Increasing appetite for GP stakes

Guest comment by **Joseph Lombardo**, managing director and head of private equity general partner advisory at Houlihan Lokey

Investors appear to be warming to the strategy as evidence of its strong performance becomes more readily available

Going back to the mid-2010s, the first private capital (non-hedge fund) GP stakes funds marketed the strategy as a low volatility, low loss ratio investment that provided strong, immediate yields to mitigate the J-curve. These funds highlighted to potential LPs that private capital firms have resilient business models with contractually locked-in management fees that limit downside risk.

Even then, many LPs understood the concept and thought it could work. However, with only limited performance data available, certain LPs did not want to be among the first to dip their toes in the GP stakes pool.

Now, with longer-term performance data available, some of those same LPs are looking at GP stakes funds' attractive net internal rates of return and low loss ratios and realising that their portfolios may benefit from an allocation to this strategy.

The GP stakes industry is benefitting from high-profile figures putting their names and reputations behind the strategy. LPs are hearing from leaders of Blackstone, Goldman Sachs, P10, Wafra, Blue Owl and Investcorp that this is a great opportunity. They then see what savvy investors such as Bennett Goodman, New York Life, CAZ Investments and White Mountains Insurance are doing, and they realise that this is a strategy to be strongly considered.

Overblown exit concerns

The elevated level of concern regarding predictable exits seems overblown. Wafra has had a variety of very successful exits, including single-asset stake sales; Petershill sold five Fund I investments to AMG in a single transaction; and Navigator Global Investments acquired six Dyal (now Blue Owl) investments in a single transaction.

Stakes have been exited via control deals and IPOs. We have even seen an IPO of a stakes portfolio in London and several securitisations of stakes. We have seen or will likely see LP secondaries, LP tenders, continuation vehicles and fund restructurings.

I believe LPs' concerns are, in part, a byproduct of the way in which GP stakes firms market their funds and a lack of LP knowledge regarding the many liquidity events that GP staking firms have historically created.

Several years ago, industry observers began asking this 'what is the exit?' question. This query has lingered for at least two reasons: first, when raising their funds, GP stakes firms do not want to commit to a specific exit path – they want to remain nimble and follow the most attractive exit path or paths available at the time of their respective exits. Second, when competing for LP dollars, GP stakes firms are naturally reticent to highlight their competitors' successful exits. Yet, the most effective way to tackle the 'what is the exit?' question is to show the success that so many GP staking firms have had in creating liquidity.

A maturing industry

The GP stakes market has rapidly evolved, and continues to do so. The industry has expanded far beyond the plain vanilla deals for large-cap US buyout firms and hedge funds that dominated the market a few years ago.

Today, we see mid-market deals; UK, EU and Asian deals; and deals with growth equity, private credit, private real estate, infrastructure and/or venture capital firms. We also see a wide variety of structures and far more bespoke transactions than we had seen prior to 2020.

As the industry continues to mature, I expect LP appetite for GP stakes to continue to increase. I expect many LPs will seek to allocate to multiple GP stake strategies as a means of diversifying their exposure across large-caps, mid-caps, international firms, seeding opportunities, structured equity funds and firm-level debt strategies. ■