HAYFIN

The Great Unbundling

Accessing PE's top performers via single asset secondaries

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Private equity markets are at a watershed moment. A structural increase in competition, driven by dry powder accumulation, and capital market dislocation, are causing a significant decrease in exit liquidity and creating a scarcity of high-quality investment opportunities.

“To unlock and evaluate these complex transactions, an investment team with a combination of a direct investing skill set, deep sponsor networks, a strong understanding of partner fit and deal agility to navigate the stakeholder ecosystem is required.”

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Historically, in similar moments of dislocation, the secondary market has proven its ability to innovate and act as a catalyst for liquidity, as well as provide attractive risk-adjusted returns. We believe the emergence of single-asset secondaries in private equity is likely one of the most profound recent shifts in the industry and is redefining the way limited partners and capital allocators construct their exposure to the asset class. Investors are now able to access some of the most coveted privately owned businesses alongside incumbent sponsors and management teams that already know these assets intimately. Single-asset secondary strategies address some of the key drawbacks of traditional primary and secondary investing. Granular control over asset selection, unbundling of portfolio construction, and an attractive returns profile with asymmetric upside can be achieved whilst retaining a balanced sponsor and company diversification profile. We believe capital allocators are now able to overweight their exposure to the top decile cohort of private equity opportunities. To unlock and evaluate these complex transactions, an investment team with a combination of a direct investing skill set, deep sponsor networks, a strong understanding of partner fit, and deal agility to navigate the stakeholder ecosystem is required.

Single-asset transactions have emerged as the engine for growth in the secondary market.

These relatively new structures started to get some momentum shortly after the beginning of the GFC in 2008/2009, but it has taken the market over a decade to embrace GP-led secondary transactions and to move away from the stigma of being linked to underperforming funds in need of restructuring. Today, there is even a new, more fitting name ("continuation funds") and GP-led transactions now account for approximately half of overall PE secondary market transaction volumes. Typically, blue-chip sponsors are utilising this valuable tool to help effectively manage the balance between exit timing and value optimisation. As sophistication and appetite for concentration amongst secondary buyers grows, the boundaries between direct investment, co-investments and secondaries start to blur. This has generated $20bn-$30bn of annual transaction volumes involving single-asset continuation vehicles over the last three years. The market depth and technology for single-asset secondaries is now established and spreading from the early adoption in the large-cap space into the much larger and more fragmented mid and lower mid-market buyout space. We believe that, in Europe alone, the single-asset secondary segment can account for 4%-8% of overall PE exit activity or €10bn-€20bn p.a. by 2025.

Single-asset secondaries are the fastest growing segment in the market

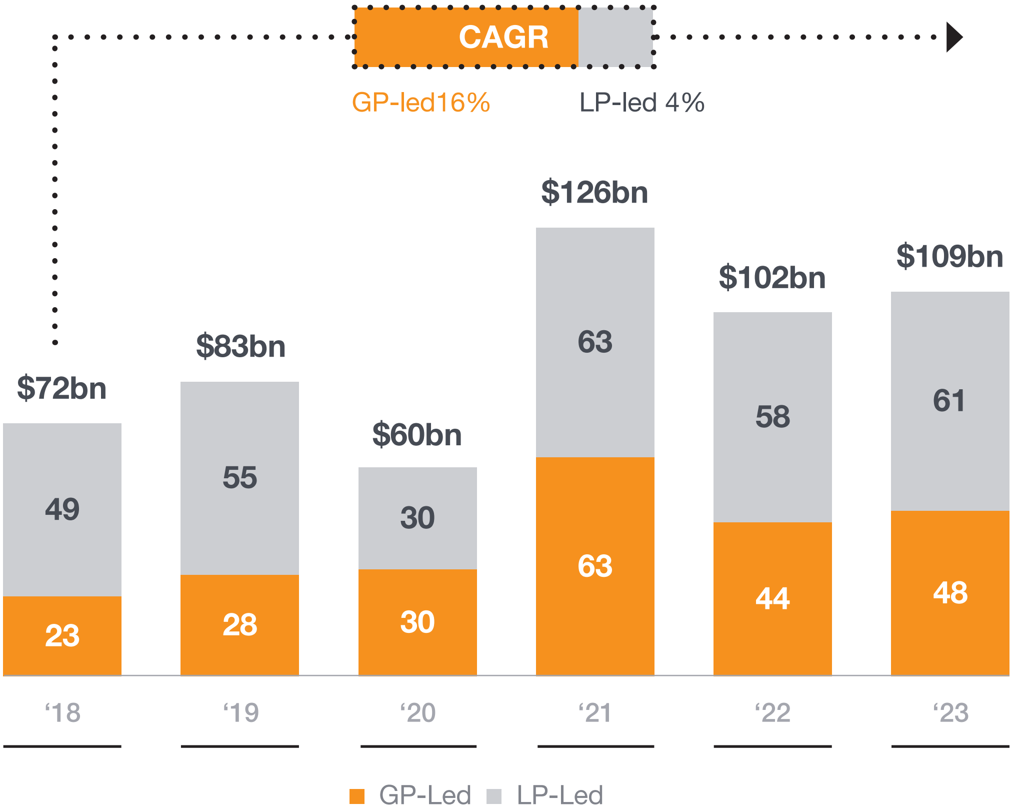
Growth Turbocharged by Dislocation
Large and structurally growing market currently boosted by significant tailwinds

Access to 'Trophy Assets' Driving Stronger Absolute Returns
Market focused on single company deals featuring "trophy assets"

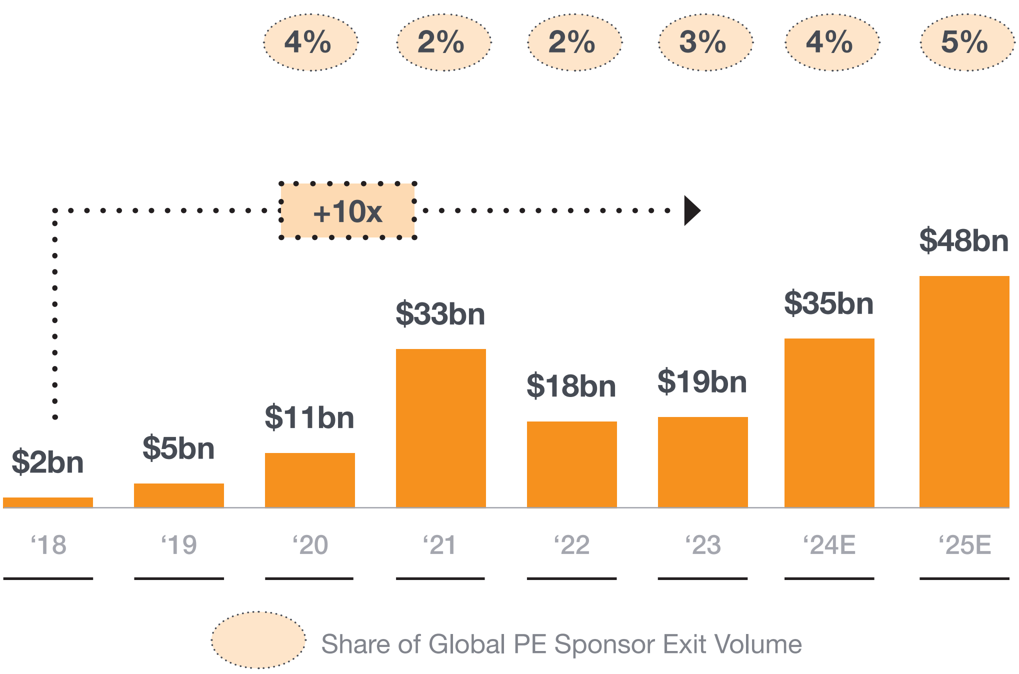
Positive Selection Bias
Incumbent GPs have unmatched insight into their assets and GP-led transactions tend to benefit from fair and aligned entry valuations

Economic Terms Structured for Alignment
Fee structures designed to reward outstanding performance whilst protecting the downside

Secondaries Market Global Deal Volume ($bn)



Focus on Single-Asset Transactions ($bn)



Sources: Evercore Secondary Market Survey; Lazard Secondary Market Report; Hayfin estimates

Single-asset secondaries

~2x-4x[1] Incremental boost to GP economics vs. traditional sale	**>3x Gross MoIC[2]** Return achieved for selling LPs by 55% of 2023 GP-led deals	**>2x Net MoIC[3,4]** Average underwriting target for single-asset CVs in 2023
>50%[3] Incremental AuM from CV as % of last fund raised	**92%[2]** % of reference date NAV achieved for single-asset CVs in 2023	**~5%[2,3]** "Market standard" GP-commitment for single-/multi-asset CVs

Sources: 1. Hayfin estimates; 2. PJT Park Hill 3. Lazard; 4. Evercore.

Here to stay

This attractive but emerging market opportunity has been created by structural changes in the private equity space, primarily increasing competition for high-quality investment opportunities in the direct buyout segment. In a maturing, high-asset price market, it is increasingly difficult to generate the historic outsized returns that private equity investors have grown accustomed to, so GPs are increasingly focused on driving their winners or "trophy assets" for longer to generate larger absolute returns. However, retaining control of a trophy asset typically requires investing incremental follow-on capital, in many cases beyond fund diversification limits, and holding these assets for longer than the term structure allowed for by traditional private equity funds. These factors, together with the increasing need for alternative routes to liquidity in PE portfolios have positioned continuation vehicle structures as a valid exit alternative and have enabled a "win-win-win" proposition for sponsors, management teams, existing investors, and secondary sponsors.

From a GP's perspective, the commercial rationale is clear: ability to retain a top-performing asset, additional time for value creation, more follow-on capital for assets, increased economics and AUM (whilst keeping to its flagship strategy in its core size bracket), and potential to realign the asset's future value creation to the current investment team and management. For management teams, these structures offer continuity and avoid the disruption of an exit and a wholesale ownership change. Existing LPs receive liquidity at attractive return levels, and also have the option to maintain exposure to some of the best investments in their portfolio. Meanwhile, secondary sponsors benefit from an incredibly compelling dynamic that allows investment in high-quality assets, alongside highly motivated partners. Incumbent GPs, who have an unrivalled understanding of their portfolio companies and management teams, can select their best assets for continuation vehicles and invest incremental personal capital in these transactions as they act as both buyers and sellers.

The market forces at play have been recognised and validated by key participants in the PE ecosystem. Over the past five years, eight out of the ten largest European PE firms have considered or executed a GP-led secondary transaction, paving the way for increasing penetration among smaller sponsors. Furthermore, in addition to secondary firms, large-cap US and European direct sponsors have started strategies dedicated to investing in the space alongside their flagship strategies. On the sell-side, which traditionally has been dominated by a handful of advisers, there has been numerous market entrants with high ambitions in the GP-led space.

Core component of a PE portfolio allocation

Although there are strong structural arguments around the attractiveness of single-asset secondaries, these transactions are still an emerging niche with no established allocation slot in institutional capital portfolios. We believe single-asset secondary strategies should be a key component of an alternatives allocation, as allocators can target much more precise long-term sector and segment exposures that reflect their overall private markets posture, whilst delivering attractive risk-adjusted returns. The strategy benefits from the key advantages of traditional secondary investing and direct co-investments, whilst simultaneously addressing some of the drawbacks.

The key driver for the initial implementation of single-asset secondary allocations in institutional portfolios is likely to be the same reason buy- and sell-side PE participants have embraced the strategy: access to high quality investment opportunities that are not available in the main M&A market. Depending on the pace of growth in the segment, concentrated GP-led deals could account for almost a fifth of sponsor-to-sponsor exit deal flow by 2025, effectively reallocating some of the top-quartile opportunities institutional investors previously accessed via direct managers to secondary capital pools.

	Traditional Secondary	Single-asset Secondary	Direct Co-Investment
Target returns profile	**>1.5x Net TVPI[1,2]** Leverage and recycling of capital base required	**>2x Net TVPI[1,2]** with partial downside protection from ratcheted economics structure	**>2x Net TVPI[3]** Impacted by selection bias of sponsor relationships
Opportunity set	**Highly diversified** private markets portfolios	Hard to access **trophy assets**	**Opportunistic investments** generated by primary fund relationships
Partner alignment	**Low / none,** but could be compensated with transaction pricing	**>5%[2,3] GP commitment,** typically largest personal wealth determinant for Sponsor	Standard **1%-2% GP commitment[1]** via main fund investment
Portfolio construction	**High level sector/geography allocation** possible but difficult to achieve	**Full control** regarding target sectors, geographies and market segments	Control over sectors/geography possible but **dependent on primary programme relationships**
Cashflow profile	**Low/no J-curve with stable distribution profile** which is highly impacted by wider market conditions	Similar to traditional buyout fund profile with **potentially shorter duration and lower volatility**	Similar to traditional buyout fund but could be impacted by **overdiversification**

Sources: 1. Lazard; 2. Evercore; 3. Hayfin estimates.

The three-legged stool of a successful single-asset deal

We believe there are three key characteristics that make the GP-led segment, particularly single-asset secondaries, at least as appealing as investing directly into businesses:

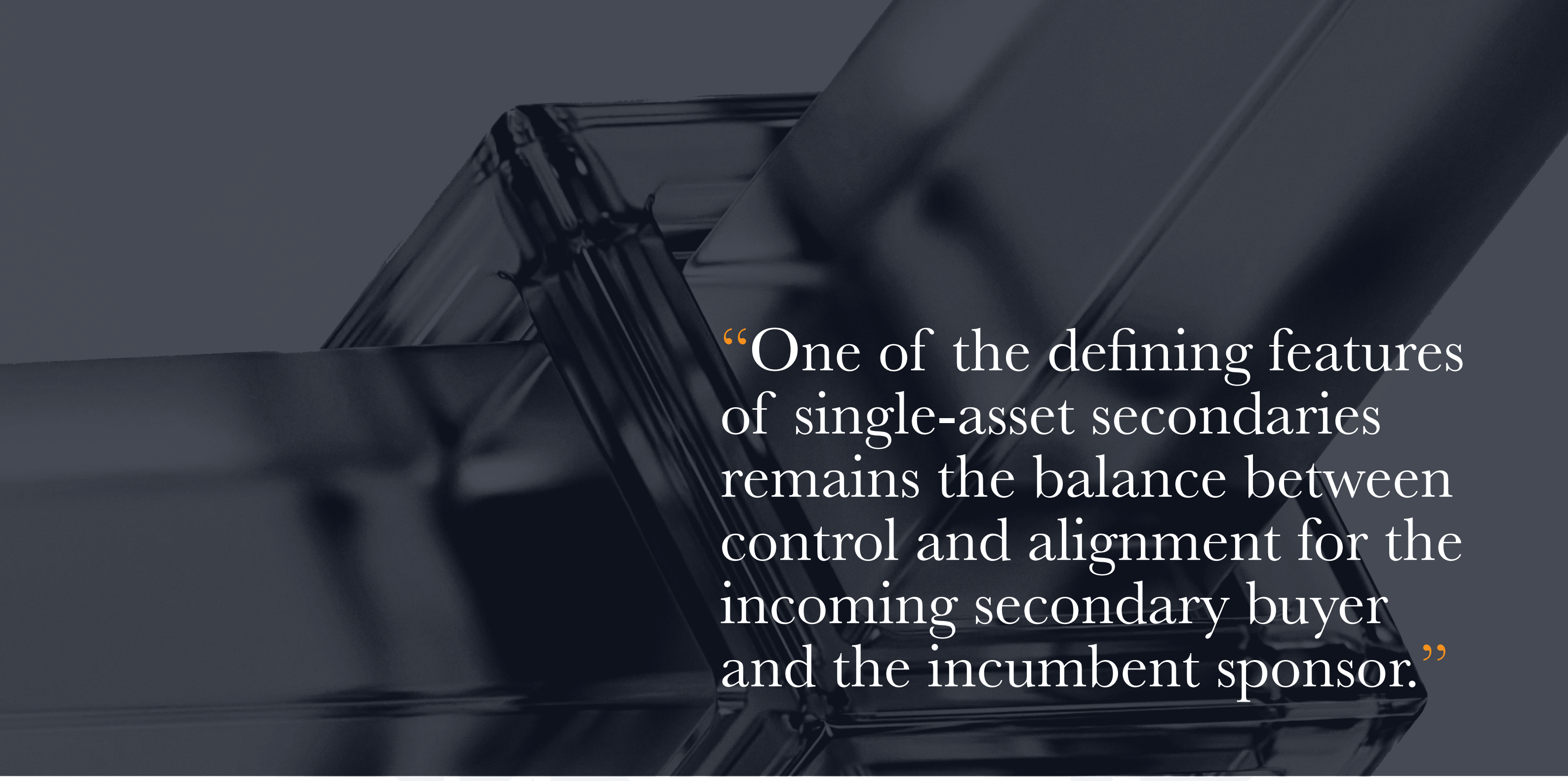
1

Focus on Trophy Assets:

Single-asset (or concentrated) secondaries are often focused on businesses that have performed very strongly and have established leading positions in their market, often being the key consolidator in a given region or sector. GPs are generally keen to retain such assets under management as they are difficult to find and originate in an increasingly competitive market, but also because they have developed deep knowledge of the business and the management team, significantly improving the probability of a successful investment.

What differentiates secondary sponsors?

Local origination directly with sponsors provides a key advantage, especially in the fragmented European lower-mid-market segment where access is limited by the strength of existing sponsor relationships. Although the single-asset secondary market is predominately intermediated, buyers' ability to have direct dialogue with sponsors, identify specific asset opportunities, and guide to a specific solution ahead of formal processes are essential. Once the pipeline of deals is built, strong business selection filters allow buyers to efficiently manage the top of their deal funnel and allocate more time for deeper diligence on fewer opportunities. Sector or segment specialisation (VC, infrastructure, real estate) allows buyers to build appropriate knowledge and team expertise. Unlike traditional secondary investing where integration between primary and secondary investment capability is beneficial, for concentrated GP-led transactions, access to a wider direct platform with a long history of assessing individual businesses across various sectors provides an edge.



> “One of the defining features of single-asset secondaries remains the balance between control and alignment for the incoming secondary buyer and the incumbent sponsor.”

2

Strong Partner Fit & Alignment:

As current owners, incumbent GPs have created strong links with management and industry participants and built a deep understanding of the business, materially decreasing the unknowns associated with a new acquisition. In many transactions of this nature, the GP is re-investing at a minimum the capital released from the realisation of the asset in the selling vehicle, including carried interest. This results in a GP commitment well above the market standard 1%-2% of total commitments. Furthermore, alignment can be targeted with negotiation of personal commitments from the individuals directly responsible for the investment for amounts that are material relative to their personal net worth. In addition, management rarely takes significant proceeds off the table and is usually re-investing proportionally higher amounts than seen in primary M&A transactions.

What differentiates secondary sponsors?

One of the defining features of single-asset secondaries remains the balance between control and alignment for the incoming secondary buyer and the incumbent sponsor. Although these structures are akin to direct buyouts, secondary sponsors are limited partners with no direct input on operational measures and portfolio company governance structures. Having proven capabilities to assess management teams and sponsors, including individual deal partners, for investments is as important as the assessment of the fundamental merits of the business. The existing sponsor knowledge within secondary sponsors’ teams allows them to evaluate how suitable a sponsor is for the next stage of growth for a specific business and the appropriate alignment to produce optimal results for all stakeholders.

3

Ability to Carve a Deal:

Not every good business makes a good deal. Therefore, the flexibility to engage with GPs and create a transaction that works for all parties is key in the context of a GP-led secondary. Buyers can not only price the deal, but also implement structural enhancements (e.g. earn-outs, vendor loans, etc). While single-asset deals generally benefit all parties, a focal point always remains the potential conflict of interest for the GP, who acts both as a buyer and a seller in the transaction. There are numerous ways to manage this conflict; however, the key levers to achieve a successful transaction are clear commercial rationale, open and regular communication with LPs, and a transparent price discovery and valuation process. Some institutional LPs have questioned the validity of GP-led deals as an optimal route to exit due to such inherent conflicts and the perceived lack of “market” pricing. The reality, however, is that many of these transactions are based on pricing that the GP has received in the market through unsolicited approaches or informal market testing. Furthermore, in most cases, existing investors can re-invest if they desire to do so and, most importantly secondary sponsors, who are now taking significant portions of concentrated exposure, have re-tooled their investment teams and processes to effectively diligence, price and execute on such complex transactions.

What differentiates secondary sponsors?

Concentrated GP-led solutions offer much more than just continuation vehicle structures. Buyers’ ability to have an agile investment strategy which can provide the best structural solution for a particular company is key. Solutions are typically tailored to the individual situation but can include, for example, incremental capital for transformational M&A within an existing portfolio company, a minority sell-down, or a wholesale disposal of an asset to a continuation vehicle.

Another important aspect is diligence and price formation - traditionally secondary sponsors have priced assets with limited information access and as a reference to the Net Asset Value as reported by the incumbent sponsor. Single-asset secondary deals require a completely different approach, where the execution capabilities of buyers are determined by their ability to analyse and diligence the business in-depth, similar to what would be expected in a direct buyout context. This can include, amongst other things, supplementing existing information with bespoke third-party diligence, accessing market experts and sector networks, and matching sponsors' expectation on M&A-like process (i.e. market pricing based on earnings and current capital structure vs simple reference to holding NAV). Building dedicated investment team bandwidth with the appropriate experience and expertise allows secondary sponsors focused on concentrated GP-led deals to position themselves as lead participants in processes, build resilient portfolios, and deliver long-term returns advantages for their investors.

These are just some of the aspects that allow secondary sponsors to differentiate their selection, origination and execution capabilities and invest through a strategy that can target specific niches of the market (i.e. regions, sectors, company sizing), rather than deliver exposure to a highly diversified pool of PE assets.

We view secondary structures as a highly valuable tool, increasing creativity in a maturing PE market, and have been involved in over 20 GP-led transactions, solving various vendor needs such as partial liquidity, growth / M&A financing, and time extensions.

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