

KEYNOTE INTERVIEW

Riding the waves in times of crisis



It is not just a case of navigating changing market conditions, but also about finding the right opportunities, says Pomona Capital's Michael Granoff

We spoke to Michael Granoff, CEO and founder of private equity secondaries firm, Pomona Capital, just two days before President Donald Trump declared a state of emergency in the US. The rapidly changing situation due to the covid-19 outbreak was on the minds of us all as countries around the world took meaningful steps to contain and slow the spread of the virus. The reverberations of the pandemic were felt across financial markets. Here, Granoff explains how Pomona Capital's risk-adverse investment approach may pay off in the new economic environment.

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Q How has coronavirus and the resulting drop in public markets impacted Pomona Capital in recent weeks?

At Pomona, although we did not predict a pandemic of this nature and scale, the probability of an external force causing market dislocation has been something we have kept in mind while investing. We have only been willing to commit capital where we

thought we had an adequate margin of safety. Last year, for example, we only bought 1 percent of the dealflow that we saw because the remaining 99 percent either did not meet our quality criteria or someone else was willing to pay a higher price than we were.

Considering this risk conscious approach in light of the current environment, I do not think that we missed out on any opportunities. In fact, we are now being rewarded on a relative basis for being careful, for paying attention to quality and for consistently buying at a discount that is bigger than the market's. Firms that placed large

concentrated bets on single funds or single companies or had significant exposure to certain regions or sectors (eg, Asia, energy or venture capital), were not penalised for that risk over the past few years when everything was going up. However, we may soon see that turning.

Q How does Pomona plan to adapt to this new environment?

There are two things that we need to do. The first is navigation. This is about how we protect the firm, our funds and investors in times such as these.

The second thing that we need to do is actively look at opportunities. When the stock market goes down, because of the denominator effect, investors may think they are overallocated to private equity. We need to make sure that we are not just navigating this crisis, but that we are also considering where the opportunities are and making the most of those transactions.

We are not trying to time the market in some way, and either step back or step in, but we are going to go where the opportunities are. That is where we will look to commit capital.

Q Looking back at 2019, how did Pomona put money to work in a risk-conscious manner?

In 2019, we persisted with our central thesis of buying high-quality assets at lower-than-market prices. The way in which we achieved that has continued to evolve. The assets we bought through our latest fund, which is now about 80 percent committed, were acquired at an average discount of approximately 14 percent. The industry-reported average discount from 2016 to today is about 4 percent.

In order to achieve that we did some different types of transactions

The year ahead

Michael Granoff on the outlook for the secondaries market in 2020

One thing that many people have been focused on is how much capital has come into the market, but today, I would describe the market as fairly balanced. If you look at the overall overhang of capital in the secondaries market, it is far less than the dry powder in the buyout market. From that point of view, we believe the market is evenly proportioned and may lead to increased opportunities for secondaries.

There may be a different composition of sellers in 2020 – fair-weather sellers may exit the market, while those who are more motivated to sell because of what is happening in the economy could enter the market. We are likely to see more changes in the market in this year than we saw in 2019. Everything has changed in 2020.

and deals with a more innovative design and structure. For example, in 2019, we did a preferred equity deal in Europe [a €105 million transaction with Palamon Capital Partners] where we worked with a GP that sought to provide liquidity to its investors. We bought a strip of a fund in a preferred structure that enabled us to purchase the type of assets that we like with a higher degree of protection. We can use such structures to acquire high-quality assets at valuations that make sense for us.

I believe that you need to continuously adapt and look for innovative ways to invest that are consistent with your values. We committed approximately \$500 million last year, and around half of the transactions in the latest fund have creative structuring elements to them. We also continue to get deal flow from GPs that are restrictive about who they allow to buy into their funds.

Q How do you envision the secondaries market's evolution in the next decade?

If you look at the secondaries market over the past 20 years or so, there are some clear trends that have developed beyond the usual cyclical movements. The secondaries market continues to

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grow with the private equity market overall. There has been a growing acceptance of secondaries in the market, and the definition of secondaries will continue to broaden.

The ingredients for success will remain similar to those we have seen over the past decade – I do not believe there is a new paradigm to be created that we have not seen yet. However, on the capital side, there are some changes occurring across the private equity industry that should continue to accelerate, and that is where the retail market comes in.

Q How important is the retail market for Pomona?

Pomona has a retail registered fund product that is now getting to critical mass. An increasing number of people are paying attention to the retail market, which is relatively unallocated to private equity and alternatives in general. We are paying attention to it. No one is creating a new pension fund in the US, so when you think about the growth of capital going forward, it is clear where it is going to come from.

Those capital flows from retail investors are likely to increase, particularly while performance levels remain strong. This may be the place where

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capital flows change the most, but it is still a work in progress.

The product we have on the retail side is similar to what we do on the institutional side from an investment point of view, but structurally it is quite different.

One of the reasons we have been successful in this area is that the product is closer to what we believe retail investors need in terms of liquidity, diversification and cashflow. It is not just about taking an institutional product and offering it to retail investors; there are differing structural elements to be considered.

Q Diversity is becoming increasingly important in private equity. How does Pomona think about promoting a diverse workforce?

When I started in private equity nearly three decades ago, investors did not ask about diversity. As the years went on, some investors began to ask what our team looked like from a diversity point of view. However, while that was something they were interested in discussing, it was not usually a part of their investment process.

Today, diversity is increasingly becoming part of both the investment and decision-making processes. Diversity-related questions are now included in many of the due diligence questionnaires we receive from investors. That is a significant change for the industry.

At Pomona, we have two women partners (out of seven partners in total), one-third of our senior positions are held by women and almost half of our staff are from minority groups. We have a very diverse team, which I believe is not very common in our business. We have built Pomona this way from the very beginning, in 1994, because we believe it makes us better investors and partners. ■