

KEYNOTE INTERVIEW

Expecting the unexpected in secondaries



The secondaries market offers significant opportunities, but in light of macro uncertainties, it is best to focus on being prepared rather than making predictions, says Pomona Capital's Michael Granoff

We have all had to adapt to different ways of working and to increased uncertainty over the past two years as the pandemic has unfolded. We are now also facing a high degree of economic and geopolitical uncertainty. And yet secondaries markets – and private equity more generally – are booming.

Private Equity International spoke to Michael Granoff, CEO of Pomona Capital, to get his take on what the macro environment means for investing in secondaries, how the market is evolving and how to hold steady at a time when it is difficult to predict what will happen in three months, let alone in three years.

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Q The past year has taken some surprise turns. How have you navigated these?

We have all been living through times that no one could have predicted, and we have all had to adapt to an environment that no one has previously experienced. One of the defining characteristics of the past year or so is that the situation keeps changing in ways that we do not expect.

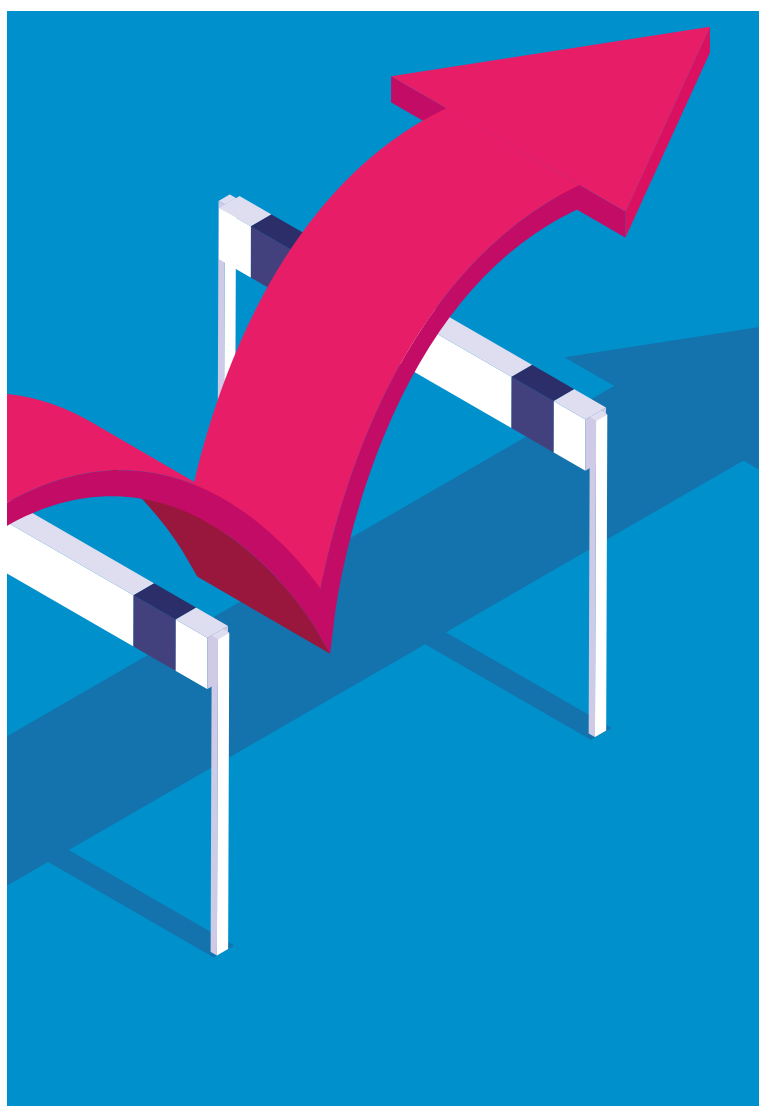
Through more than 25 years of investing at Pomona, we have navigated

multiple market cycles and events and have learned to prepare for the unexpected. As an organisation, we are reminded that fast-moving events require us to be both nimble and disciplined. On one hand, we must have the ability to react quickly to changing circumstances, whether to protect assets or capitalise on opportunities. This dynamic requires an organisational structure that is responsive and supports a free exchange of the best ideas and practices. We adapted to operating all segments of our business virtually. Communication between our global offices is more integrated and enhanced. Meetings with our investors

Q With high uncertainty and a lot of competition in the market, what will it take to be successful in secondaries moving forward?

We are in the business of preparation, not prediction. Our LPs trust us to navigate whatever comes our way. They expect us not to time the market but to do well in a variety of potential outcomes. That means we must be wary of the assets that do not meet our criteria, while being aggressive towards those that do. It is a traditional approach, but one that also requires creativity – we need to find new ways of doing things to unlock quality assets. It is also dynamic – we need to be nimble and close transactions fast.

The current environment has underscored the importance of adapting to different circumstances while keeping the value system intact through the whole team. This need for adaptation and values will not fade when the virus eventually wanes.



are now primarily virtual but still maintain the same depth of information. At the same time, we kept discipline and structure in our execution and decision making to ensure we make investment and operating choices that are consistent with our strategy and core values.

Q What about the market? That has held some surprises, too, hasn't it?

It certainly was not obvious from the macro and geopolitical environment we experienced over the past year that the market activity would be so active and robust. While our slice of the private equity market has been growing steadily over the long term, it was not foreseeable that in this environment the secondaries opportunity set would become so much larger that it could reach \$100 billion in transactions in 2021.

When we look back at the past year, we realise that no one can predict market disruptions or how they will manifest. Our approach is to invest and construct portfolios that achieve two goals: protecting capital and capitalising on growth opportunities. We want to be in a good position to benefit from better-than-expected market dynamics, while also protecting our investors if the market outcome is not so ebullient.

Q What does the growth in secondaries mean for Pomona?

A fast-growing market will inevitably bring greater complexity but also greater opportunity. Through this growth and evolution, we have kept our approach constant and never backed away from our values. Pomona seeks to deliver on the fundamental premise of secondaries investing: taking a value-oriented investment approach to seek long-term capital appreciation with enhanced liquidity and a lower risk profile.

This all begins with asset quality and selection. Pomona uses a proactive and tactical sourcing approach to generate

investment opportunities rather than buying a slice of the generic secondaries market. Our modest fund size enables us to be nimble to move across transaction sizes and types and flexible enough to provide innovative liquidity solutions to access higher-quality assets. Over the past 12 months, we have invested over \$1 billion across 14 transactions at an average discount of 31 percent and each deal has its own unique story that highlights our philosophy and creativity.

Q Where do you see the most opportunity?

There is a diverse opportunity set in the secondaries market as new transaction types, new participants and new types of sellers have emerged. The secondaries industry continues to innovate, creating solutions for limited partners and fund managers to unlock liquidity and value. Pomona is at the forefront of these efforts, creating liquidity solutions for institutional asset managers and closing preferred equity investments that have accelerated distributions to limited partners and provided growth capital for existing portfolio companies. Secondaries market investors have also led the charge on GP-led transactions, another liquidity path for limited partners.

For Pomona, when determining any opportunity, we focus on quality and price. Most of the time, assets do not meet our quality threshold or someone is prepared to pay more than we are. Private equity is a big market and only a small percentage will meet our quality criteria – we want to buy assets that will grow and that will withstand more difficult times and generate liquidity. We think of ourselves mostly as a bottom-up investor – we are not in the business of making macro bets.

However, we also recognise that we cannot put our heads in the sand. We do not want to get carried away by the market dynamics, and we believe you cannot just extrapolate the present indefinitely to the future.

“The secondaries industry continues to innovate, creating solutions for limited partners and fund managers to unlock liquidity and value”

Q How attractive are GP-led deals for you?

We are agnostic about how we find good quality assets at attractive prices. They could be in an LP portfolio, a preferred equity opportunity or in a GP-led deal with a GP we know and priced in a way that makes sense. The GP-led space is dynamic and has grown from being a market that did not really exist five to six years ago to one that has room to grow significantly because of the number of assets that could be sold through GP-leds. But historically, we have been a seller more than a buyer

in these transactions. GP-leds are easier to do in some ways than LP portfolio deals, where you need to be very proactive to source, price and structure transactions. GP-leds are almost always intermediated and so you just have to answer the phone! In fact, we could commit every dollar in our current fund we have to GP-leds by the end of the year because there are so many in the market. But that would take us away from asset selectivity and discipline. We have not seen realised results from most of these transactions yet and it is clear that some will work well while others will not.

GP-leds are also concentrated, sold at little to no discount to NAV and do not have a lot of the risk reduction features that investors value about secondaries. There is not the same robust liquidity, for example, because you are resetting the clock and do not have the highly diversified portfolio that LP deals bring.

Q How is activity shaping up on the LP deals side?

The emergence of GP-leds has obscured how robust the LP-led space is. A significant amount of capital has flowed into private equity over the past few years and the turnover is significant. In fact, we recently completed one of the largest LP transactions in our history. In this instance, we had previously worked with the seller, and we were able to create a customised liquidity solution to meet their needs.

LP deals are difficult to source and analyse and GPs are becoming more restrictive about transfer, but there is no shortage of them as the motivation to sell is often driven by something happening to the LP, such as a change of team, regulatory requirements, or selling for portfolio management reasons. Some LPs are also selling due to cyclical factors. For example, we were quite aggressive in spring 2020 and bought interests in some of the best buyout funds at a 50 percent discount from distressed sellers. ■