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Liquidity Options Survey Results and Insights

More work needed to give LPs comfort with emerging liquidity tools

In the current challenging exit environment, GPs are increasingly finding more and varied ways to provide liquidity to their LPs, while also securing capital to meet the financing needs of portfolio companies and expansions of their platforms.

The latest Liquidity Options Survey from global placement agent Capstone Partners, a Mizuho Company, which canvasses the views of over 500 GPs and LPs across the world, highlights the acceleration of this trend, while also revealing that LPs have some way to go to become fully comfortable with the use of new non-traditional financing alternatives.

The survey reveals that LPs are at different stages of their understanding of alternative liquidity and financing techniques, which in turn means that they give GPs varying levels of credit for their use as they underwrite new fund commitments. The market is still nascent and it is clear that there are some divergent views between GPs and LPs, with a perceived lack of transparency underscoring the need for effective communication.

This uncertainty is in direct conflict with LPs' need for liquidity, with the survey showing that over a third of GP participants across the world are ready to exit mature portfolio companies but are constrained in doing so by the economic climate. LPs in turn acknowledge that the current lack of liquidity is deeply impacting their portfolios, mostly on IRR.

In the case of GPs needing additional liquidity to support portfolio companies, increase their GP commitments to new funds or launch new platform strategies, many LPs are amenable to well understood financing tools such as co-investments or recallable distributions, but Capstone's survey shows that not all are comfortable with more nascent techniques such as NAV loans and GP stake sales. These are not yet widely understood. A material number of LPs do expect their GPs to launch longer term funds in response to the current environment, and a fair proportion appear ready to invest in these vehicles.

Key findings from the survey include:

- GP's use of liquidity tools has accelerated over the last 12 months, with this trend expected to continue into 2024 and beyond.
    - NAV financing has been used by 12% of the participant GPs in the past and 14% plan to use it in the year ahead.
    - GP-led secondary transactions have been used by 21% of the participant GPs in the past and 28% plan to use it in the year ahead.
    - Minority or dividend recap has been used by 30% of the participants GPs in the past and 28% plan to use it in the year ahead.
    - GP stakes remains more circumstantial – it has been used by 11% of the participants GPs in the past, and 5% plan to use it in the year ahead.

- More than half of the survey's participant LPs currently consider their GPs not transparent in their use of liquidity tools.
- While GP-led secondary transactions and dividend or minority recaps are the most common and widely accepted liquidity options, just over half of the participant LPs show less ease with NAV financing.
- GPs and LPs also have different perceptions of the motivations behind GP-led secondary transactions and NAV financing. For instance, for LPs, the main objective of a GP-led secondary transaction is to provide liquidity to LPs. However, 75% of North American GPs and 50% of Asian Pacific GPs view providing additional capital for growth or significant acquisitions as its main objective. This is reflected by the high number of LPs who take the cash out option offered by such transactions.
- Despite the pressure on liquidity, the majority of LPs currently give only partial credit to their GPs for distribution via liquidity options (58% of European LPs, 80% of North American LPs and 73% of Asian Pacific LPs). There is a significant portion of LPs who would not give any credit to their GPs for such distributions (23% in Europe, 14% in North America and 16% in Asia Pacific). This highlights that these nascent tools are not yet widely understood, with work to be done to give LPs greater comfort about their value.
- To address funding challenges or scarce capital, the vast majority of LPs prefer GPs to use co-investment.
- Despite their perceived unpopularity, more than 10% of LPs in all regions would prefer their GPs to use recallable distributions; and 21% of GPs are planning to use these in the next 12 months.
- While 12% of participant GPs plan to launch a longer-term fund (12-15 years) as a response to the current environment, a third of participant LPs see their GPs launching such funds. 40% of these LPs are ready to invest in such vehicles.
- Finally, LPs acknowledge that the current lack of liquidity deeply impacts their portfolio (37% in Europe, 46% in North America and 45% in Asia Pacific). The impact is mostly on IRR, with LPs confident in the future level of exits, especially in North America where 79% of LPs think the impact is mostly on IRR. In Europe and in Asia Pacific, c.45% of LPs quantify the impact on their portfolio between -0.5x and 0.

Steve Standbridge, Managing Partner and President at Capstone Partners, a Mizuho Company, said:
"There is no doubt that the current market conditions have inspired innovation in the private equity market, with GPs finding more and varied ways to provide liquidity to their LPs. However, some of these tools are still nascent and, in some cases, not widely understood. This has the potential to create confusion or mistrust. Our survey clearly shows that despite the scarcity of liquidity and its considerable impact, there are still some divergent views between GP and LPs about the benefit of using these tools and the motivations behind them."

He added: *"This makes it critically important for GPs to allow LPs time to properly understand their liquidity activities, as well as to prioritize clear communication via well managed processes. GPs and LPs alike are demonstrating a high level of willingness to learn more about liquidity options, paving the way for continuous momentum in this market in the year ahead."*

About Capstone Partners, a Mizuho Company

Capstone Partners, a Mizuho Company, is a global placement agent focused on fundraising and advisory services for private equity, credit, real assets, and infrastructure investment firms. It has a global network of more than 1,500 Limited Partners across the US, Europe, and Asia.

In 2022, Capstone was acquired by New York based Mizuho Americas, expanding the Firm's broader investment banking and advisory capabilities for financial sponsors. Mizuho Americas is an integral part of Japan-based Mizuho Financial Group, Inc. (NYSE: MFG). To learn more about its capabilities, visit www.mizuhogroup.com/americas/banking/industry-coverage/financial-sponsors.

For additional information about Capstone's experience and team, visit www.csplp.com.