Secondaries stalwart

Having closed its ninth fund at $14 billion, Lexington Partners is hunting for assets in a secondary market that is becoming larger and more diverse. Asia is on the agenda, whether it's GP-led deals or LP portfolios

LEXINGTON PARTNERS HAS MADE ITS presence felt in Asia over the past couple of years by taking the lead in the region's two-largest GP-led secondary transactions. Deals of this nature have emerged as a significant growth driver of secondaries globally. According to Greenhill, GP-led volume hit $24 billion in 2018, up from $14 billion the previous year. It reached $14 billion in the first six months of 2019 alone.

Nevertheless, Wilson Warren, president of Lexington Partners, isn't overly bullish on the trend. The secondaries investor has dry powder aplenty, having recently closed its ninth fund at $14 billion, but it is unclear how prominently GP-led deals will feature. "It's a bit episodic. The percentages can be different every year because these transactions are lumpy," Warren says. "There is an interest in that percentage increasing but it's dependent on a lot of factors. One factor is can buyers offer a liquidity alternative to holders of these assets that clear the market."

When these deals are used to reshape an LP base or finish off a fundraise – i.e. not when a troubled manager is struggling to get initial traction – they are often priced close to net asset value (NAV). If investors started making discounted bids, LPs might well decide it is in their interests to persevere rather than trade.

"We are receiving more inbound inquiries and that will continue to be the case, but our bar is very high. We have turned down multiple deals," adds Kirk Beaton, a partner at Lexington. "You must get the right price for sellers to come to market and each deal is different. Even if it's a high-quality GP, a transaction might not work for Lexington. The Warburg Pincus deal was an interesting one for the market because they are a blue-chip GP and it enabled us to have conversations with other groups that hadn't really thought about that type of transaction in Asia."

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Accessing Asia

In late 2017, Lexington teamed up with Goldman Sachs to acquire a $1.2 billion strip from Warburg Pincus' 11th global fund, comprising a minority stake in every Asian investment. Warburg Pincus – which continues to manage the investments – wanted to right-size the portfolio and lock-in some gains. Lexington returned in 2018 with a stapled $1 billion secondary involving TPG Capital's fifth and sixth Asian funds. It made a tender offer to LPs and took out various existing positions as well as investing new capital in TPG's seventh fund. The pricing was close to the NAV of the blended portfolios and most LPs chose not to tender their stakes.

The point about episodic deal flow is especially pertinent in Asia, which lacks the depth of Europe and the US. GP-led transactions worth a combined $4.8 billion were completed in 2018, up from $2.7 billion the previous year, according to Lazard. However, 2019 was more muted. A handful of investments closed, though nothing to match Warburg Pincus or TPG.

Secondary volumes globally rose from $58 billion in 2017 to $74 billion in 2018 (so the record level of GP-led activity still only accounted for one-third of the overall market) and then $42 billion in the first six months of last year. Nine deals of $1 billion or more were struck in the first half. They included what has been described as the largest-ever secondary transaction as Ardian acquired a $5 billion portfolio from Japan's Norinchukin Bank. Earlier in the year, Lexington picked up assets worth $1.4 billion from the same seller.

Meanwhile, Greenhill estimated that secondaries investors held $91 billion in dry powder as of June 2019, with a further $34 billion in available leverage.

Lexington's ninth fund is the joint-largest ever raised in the secondaries space, with commitments coming from more than 450 investors, ranging from sovereign wealth funds to high net worth individuals. The firm beat its $12 billion target and comfortably exceeded the $10.1 billion raised for Fund VIII, which closed in 2015. The fundraise is seen as a reflection of the secondary opportunity set within the $3.4 trillion committed to alternatives in the primary vintage years of 2012-2018.

A diverse market

Lexington has already committed approximately 30% of the corpus across more than 30 transactions sourced from public and corporate pensions, foundations and endowments, banks, and other financial institutions. It expects continued growth as LPs engage in active portfolio management, some investors seek earlier liquidity, and sponsors pursue GP-led deals.

At the same time, these private equity positions have become increasingly complex. "There are a lot of holders of co-investment these days, commitments to funds have gotten larger, there are separately managed accounts out there. The secondary market and the sellers have become more diverse over time. And that's before you even start talking about more organized transactions, what the market is now calling GP-led transactions," says Warren.

Norinchukin's activity in 2019 offers a snapshot of what might be achieved in Asia as large investors undertake portfolio rebalancing. Lexington celebrates its 10th anniversary in the region this year and the local team now numbers 10. The firm has spent its time cultivating relationships in the anticipation of future deal flow as well as initiating transactions and bidding for assets. Warren observes that Asian sellers might be quicker to embrace secondary solutions than their Western peers.

"Even though the programs might be younger, some of the main issues from a portfolio standpoint that US and European holders of these assets have realized over a longer period, some of Asian investors have figured out early," he says. "They have thought about how many managers they want to have and what to do with non-core as their strategy changes and evolves."

How quickly this translates into increased deal flow remains to be seen, but Lexington is willing to be patient. The firm looked at $125 billion of assets last year and invests at a pace of $3-4 billion per annum. "A fair percentage of that $125 billion didn't trade, so maybe it's not a transaction for today but it's a relationship and a discussion we've begun and come back to," Warren adds.