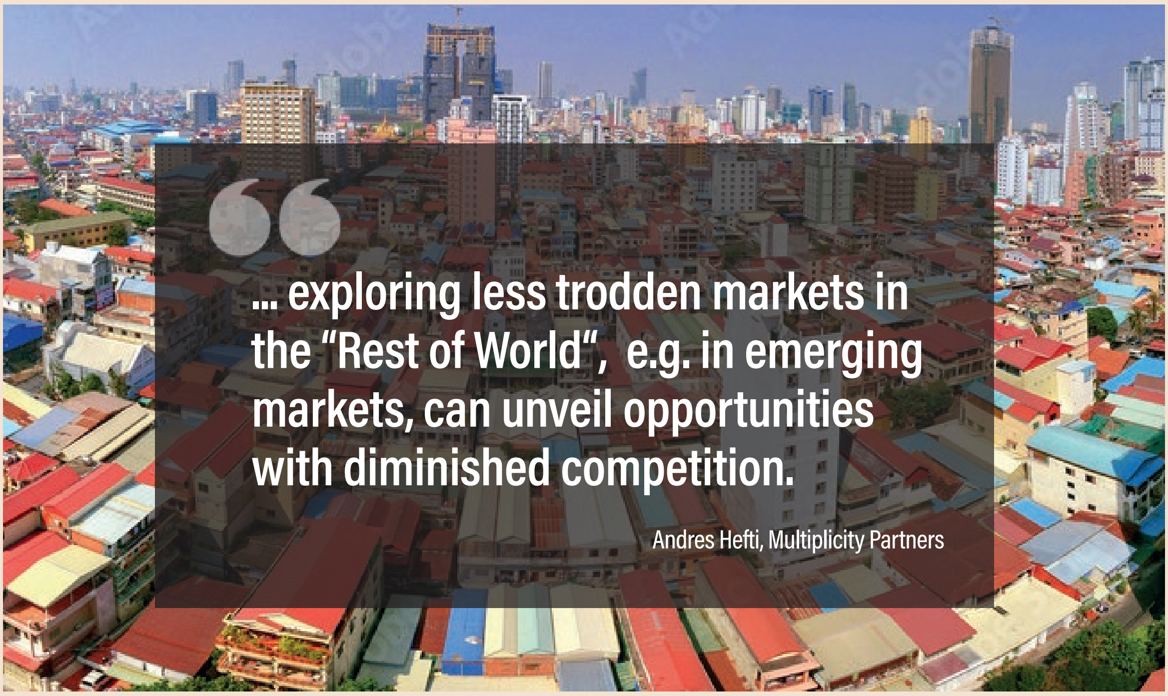
1. Asset Classes: The asset class is a key determinant of competition levels. Private equity (PE) commands more than 80% of secondary deal volume, resulting in fierce rivalry. However, PE's dominance doesn't correlate with its share in total assets under management (AUM), pointing to intensified competition within this sector. Secondary market capital in sizable asset classes such as real estate, private debt, infrastructure and niche alternatives is much scarcer.

2. Geography: Geographical dynamics play a vital role, with nearly two-thirds of 2022 secondary transactions originating from the US. So exploring less trodden markets in the "Rest of World", e.g. in emerging markets, can unveil opportunities with diminished competition.

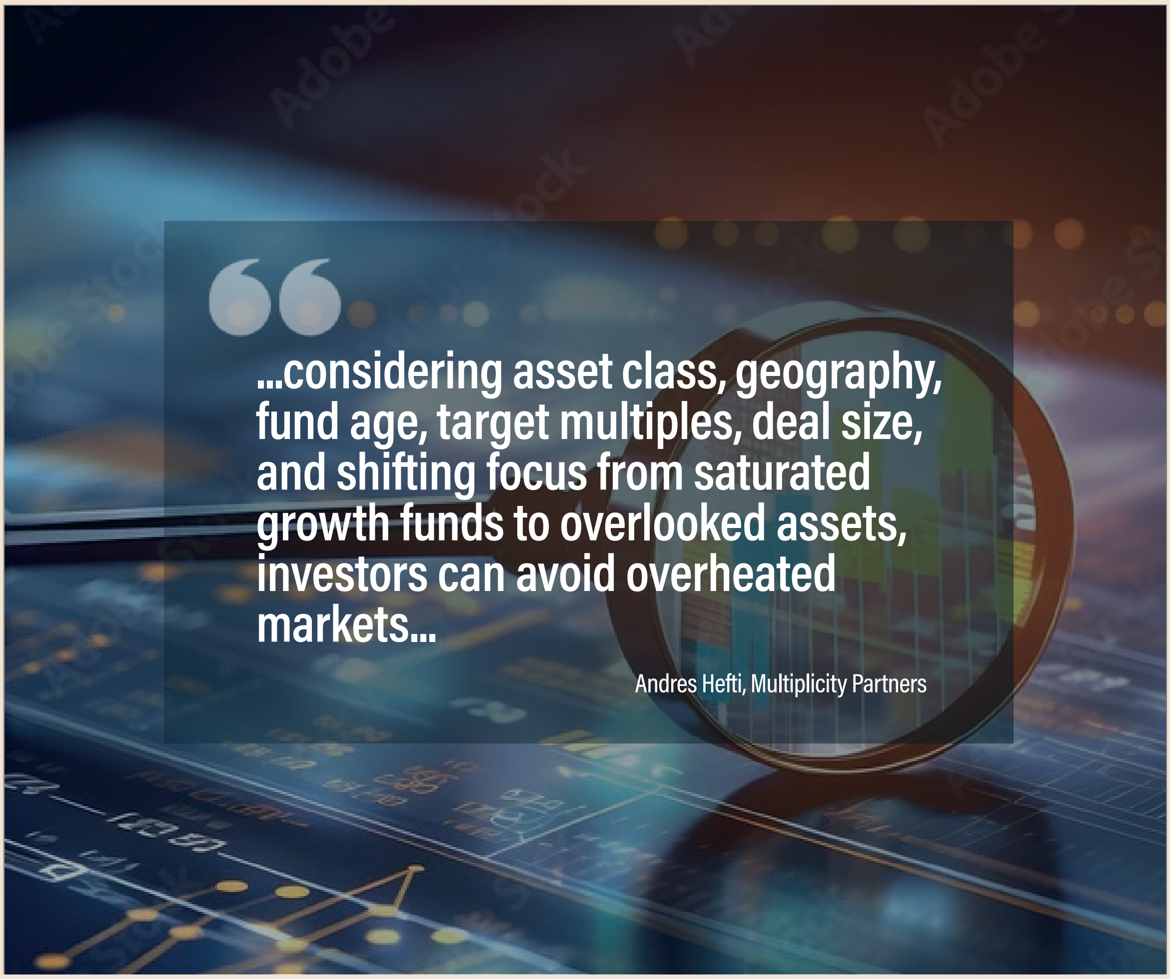
3. Fund Age: Middle-aged funds (4-6 years old) witness the highest transaction volumes due to their proximity to full investment and potential value appreciation. In contrast, tail-end funds present a road less travelled for astute investors seeking attractive shorter-term profit potential.

4. Target Multiples: Most secondary investors target a 1.5-1.7x multiple on invested capital (MOIC) for a balanced risk-reward ratio. However, overlooked deals with lower MOICs but higher certainty and shorter horizons, or higher-risk prospects with 3-5x potential, can add diversity to a portfolio's risk profile.

5. Deal Sizes: Secondary funds' bite size has increased in line with their ever increasing size of AUM. In today's market, deals above $50 million attract most interest from secondary buyers, leaving smaller



GUEST ARTICLES (cont.)



opportunities relatively unnoticed. In particular, deals under $10 million are less competitive and hence offer better bargaining power for buyers willing to put in a lot of work for a smaller amount of capital deployed.

6. Quality and Growth: Historically, the winning strategy of the secondaries investor community has been to buy good funds and rather small discounts to NAV. Hence, most investors today gravitate toward quality funds with growth potential, saturating the market for top-quartile funds. An alternative strategy involves exploring underperforming funds with substantial discounts, revealing untapped value.

In this competitive landscape, employing these six strategies can be instrumental. By considering asset class, geography, fund age, target multiples, deal size, and shifting focus from saturated growth funds to overlooked assets, investors can avoid overheated markets and identify overlooked opportunities.

Andres Hefti, Partner, Multiplicity Partners

Multiplicity Partners is an investment boutique specialized in providing liquidity to holders of private market funds and distressed assets. The firm also offers a range of advisory and governance solutions across alternative assets.

Andres Hefti is a partner of Multiplicity Partners and the Portfolio Manager of the LTO Fund family. He joined the firm in 2013 and built up its capabilities to identify, analyse and execute investment opportunities in hard-to-value assets. He oversees the firm's secondary investments in tail-end portfolios and niche strategies and is responsible for deal origination. Andres has more than 20 years of experience in private markets, distressed investing and portfolio management.