HQ Capital
Insights

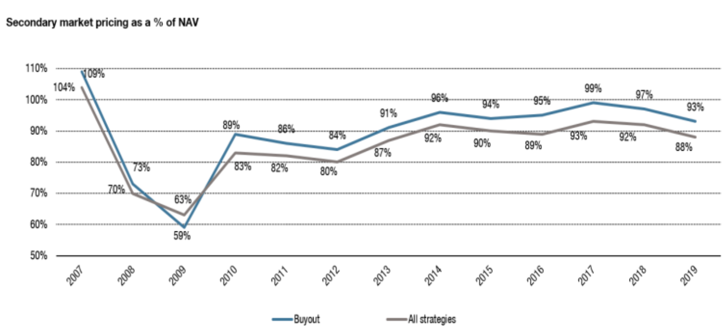
Timing – Size – Quality

Key investment trends for global secondaries in light of COVID-19

The effects of the COVID-19 pandemic have created an overall environment of stress and uncertainty. Unexpected market dislocating events such as this, often referred to as “black swan events,” can also create advantageous investment opportunities and this is particularly true in the secondary market today.

Current secondary market sentiment in light of COVID-19 echoes the investment conditions of the Global Financial Crisis during 2008/2009. Global secondary investors can benefit from these conditions for the following reasons:

1 High discounts in times of market dislocations



Source: Preqin, Greenhil Cogent (February 2020)

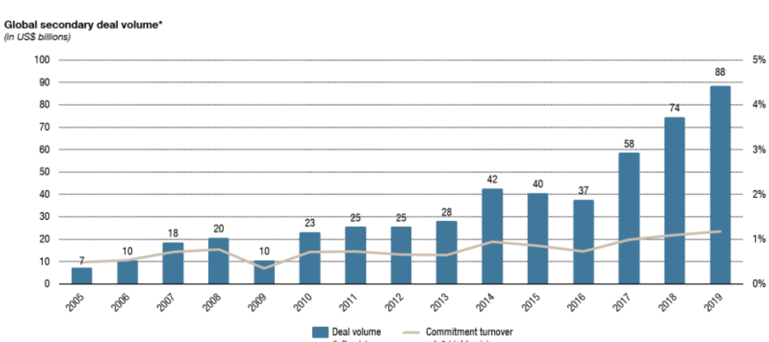
Pricing and Valuations

In the quarters following the Global Financial Crisis, NAVs in general decreased as portfolio companies’ financial projections and public market comparables’ valuation multiples declined.

Additionally, secondary market pricing as a percentage of reported NAV decreased in 2008/2009 creating a compounding effect resulting in compressed pricing relative to value. We are already seeing similarly compressed pricing in the current environment.

For secondary buyers that can properly pursue transactions in this type of market, the outlook for opportunities is very attractive.

2 Opportunities for smaller secondaries transactions



Source: Preqin, Greenhil Cogent (February 2020)

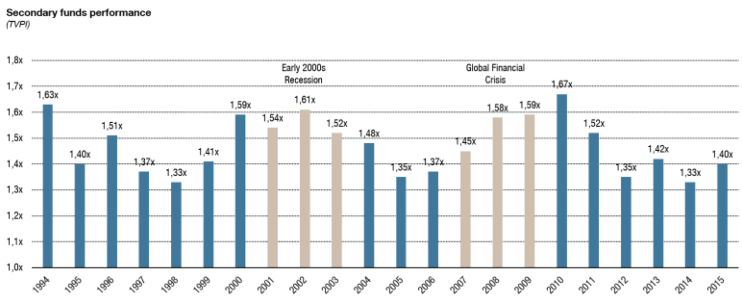
Volume and Returns

Global secondary transaction volume declined materially from 2008 to 2009 as many secondary buyers and sellers decided to stand on the sidelines, taking a “wait and see” approach. Market participants expect to see lower volume as a result of COVID-19, particularly over the next 6 to 12 months, as larger and more standard-process portfolio deals will likely be put on hold.

Investors with a relatively smaller fund size and access to high quality managers through primary, secondary and co-investments, will benefit from this market situation. Sellers will look for trusted and flexible partners to pursue smaller deals, including single LP interest and secondary opportunities with quick turnaround times.

All data and information is as of June 2020 unless otherwise noted. Based on HQCPE analysis and research using the sources listed at the end of the document.

3 High returns from high-quality assets & managers



Source: Cambridge Associates (September 2019)

About the Author

Ben Wilson
Managing Director
HQ Capital Private Equity

Flight to Quality

During an economic dislocation, investors typically start to seek out higher-quality assets. For these investors, however, it will be too late in most cases as they have failed to lay the necessary groundwork in order to access high-quality secondary transactions.

High-quality managers are typically very selective in accepting LPs into their funds. This selectivity applies on both a primary basis, when allocating positions to oversubscribed funds, and, more importantly, on a secondary basis, when deciding on whom they will approve transfers of LP interests.

The overall result of investing during market dislocations is often a higher return. This happened to be the case with secondary transactions during, and immediately following, the Global Financial Crisis with estimates showing IRRs up to 240 basis points higher than long-term returns.

The foundation for these returns are the focus on high-quality assets from high-quality managers.

Sources: Preqin (as of February 3, 2020), Greenhill Cogent (Secondary Market Trends & Outlook, January 2020), Cambridge Associates Fund of Funds & Secondary Funds as of September 30, 2019

About HQ Capital Private Equity

HQ Capital Private Equity is a pioneer in alternative investments with a track record dating back to 1989. As of December 31, 2019, the firm manages $7.7 billion in assets, has invested in 540+ funds and 90+ direct companies alongside 271 GPs, and holds over 90 Advisory Board seats.

HQ Capital Private Equity's secondary and firm-wide strategy has been to focus on high-quality assets and high-quality GPs throughout all market environments since 1989. Since 1992 HQ Capital Private Equity has invested over $2.2 billion in secondaries and conducted over 170 transactions.

For more information, visit www.hqcapital.com

Contact:

HQ Capital Private Equity
1290 Avenue of the Americas, 10th Floor
New York, NY 10104
U.S.A.
T +1 212 863 2300

HQ Capital (Deutschland) GmbH
Am Pilgerrain 17
61352 Bad Homburg
Germany
T +49 6172 402 801