

January 2022



Lazard Private Capital Advisory

# Sponsor-led Secondary Market Report 2021



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As used herein, "Lazard Estimates" refers to a global survey that Lazard launched to take inventory on the secondary market in 2021 and an internal database at Lazard that tracks financial sponsor secondary transactions. The database aggregates information gathered from publicly available sources, discussions with secondary investors and transactions Lazard has executed in the applicable calendar year. The database does not capture all financial sponsor secondary transactions, and certain values in the database are estimates.

## What a Year!

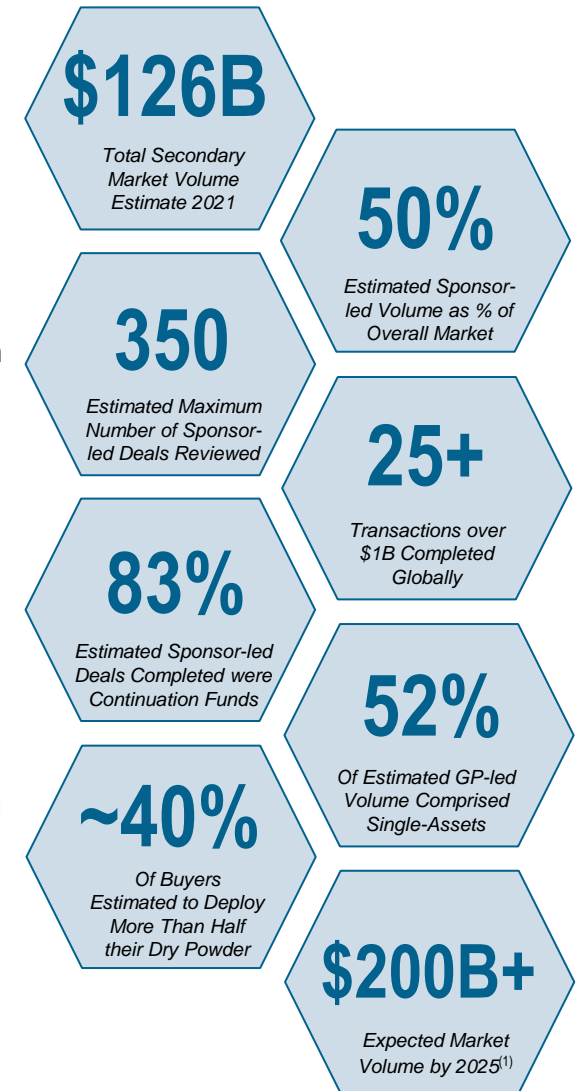
**2021 marked a year of unprecedented growth** for the secondary market. With the broader macroeconomic environment stabilizing, the secondary market flourished with both the LP and GP-led segments posting record results. Lazard Estimates suggest that aggregate market volume grew substantially to over \$126B, with the sponsor-led segment estimated to account for 50% of the market. That represents a 110% increase on 2020's prior estimated record high for the segment.

So what's driving the expansion? The volume of sponsor-led transactions being completed across the globe illustrates the **normalization of these processes as viable alternatives to traditional routes to exits and liquidity**. Today, the market is being used by some of the most sophisticated sponsors in the world to actively drive further value from their portfolio companies and provide a more fulsome suite of liquidity options to their limited partners. 56% of the top 50 sponsors across the world are estimated to have already used the secondary market in some form and we expect this figure to continue rising in the coming years.

One of the key themes of 2021 was the **rise of single-asset transactions**, which is estimated to account for 52% of sponsor-led volume, up from 38% in 2020. Brand-name sponsors raised the bar regarding what is possible in the secondary market, with CD&R's recently completed \$4B deal on Belron illustrating that there is capital available to underwrite multi-billion dollar transactions. Yet it was the **proliferation of these deals that was notable**. Financial sponsors in all geographies and across all sizes used the secondary market to find solutions for strong portfolio companies with attractive growth prospects. With this segment characterized by high-quality transactions, demand kept pace with supply despite many secondary investors facing concentration limits. **New entrants**, particularly traditional limited partners with primary pockets, participated in broader syndicates, many of whom did so for the first time.

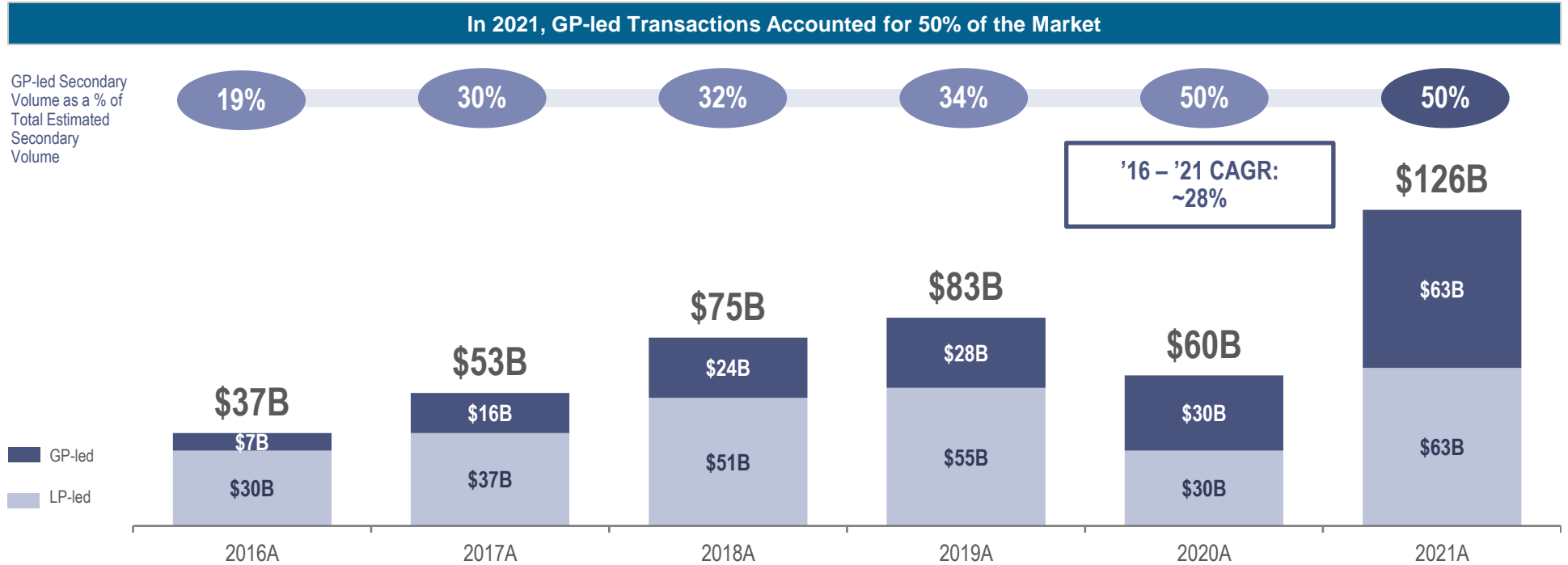
**Looking ahead, another record year for 2022 is expected.** Single-asset deals are expected to continue to form a substantial part of the market, but in the near-term, secondary investors are likely to prioritize multi-asset deals as they look to balance their portfolios. Valuation is expected to be a key area for debate in 2022. New innovations such as equity bridge financing are becoming increasingly commonplace, and as the returns in the segment are further validated, more capital should flow into the market.

This report encompasses the results of Lazard's market research and tracking, as well as a survey of secondary market investors that we conducted in January 2022. We appreciate your taking the time to read the report and look forward to further discussion.



## Record-Breaking Volume, With GP-led Deals Doubling From Previous High

With the COVID crisis stabilizing in 2021, secondary market activity soared, with volume estimated to have doubled on estimated 2020 figures and GP-led transactions accounting for 50% of the market. LP-led activity started to recover in the second half of 2021



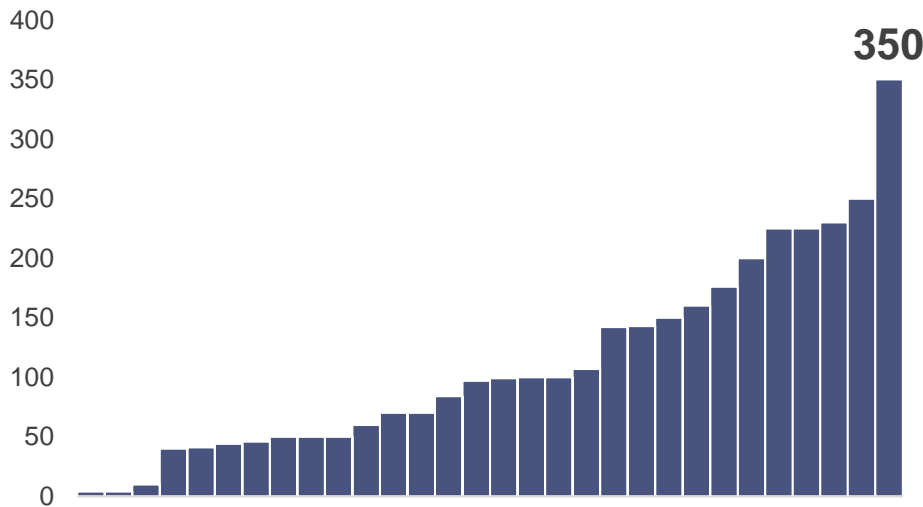
### Key Growth Drivers of the Sponsor-led Market

- BECOMING A NORMALIZED EXIT ALTERNATIVE TO SALE / IPO
- MORE TIME / CAPITAL NEEDED TO MAXIMIZE VALUE
- RELUCTANCE TO SELL HIGH QUALITY ASSETS TO A COMPETITOR
- CRYSTALLIZE STRONG RETURNS AT ROBUST VALUATIONS
- RECORD SECONDARY FUNDRAISING SUPPORTING DEMAND
- HIGH-PROFILE DEALS COMPLETED BY BLUE-CHIP SPONSORS

## 2021 Market Volume at a Glance

Despite further headwinds from the COVID-19 crisis in H1 2021, the GP-led market continued to grow as demand from sponsors remained strong and buyers continued to focus deployment on this segment of the market, based on the Lazard survey conducted in January 2022

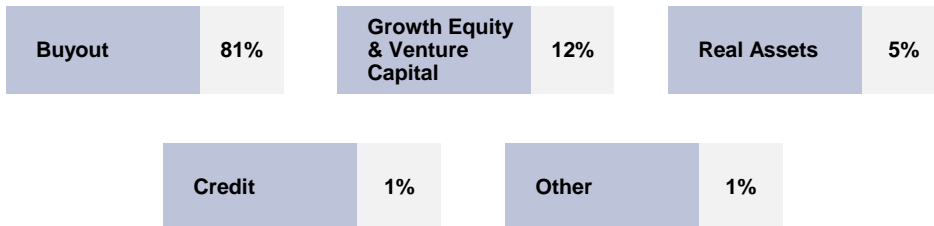
### GP-led Transactions Reviewed in 2021 by Count<sup>(1)</sup>



The number of transactions reviewed varied across market participants, with a low of 10 and a high of 350 potential transactions

### GP-led Transactions Completed in 2021 by Strategy

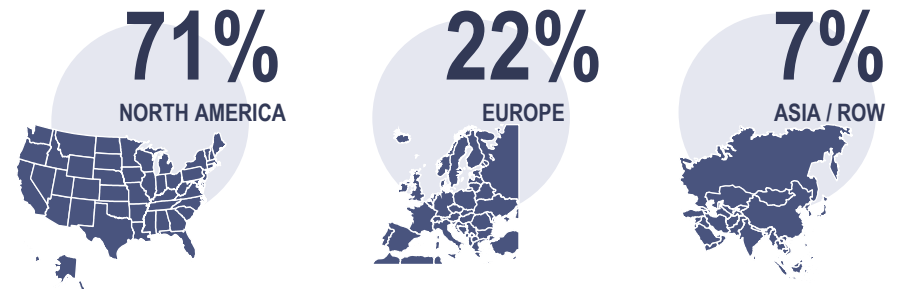
% completed by volume



**25+** GP-led transactions had a transaction size greater than **\$1B** in 2021

### GP-led Transactions Completed in 2021 by Geography

% completed by volume



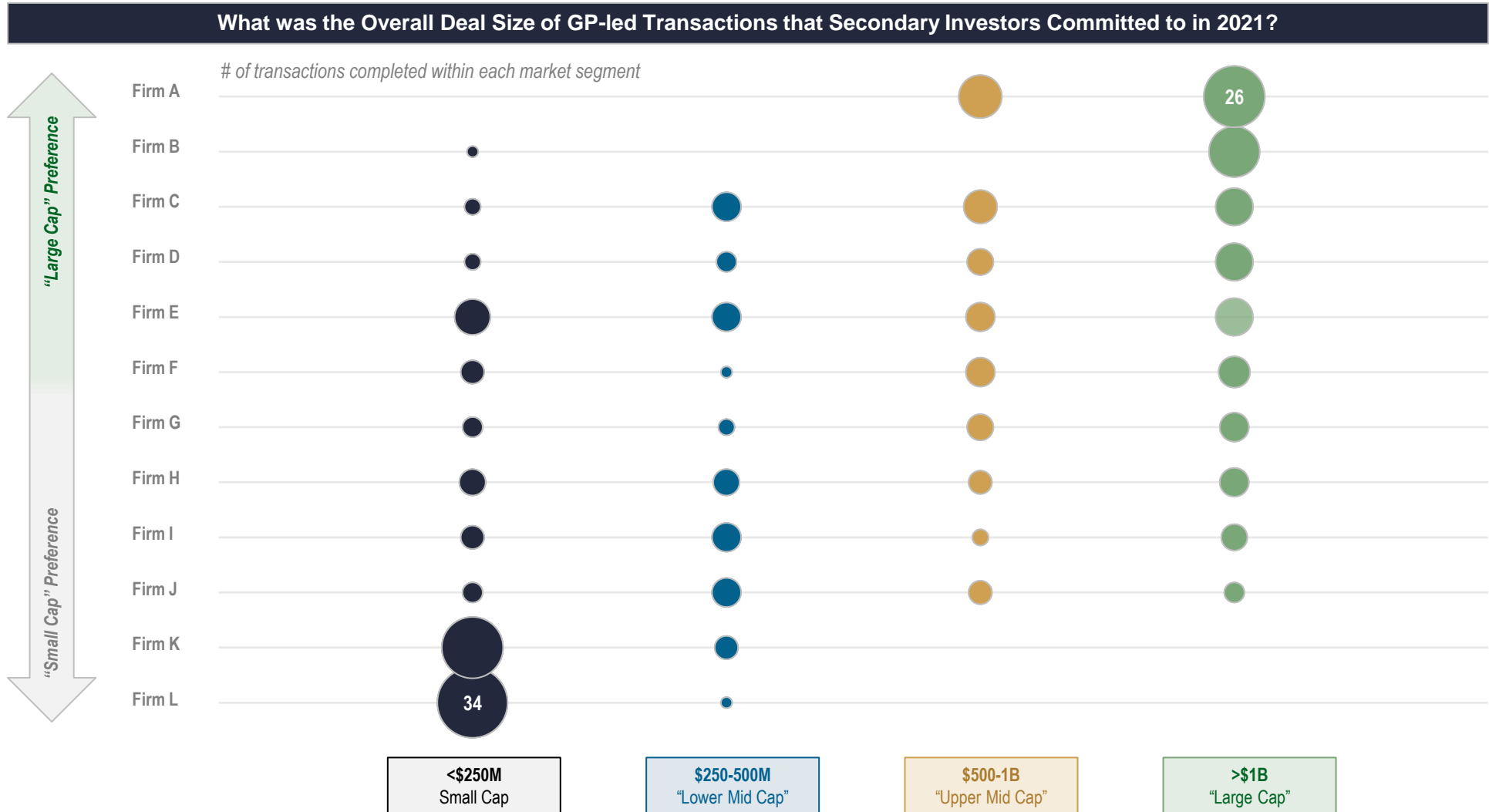
North America remained the busiest region by transactions completed (at 71% of total sponsor-led volume), followed by Europe at 22%



Rebound in LP-led transaction volume in H2 2021 (primarily in the US with Europe yet to fully rebound from COVID-19)

## Broad Range of GP-led Transactions by Size Completed in 2021

Some buy-side firms clearly demonstrated a preference for either “large” or “small cap” GP-led transactions in 2021, while others appear to have opted for a more broad-based deployment strategy



## Capital Deployment by Sponsor-led Transaction Type

Continuation fund transactions remained the most common transaction structure in 2021, specifically single-asset continuation funds estimated to account for greater than 50% of overall sponsor-led market volume for the first time

Capital Deployment by Transaction Type and Invested Capital<sup>(1)</sup> in 2021

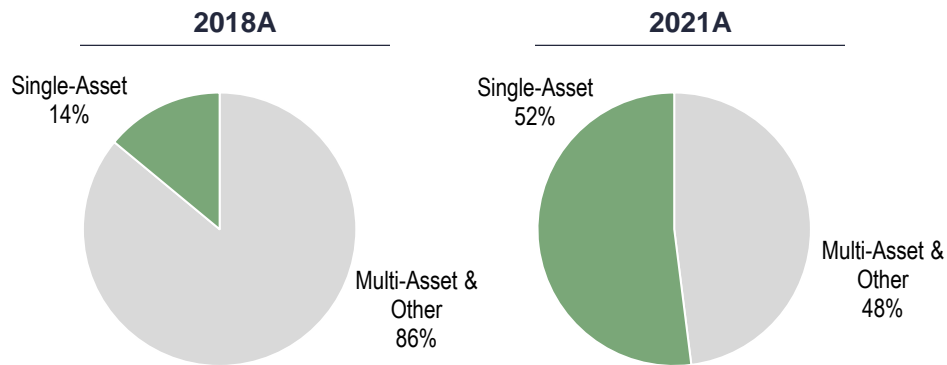
Secondary Transaction Type	Invested Capital Deployed <sup>(1)</sup>							2021 % of Total	2020 % of Total
	\$0-50M	\$51-100M	\$101-150M	\$151-200M	\$201-300M	\$301-400M	\$401M+		
Continuation Fund - Single Asset	17%	6%	7%	4%	6%	2%	9%	52%	38%
Continuation Fund - Multi Asset	6%	5%	4%	3%	4%	3%	5%	31%	34%
Tender Offer	2%	0%	1%	1%	1%	--	2%	7%	5%
Strip Sale	0%	0%	0%	1%	0%	--	--	2%	4%
Preferred Equity	0%	1%	0%	--	1%	2%	1%	6%	11%
Other	2%	0%	--	0%	--	--	--	3%	8%

- 2021 was characterized by a **very strong increase in activity in the single-asset market** as sponsors across the globe embraced the technology to find liquidity solutions for some of their strongest performing assets. With large **blue-chip sponsors recognizing secondaries** as a viable exit route, there was much greater adoption by mid-market sponsors in the latter half of the year, with this theme expected to continue into 2022
- **Multi-asset deals** represented roughly a third of the market, slightly down on 2020 (34% vs. 31%), with **demand substantially outstripping supply**. While tender offers were more popular in 2021, **preferred equity deals represented a meaningfully smaller portion** of the market. The US and European economies and broader financial markets experienced more stable conditions in 2021, which caused there to be less demand for defensive capital and more emphasis on equity solutions for quality assets

## Record Deployment in 2021, Single-Asset Demand is Expected to Taper in Q1

Single-asset secondaries accounted for over 50% of sponsor-led volume in 2021. While some investors are overallocated and have become increasingly selective on these transactions as a result, others are still actively targeting the segment for deployment

### Continued Growth in the Supply of Single-Asset Deals is Expected...



### Commentary

- **Close to half of the top 10 largest** buyout single-asset transactions were completed in 2021
- **High-profile deals raised the bar around** what is possible for the market to underwrite and further normalized the single asset market as a viable exit option alongside more traditional routes
- **Increased education within M&A advisory circles** – a significant driver of origination that did not exist as widely 18-24 months prior
- Dealflow increasingly being **driven by individual investment teams within sponsors** focused on their single portfolio company
- **Increasing dedicated pools of capital** being raised by traditional secondary investors, as well as new entrants with direct PE backgrounds

### Select \$1B+ Single-Asset Secondaries Completed in 2021



### ...Although Buyside Appetite May Be More Selective in Near-Term

“ **The supply of single-asset deals risks outstripping dry powder for these deals** ”

“ **Given the supply-side skew towards single-assets; we expect a pivot back to multi-asset deals as we have more dry powder to deploy here** ”

“ **The growth in single-asset GP-led deals is leading to traditional LPs growing their share in these transactions, albeit as non-leads** ”

“ **Groups will continue to raise pools of dedicated GP-led secondary capital** ”

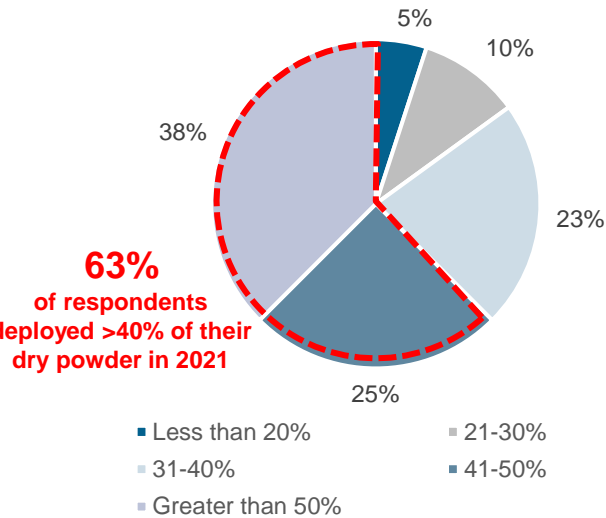


# Deployment Trends

2021 saw record dry powder deployed among the secondary investor community. More than 10 market participants in our survey deployed over \$2.5B in GP-led transactions alone, either as a lead or syndicate investor

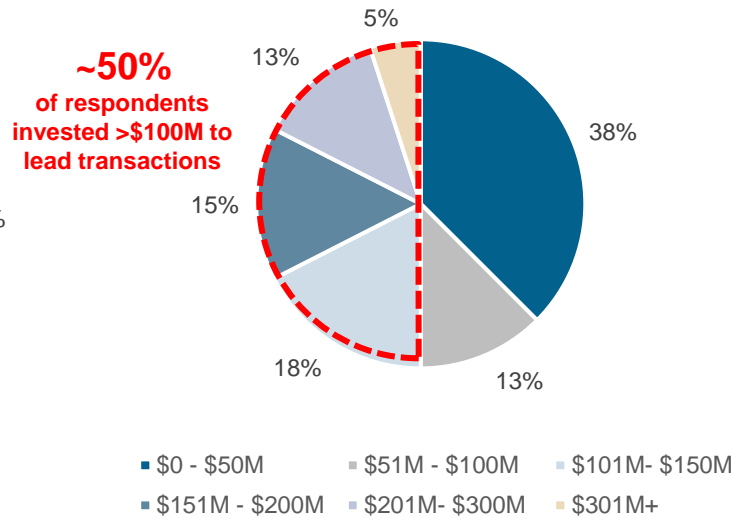
## % Dry Powder Deployed

% of respondents in the survey



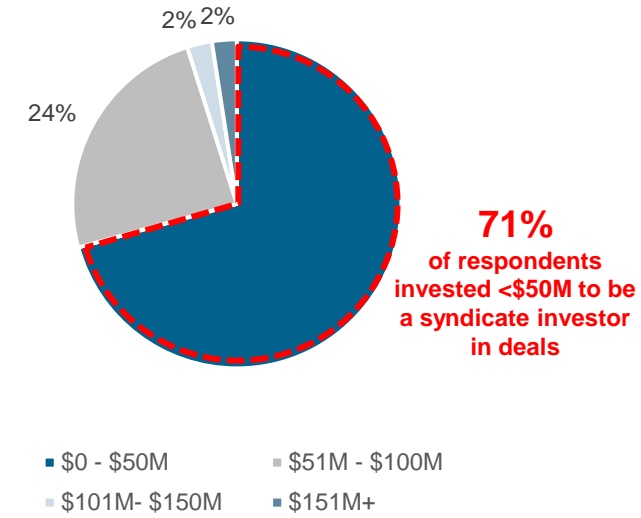
## Average Lead Investor Commitment

% of respondents in the survey



## Average Syndicate Investor Commitment

% of respondents in the survey



**63%**

Deployed more than **40%** of their dry powder in 2021

**>\$100M**

Average lead investor commitment

**71%**

Said their average syndicate commitment was less than **\$50M**

**38%**

Deployed more than **50%** of their dry powder in 2021

**<5**

Buyers globally with an average lead ticket of **\$300M+**

**+10**

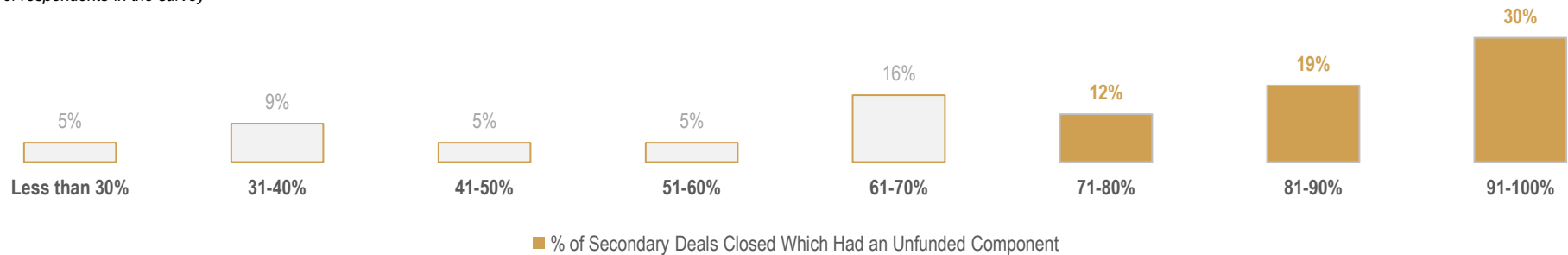
Investors deployed **>\$2.5B** in Sponsored transactions alone

## A Large Majority of GP-led Transactions Included Unfunded Capital

Secondary market GP-led transactions continued to include i) unfunded commitments to generate follow-on capital for portfolio companies (particularly when a sponsor has depleted unfunded capital) or ii) primary staple commitments to support an ongoing fundraise

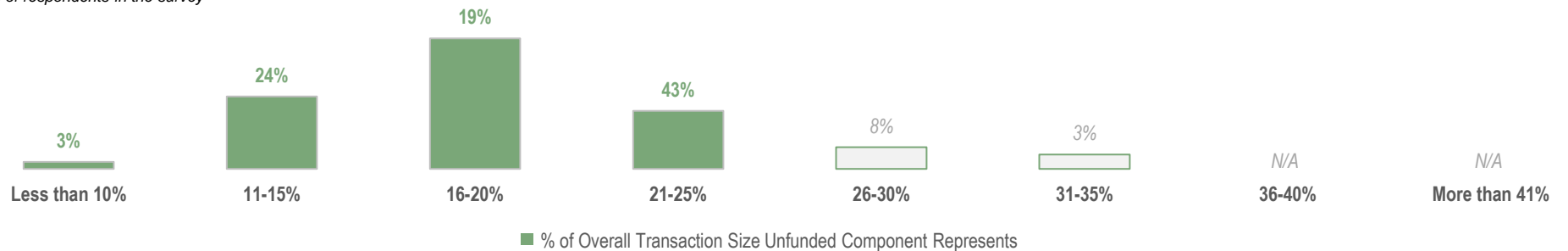
**60% of Survey Respondents Stated at least 70% of Secondary Transactions Completed Included an Unfunded Component...**

% of respondents in the survey



**...With 88% of Survey Respondents Stating the Unfunded Formed no More Than 25% of Total Deal Size in Transactions Completed**

% of respondents in the survey



**A Select Number of Financial Sponsors Continued to Raise Primary Staple Commitments via the Secondary Market**

**<20%**

Of Deals Included a Primary Staple

**Limited Number of Primary Staple Secondary Transactions Executed in 2021 Due to:**

1. GP-led volume in 2021 comprising mostly single/multi-asset continuation fund transactions
2. Many GPs using secondary market are GPs where primary fundraising is not the main objective

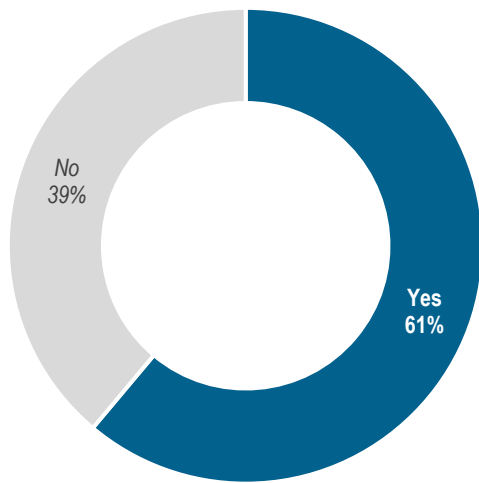
# Buyside Underwriting Targets for GP-led Transactions

Majority of firms underwriting single-assets to returns of greater than 2.1x net, higher than multi-assets, which are typically targeting 1.7-2.0x

## Analysis of the Market Suggests a Clear Difference between MoIC Expectations for Multi & Single-Asset GP-leds...

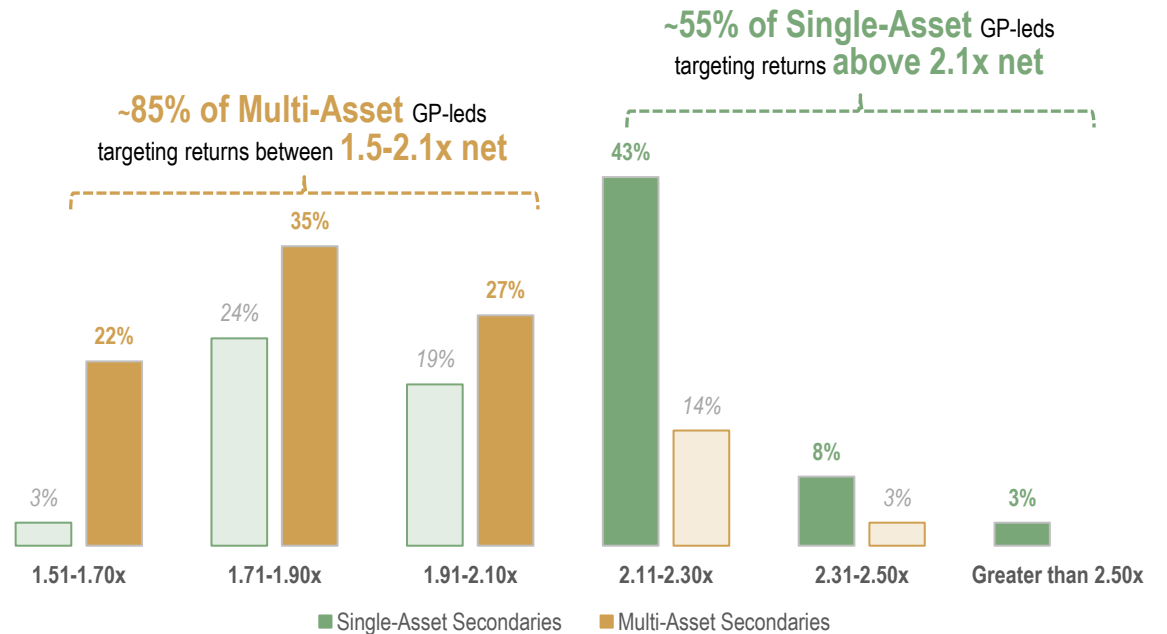
% of respondents in the survey

Is There a Difference in Secondary Investor Return Targets For Single & Multi-Asset Deals?



61% of respondents have differing return expectations between multi & single-asset transactions

What Are Secondary Investor Return Targets For Single & Multi-Asset Deals?



## ...But Not Necessarily When it Comes to IRR Expectations

- Our survey suggests ~50% of respondents have the same IRR expectations for both single & multi-asset transactions (vs. 39% for MoIC expectations)
- This is likely reflective of the fact that multi-asset transactions often have earlier liquidity events for buyside investors vs. single-asset transactions, where the base case MoIC can be higher but often with limited interim liquidity activity
- ~77% of respondents confirmed to Lazard an IRR underwriting target on single-asset deals of ≥20% vs. multi-asset deals where only ~60% of respondents were targeting net IRRs ≥20%

## Increased Use of External Valuations to Set the Price for GP-led Transactions

There has been notable increase in the use of external M&A processes to set the valuation for single-asset GP-led transactions. From a buy-side perspective, our survey suggests a bifurcation in buy-side appetite for this mechanism. Some buyers had a strong preference to set valuation themselves, while others were more comfortable with pricing set externally

### External Valuations Attractive for GPs in Select Circumstances...

#### Overview

- **Valuation based upon a third-party price** received rather than secondary investors pricing the transaction based on a reference date NAV figure
- **Secondary investors do not price the transaction** however instead decide on whether to participate in the transaction based on the price set externally to the secondary market

#### Key Considerations

Can be an **attractive for Sponsors in a number of scenarios:**

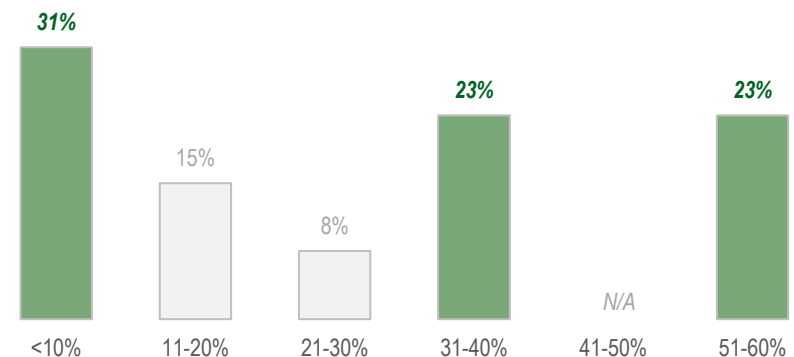
- For instance, if the **Sponsor has conservative valuation marks** (e.g., multiples unchanged from entry)
  - The secondary market typically price transactions within a relatively tight range around the Sponsor's reported NAV. If the NAV is markedly conservative, then the Sponsor may be able to achieve a higher value through an external M&A process
- Can also be a useful tool where the GP receives an **attractive M&A offer for a minority position in the company** but wishes to hold the remainder of their equity for the medium term
- In **many circumstances**, a competitive **secondary market process** is still expected to lead to the optimal valuation outcome for selling LPs

### ...But Have Been a Polarizing Dynamic Across the Buy-side

- The results of our survey are in line with Lazard's experience:
- Some buyers appear to very much like this dynamic → **~46% of lead buyers completed between 31-60% of their deals with an external valuation**
  - Investing alongside multiple credible GPs at a market-tested valuation can be attractive
- Whereas others have a strong preference to set valuation themselves → **~31% of lead buyers completed <10% of their deals where valuation was set externally**

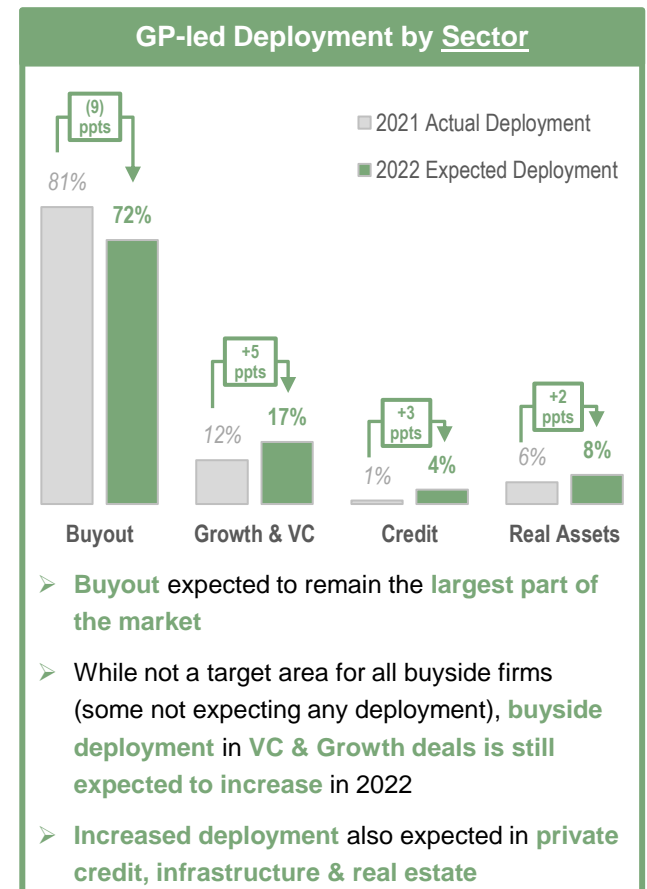
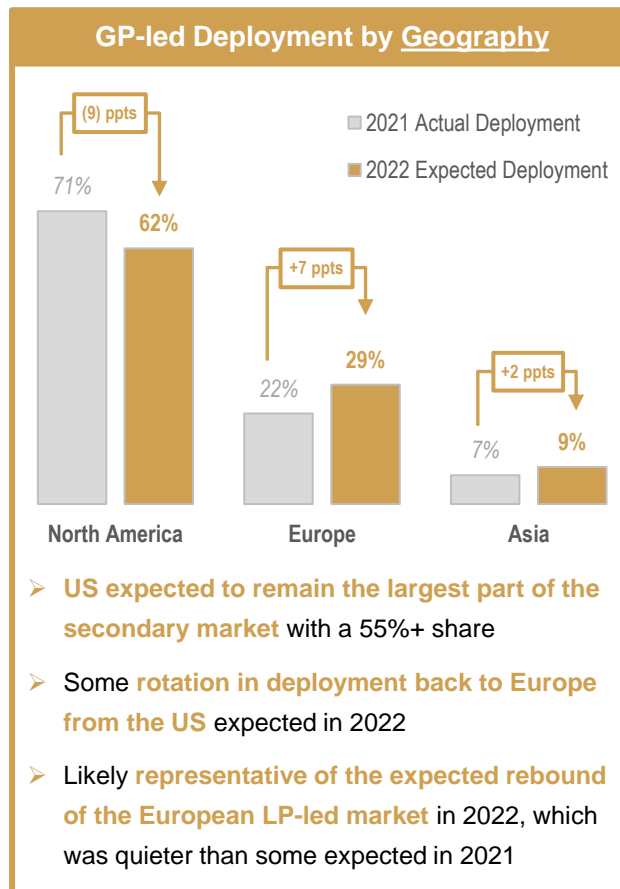
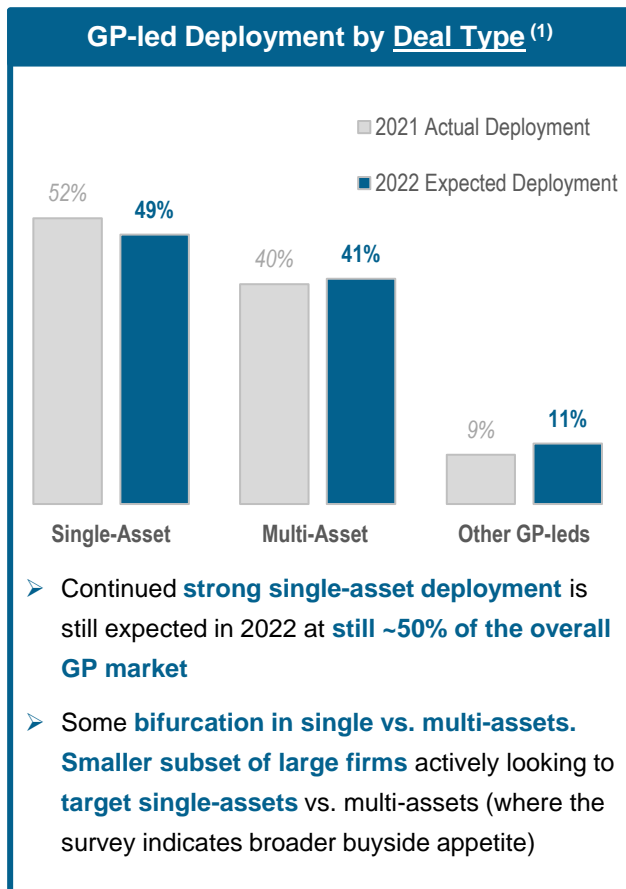
### What % of your 2021 Deals Had Price Set Externally? (e.g., M&A)<sup>(1)</sup>

% of respondents in the survey



## Looking Ahead to 2022 – *Expected Deployment Trends*

Based on our survey, market participants expect a rebound in the European LP market to increase buyside investment in Europe and single-asset transactions are anticipated to remain a material part of the market even if buyers target more multi-asset investment in 2022

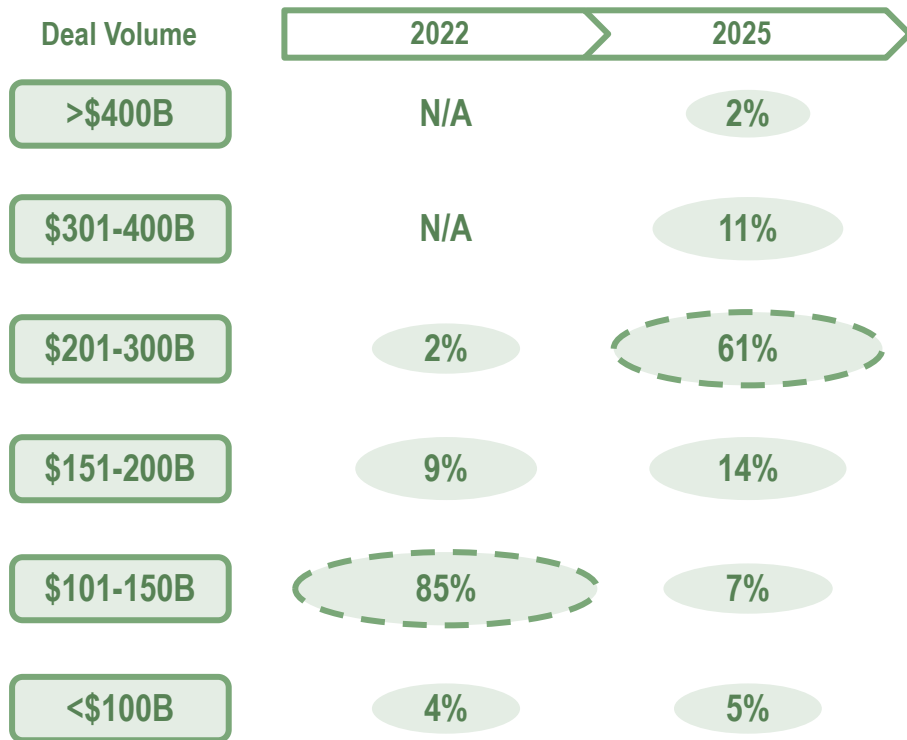


## Secondary Market Transaction Volumes Anticipated to Surpass \$200B by 2025

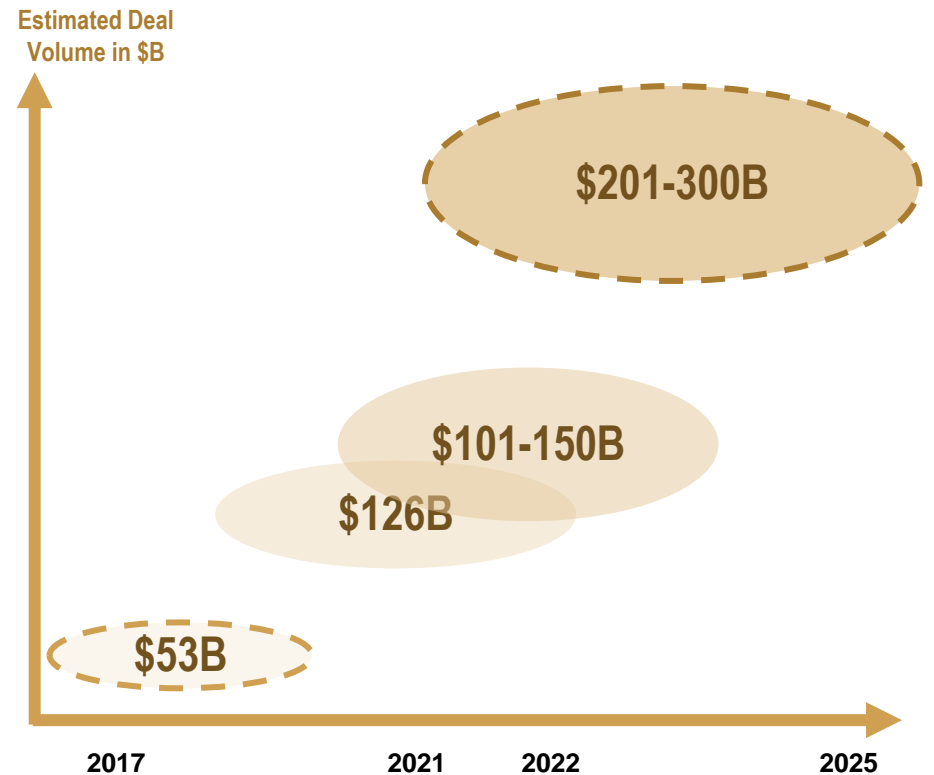
Secondary market participants anticipate transaction volume will continue its growth trajectory in 2022. A majority of market participants also believe that secondary market volume could surpass \$200B in 2025

### Market Respondents Expect Deal Volume to Grow...

% of respondents in the survey



### ...With 2025 Volume Estimated to Reach at Least x4 2017 Volume



### Long Term Trend of Secondary Market Transaction Volume Growth is Supported by:





RECORD PRIVATE CAPITAL FUNDRAISING

GROWING PRIVATE CAPITAL VS PUBLIC DEAL ACTIVITY



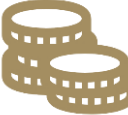

CONTINUED LP NEED FOR LIQUIDITY IN ILLIQUID ASSETS

INCREASED GP USE OF THE SECONDARY MARKET TOOLKIT

## Market Predictions for 2022 – (1/2)

1	<p><b>All Top 50 Sponsors Likely To Use The Secondary Market In The Next Two Years</b></p>		<p>Over the next two years, all of the top 50 sponsors globally are likely to use the secondary market to deliver liquidity to their LPs and retain upside to top-performing assets</p> <p>To date, 56% of these groups have already successfully completed transactions in the secondary market</p> <div style="border: 2px dashed #005696; border-radius: 50%; padding: 10px; display: inline-block; text-align: center;"> <p style="font-size: 24px; font-weight: bold; color: #005696;">56%</p> <p style="font-size: 10px; color: #005696;">Of top 50 GPs estimated to have completed secondaries</p> </div>
2	<p><b>Investors Seeking Diversification To Balance Against Concentration</b></p>		<p>The majority of dedicated secondary funds have raised capital from investors around a premise that their portfolios are expected to be broadly diversified. Given the substantial transaction volume in single-asset and concentrated GP-leds over the past few quarters, many buyers are expected to prioritize diversified transactions</p> <p>This market demand should lead to more multi-asset sponsor-led transactions brought to market in 2022, as well as an increased volume of LP-led deals</p>
3	<p><b>Broader Participation From Traditional LPs In Syndicated Transactions</b></p>		<p>In 2017, on average over 80% of the capital in GP-led transactions came from dedicated secondary pools. In 2021, c.70% of the capital in our syndicated deals came from primary investors. In 2022, a number of large institutional primary investors should complete their first single asset secondary transactions, and some of these may lead transactions too</p> <p>This is an attractive market dynamic for GPs, who can use a secondary transaction to establish new relationships with investors that have ability to become long-term partners</p> <div style="border: 2px dashed #c08040; border-radius: 50%; padding: 10px; display: inline-block; text-align: center;"> <p style="font-size: 24px; font-weight: bold; color: #c08040;">70%</p> <p style="font-size: 10px; color: #c08040;">Of capital estimated to have come from investors with primary arms</p> </div>
4	<p><b>Concurrent Equity Bridge Financing / Refinancing</b></p>		<p>One of the emerging themes over the past few months has been the increasing adoption of equity bridge financing used within continuation vehicles to fund a proportion of the purchase price. These are typically secured against uncalled capital within the continuation fund and help to substantially boost the returns to secondary investors, who effectively view the bridge as a deferral</p> <p>Refinancings have also started to happen alongside secondary transactions on single-asset deals</p>

## Market Predictions for 2022 – (2/2)

5	<p><b>High Sellside Volume As LPs Seek Liquidity to Fund Commitments</b></p>		<p>The fundraising market for 2022 will be highly active. After the worst of the pandemic, deal activity picked up dramatically – leading to record deployment over the past 18 months. This has meant a large number of sponsors, including the mega-funds, are coming back to market faster than anticipated</p> <p>LPs are seeking greater liquidity to fund these commitments and de-risk their portfolios. Sellside volume (both in sponsor-led deals and LP portfolio sales) is expected to stay high in the coming quarters to fuel these commitments</p>
6	<p><b>Increasing Specialization Within Buy-side Teams</b></p>		<p>Given the growth of the market, more specialization within buy-side teams around various verticals is anticipated. There will likely be more specialization across segments of the market such as dedicated LP-led and GP-led deal teams, or dedicated VC/Growth specialists</p> <p>As the market continues to mature, and diligence on concentrated GP-led transactions becomes even closer to that undertaken in the direct market, an increase in specialization around key sector verticals such as tech and healthcare is expected</p>
7	<p><b>Portfolio Company Management Team Liquidity Offerings Start To Emerge</b></p>		<p>While still nascent, secondary market technology is expected to start being applied outside of the traditional LP universe, with liquidity solutions being offered to the management teams of sponsor-backed portfolio companies. These processes facilitate the acquisition of management stakes, which are transferred to a vehicle managed by the sponsor</p> <p>These transactions could give sponsors the opportunity to increase their exposure to assets they have strong conviction in, while providing some interim liquidity to management teams ahead of a full exit</p>
8	<p><b>Investment Thesis For GP-leds Increasingly Validated</b></p>		<p>The first realizations from sponsor-backed transactions completed in the initial stages of the market's development are starting to come to fruition</p> <p>As the track record of these deals becomes more established, the investment thesis behind sponsor-led transactions is expected to be increasingly validated. This in itself should attract further capital to the market and lead to more dedicated pools of capital raised exclusively for sponsor-led opportunities</p>



# Lazard Private Capital Advisory

FOR OPPORTUNITIES OR FURTHER INFORMATION PLEASE CONTACT



**HOLCOMBE GREEN**  
holcombe.green@lazard.com



**PHILIP CHAPMAN**  
philip.chapman@lazard.com



**KEVAN COMSTOCK**  
kevan.comstock@lazard.com



**MARION COSSIN**  
marion.cossin@lazard.com



**ADAM HANDWERKER**  
adam.handwerker@lazard.com



**NADIRA HUDA**  
nadira.huda@lazard.com



**JAMES JACOBS**  
james.jacobs@lazard.com



**DAN KLIMA**  
dan.klima@lazard.com



**NICHOLAS MILES**  
nicholas.miles@lazard.com



**ABHIJIT MITRA**  
abhijit.mitra@lazard.com



**PATRICK NO**  
patrick.no@lazard.com



**WILLIAM OSBORN**  
william.osborn@lazard.com



**WILLIAM RIDDLE**  
william.riddle@lazard.com



**STEPHEN SALYER**  
stephen.salyer@lazard.com



**AMANDA UGARTE**  
amanda.ugarte@lazard.com



**JUDE WONG**  
jude.wong@lazard.com

## BOSTON

222 Berkeley Street Suite  
1100-A Boston MA 02116  
United States

+1 617 342 8000

## CHICAGO

300 North LaSalle St  
Chicago IL 60654  
United States

+1 312 407 6600

## LONDON

50 Stratton St  
London W1J 8LL  
United Kingdom

+44 20 7187 2000

## LOS ANGELES

1999 Avenue of the Stars  
Suite 1800  
Los Angeles, CA 90067  
United States

+1 310 601 3400

## NEW YORK

30 Rockefeller Plaza  
New York NY 10112  
United States

+1 212 632 6000

## PARIS

175 Bd Haussmann  
75008 Paris  
France

+ 33 1 44 13 01 11

## SAN FRANCISCO

4 Embarcadero Center  
24th Floor  
San Francisco CA 94111  
United States

+1 415 623 5000

## SINGAPORE

One Raffles Place  
#29-63 Tower 2  
1 Raffles Place  
Singapore 048616

+65 6534 2011