



Episode 131: GP-Led Secondaries in Lower Middle Market, With Chris Lawrence

Episode Summary

The secondary market has grown to roughly \$220 billion as GPs and LPs scramble for liquidity in a private markets cycle stuck in a “worse distribution profile” for three and a half years. [Chris Lawrence](#), managing partner at Labyrinth Capital Partners, joins McGuireWoods partner and host [Geoff Cockrell](#) to demystify GP-led secondaries.

Chris breaks down continuation vehicles, strip sales and fund restructurings. He explains why secondary pricing ranges from par to as low as 72 cents on the dollar and makes the case that GP-leds are now a mature, institutionally accepted portfolio management tool.

Transcript

Voice Over ([00:00](#)):

This is The Corner Series, a McGuireWoods series exploring business and legal issues prevalent in today's private equity industry. Tune in with McGuireWoods partner Geoff Cockrell, as he and specialists share real world insight to help enhance your knowledge.

Geoff Cockrell ([00:18](#)):

Thank you for joining another episode of The Corner Series, I am your host, Geoff Cockrell, a partner at McGuireWoods. Here at The Corner Series we try to bring together deal makers and thought leaders at the intersection of healthcare and private equity. Today, we're going to have an interesting discussion with Chris Lawrence, who's the managing partner at Labyrinth Capital Partners. Labyrinth has worked themselves into a corner of the private equity market that is really booming right now but is a little off the main path. Talking about GP-led secondaries and a number of versions of that that have become very popular in the market. Chris, maybe give a little introduction of yourself and Labyrinth, and then we'll jump into a discussion.

Chris Lawrence ([00:57](#)):

Great, Geoff. Thanks for having me, pleasure to be here. Labyrinth is a continuation of an investment strategy that we had at my prior firm, effectively in the global secondary space where we were doing both LP-leds and what has now been codified as GP-leds, as you mentioned. But specifically the way to think about it here at Labyrinth, we are only focused on the GP-led type of transactions.

Specifically, what are those? Those are continuation funds, strip sales, fund restructurings, which in and of themselves fund restructurings can meet about seven different types of transaction types. But we also add on to that, hence the GP-led plus term that we use in our vernacular, direct secondaries and also what we call hybrids, which is another way of which, and ultimately these five things are to get equity exposure to really good private market companies in a less risky way.

([01:40](#)):

But effectively, did about six, 700 million of these types of things at my prior firm, launched Labyrinth. We've been in the market now for about five years, excited about the opportunity set. It's only getting bigger. We focus predominantly in the lower middle market type of opportunities, really deal sizes that allow it smaller than 100, which means we don't do a lot of the participation than probably what you've seen, Geoff, in the press, are these large \$500 billion, \$750 million GP-led transactions. That's not really what we're focused on. We're focused on an area of the market I think that has probably a lot more volume in terms of the number of opportunities, but it does require a lot more thinking and institutional approach. And thankfully, my gray hair has allowed me to figure out how to maybe navigate some of that turbulent water, if you will.

Geoff Cockrell ([02:22](#)):

Some of the dynamics that have made these popular have been the difficulty of certain vintage fund years of bringing their investments individually to a sale. Thinking largely of vintage 2019, 2020, maybe '21 and earlier, but centering on a lot of the direct investments that happened during COVID, '20, '21, maybe early into '22, that was like the high point of middle market and broader private equity investing. So, lots and lots and lots of deals have been done, and a lot of funds still hold those. Can you speak a little to those market dynamics and how that fit into what you guys are doing?

Chris Lawrence ([03:06](#)):

Yeah. No, absolutely. And I think that the precursor here is the fact that this isn't the first time we've been in a situation like this thing. As you remember, there was a thing called the global financial crisis, which was a little bit similar in the fact of what we've got going on with COVID structurally, if you want to think about it from a liquidity standpoint. Because back in the GFC, not a lot of companies were being bought and sold during '08, '09, and '10, which caused a delay in some of those vintage funds. And now to your point, going into 2019, '20 and '21, you had all this volume of activity while COVID's going around, but guess what? We have been probably in a worse distribution profile in

private markets for the last three, three and a half years, which has caused a lot of questions and concerns because we are in a circle of life in private markets, Geoff.

[\(03:50\)](#):

We put money to work, it's supposed to be sold and come back to us at some point in time, and then everybody gets to reinvest. But we are in a cyclical problem right now, which is the fact that the reason why you saw the secondary market go from 100 billion now up to roughly 220, and some are forecasting '26 to be overall 260 billion, primarily because people are looking for liquidity options. And LPs, investors, GPs are trying to figure out exactly what's the best way to navigate that, given their fiduciary responsibilities to their limited partners.

Geoff Cockrell [\(04:20\)](#):

Let's take some of these different vehicles one by one. So if you think of continuation vehicle, in my mind that's the GP of a fund forming a new fund. And then, in addition to raising capital in that new fund, they would be putting in some of, or maybe all, but often some or a single asset for the earlier fund into that new vehicle. What is Labyrinth's role in that sort of transaction?

Chris Lawrence [\(04:46\)](#):

Yeah, it's very simple. What you've done is you've entered into a conversation with a general partner who's probably had a very thoughtful discussion with its own limited partners and saying, "How are we going to generate liquidity from this portfolio?" Because they've probably gone out and said that, "The five companies that have got left in fund three, really it's been difficult to liquidate them but we really want to hold onto a couple of these, but there's probably a couple that we have interest in from financial buyers," such as Labyrinth or "other secondaries." So from a general partner's perspective, the attitude is very similar to simply how am I going to generate liquidity from my existing portfolio? So, they choose a company. There's a conversation that's held with buyers like ourselves. You ask the question, "What do we do?" Well, we step in, we work with the GP, ultimately understanding exactly what they're trying to achieve, making sure that everybody's above board about what the transaction, which is the outcome of what we're trying to do is really get proceeds back to limited partners in that GPs fund.

[\(05:40\)](#):

And by doing so, we effectively come in as buyers, step in, create a vehicle with a GP who's now going to manage another vehicle, this continuation vehicle of a company that they previously managed, and an old vehicle now just comes over to be managed in a brand new one. What does it accomplish? At its core, that transaction led by us with a new economic structure and the continuation fund allows a couple of things to happen. One, most often it's the most important thing, which is it created a liquidity event inside the GP's prior fund to get money back to LPs. Great, that's one. What

does it give us as a buyer? It gives us an opportunity to step into a situation where the attribution, the performance, et cetera, is very easily to be diligence, from a due diligence perspective. So, that's great. So, we're up the curve quickly on a mature asset.

[\(06:29\)](#):

We also are up to curve quickly on the maturity of the GP and their involvement within that company, and we get to basically put into it a new economic structure and ride for a shorter duration period of say two to five years, hoping that the outcome will occur in private markets going forward, but that's okay because the clock's starting day one for us, maybe not day 11 or year 11 for the other LPs in the prior fund.

Geoff Cockrell [\(06:53\)](#):

From a pricing perspective, I would think that the apex of pricing is in a market clearing auction process. That's not exactly what's happening in a GP-led secondary. I understand the need for liquidity, I also assume that that comes at some cost. If you think of 100 cents on the dollar as the full market clearing auction price, how do you think of pricing of secondaries against that mark?

Chris Lawrence [\(07:21\)](#):

It's a great question because unfortunately there's a lot of nuance in there. Number one, no GP marks their assets the same way and consistently. There's this old adage within your audit law, audit firm that says product 820 tells you this is your guardrails for valuing your companies. So, you as a buyer must first understand how the GP is marketing that book. To understand whether or not the NAV, if it's aggressive, you may want a deeper discount just because you know that they think that maybe they're too aggressive in their marks that they put in there. But to your point, we are dealing with illiquid securities. So, the idea here is that we're providing liquidity for illiquid securities, and we go back to that old finance 101 undergraduate and even an MBA that there should be some form of illiquidity discount, just for fact.

[\(08:06\)](#):

That can range, Geoff. To be candid, I think things price at par at 100, and I've seen things price at 72. Why? Not every situation is the same, not every company is the same. So, you may have a company where it's got maybe a balance sheet that looks a little iffy and people want to basically de-risk that by their intake by going in with a cheaper price. Or the fact is, is that maybe there's a speed out, maybe this particular fund, this is the last asset and they need to close it up because it's been around for 14 years, like I've been involved with where there have been actually one asset left but the LPs are like, "We're out at the end of the year. We need to close this up." So you try to basically say, "The only way you're going to move it quickly is to make me attractive." Well, obviously the lever price can do that.

[\(08:48\)](#):

So to your point, generally speaking, yes, I typically am trying to get a discount for creating liquidity to an illiquid asset. Those can range, asset quality, financial terms of the continuation vehicle come into play and a whole bunch of other things at the end of the day may put that pricing in a different view for the buyer.

Geoff Cockrell [\(09:06\)](#):

When I think of CVs, especially like a single asset or maybe two assets from a prior vintage fund that is moving into the CV, I usually think of that as them putting in the darling of the fund as an enticer in raising the next fund of a, yes, it's going to be a blind pool to some extent but it's starting with these couple or one shiny thing that was the shiniest thing that we had. You were describing other scenarios where it might be a little long in the tooth or other reasons other than it being the coolest thing that it is still in the fund. What's the mix of that, that you see in those secondaries market of being the coolest thing versus the less cool thing?

Chris Lawrence [\(09:46\)](#):

Yeah, I'm going to be candid here. I think the coolest thing, that narrative has gone by the wayside. That started off in '17, '18 and '19 where even at that point in time GPs weren't really giving LPs a heads-up of what they were doing. That dynamic has clearly changed given some of the LPAC movement that's gone on here in the last five years. I'm going to say this, the assets that are being moved in success, because not every one of these initiatives has been a success, some have been tabled, is because maybe the asset themselves aren't actually that attractive to be sold. So, the ones that are getting close are assets that are attractive to a buyer. That's full stop. Whether or not they are the grade Aa1 or are they the B+, that's the question for the buyer at the end of the day to figure out whether or not he wants to take that risk.

[\(10:30\)](#):

I will tell you, most oftentimes these assets are good enough to be sold. That's it. So some, if they're really grade A assets and they're rolling over and the LPs can't roll over with them, but there's a lot of excitement from the buyer community to get in on that deal, bingo, you probably have got a great price, probably have a really good attractive asset, probably has great margins, great growth, and probably has a good path to a liquidity event at some point.

Geoff Cockrell [\(10:55\)](#):

Maybe moving beyond the straight CV process, talk a little bit about either a secondary of an individual asset or a strip sale, maybe starting with the strip sale and give a little definition of what that is, and then what your role is and how you think about those sorts of deals differently from a CV.

Chris Lawrence ([11:13](#)):

So, the way to think about a strip sale is effectively, let's just use an example, this is an idea where maybe a portfolio has, say a general partner has 10 portfolio companies and he figures out, you know what? Four of these are doing really, really well and we could probably, because the valuations on these have run up, we could probably "take some chips off the table." So we may want to sell 10% of our positions in one of them, 15 in another, 10 in another, 10 in another. In other words, you end up with four companies selling some securities in those four companies to a buyer. Sometimes, Geoff, that entire transaction can move into a multi-asset CV if the GP's still really heavily involved or not. Or essentially the buyer's just stepping in to buy the securities that the fund owns in those four.

([11:56](#)):

That's the strip idea, you're buying sort of a strip of four out of the 10 companies in that example. What does that ultimately do? Well, obviously to the buyer that may be terrific if you're buying the right securities at the right level where they sit in the capital stack, et cetera, but it also gives them diversification by buying not one, but four. So, it's an interesting way to craft some sort of liquidity event for that fund in a way that allows the GP to manage the process, hence the word it's a GP-led deal.

Geoff Cockrell ([12:23](#)):

How often are GP-led deals paired with LP-led where LP-led meaning the LP is just wanting to sell some of it and it's outside of the pricing and mechanics that the GP is leading? How often are there LP-leds going on at the same time?

Chris Lawrence ([12:41](#)):

Yeah, it can always happen. Depends on the size of the vehicle. Obviously, Geoff, when you're talking about the multi-billion dollar bio funds, there could be over 100 and change of limited partners alone in that type of fund. Where you find it a little bit and a lot more concentrated is obviously on fund sizes that are south of 500 million. And to your point about how these things actually navigate, remember an LP commitment that's being transact is not necessarily always the best thing for a general partner because they want those LPs to stay around for the next fund. But make no mistake about it, the LP laid hook, if you want to think about it, is the GP can use that as an offensive mechanism by which they can use that and try to find another buyer, or use that as "bait" to attract a new limited partner for the next fund.

([13:24](#)):

So, sometimes those LP-leds are just in and of themselves nothing more than an opportunity to bring in a new LP for the next fund. Now to your point, these things happen in parallel all the time, these things being an LP-led or a continuation fund. Maybe the LP-led doesn't want to participate with the

GP. They've got issues, they can't participate in the CV, but a new LP coming in to buy that position may use it as an opportunity to participate in that CV. That's really where the GP can use that LP sale to attract some interesting new investors to their franchise.

Geoff Cockrell ([13:58](#)):

LP-led secondaries are nothing new, and while they could be more prevalent or less prevalent in different market conditions, they've always been around. The GP-led is a little different. To what extent are these transactions purely dependent on some rather specific market dynamics of what happened in '20, '21, early '22 versus what the market looks like now, or to what extent is this a burgeoning asset class that is making its own market?

Chris Lawrence ([14:31](#)):

So, the good news is it's relatively easy to understand. If you understand our premise of where we play, we are all a function of private market AUM. Private markets have gone and grown tremendously well, we've doubled private market AUM up to 13 trillion globally now today. So, we in and of ourselves are a function of private market AUM, which is why you've seen the secondary market become a turnover ratio of about one to one and a half percent in aggregate. So to your point about catalyst, the LP market is a mature market now, Geoff. It is now a portfolio construction tool used by people managing their private markets book. It's an accepted practice. These are ways in which people can "clean off" some of the older funds to make room for new managers, et cetera, coming into the fold. So LP-leds mature market, it may have some peak volumes and periods of distress globally, but not all sides of the LP community is the same.

([15:27](#)):

Some pensions may be in problem, some family offices may be in problem, that may require them to hit the LP-led market faster than somebody else, but it is an accepted tool, it's mature. It's going to be around for a long, long time because of where all the private market money is going. To your point about GP-leds, there is no question, even though my first GP-led transaction was in 2010, these types of transactions have been around. It's just become, again, more of a mature market here over the last six to seven years as it relates to people being accepted to this is how another way we can generate portfolio liquidations without necessarily giving up, to your point, a dual asset for the next five to seven years and moving into a continuation fund.

([16:12](#)):

So yes, there are periods of distress. You will see pickup in volumes as people chase liquidity and illiquid assets, but the key is these are both LP-led and GP-leds are institutional approaches that now are widely accepted, and tools that can be used not only from CIOs but also from the GPs

themselves, to construct and manage their portfolios as they look to get to that liquidity then over time.

Geoff Cockrell ([16:36](#)):

How often is leverage a part of these transactions? Think of a strip sale as an easy example. So, layering in what is ostensibly almost fund level debt as opposed to platform level debt, what's the role of debt in these deals?

Chris Lawrence ([16:50](#)):

Yeah, no, it's increasing, especially at the larger end, Geoff. That's a great point. I think we've all read enough about private credit obviously increasing over the last number of years, but make no mistake about it, when we were in that period of time from, call it 2012 all the way up to 2019 and change when interest rates were extremely low, the LP-led market started to have a moniker saying it was basically just a levered beta product. Because effectively, if you can build a large book of LP interests that represents thousands of companies, that starts to look like a credit security view, which means then leverage was actually acceptable to use as part of that purchasing power to get that portfolio. That's still here today, Geoff. It's not going away. Even in the leverage situations in these CVs is the same sort of thesis.

([17:37](#)):

We all know that buyouts use leverage to dry equity returns. Well, if I'm buying equity securities in a company, moving them into a CV, maybe there's an opportunity to use the 20 to 40% leverage in that vehicle to purchase those assets. There are plenty of people that are doing that today. You've seen the proliferation of groups like 17Capital or Hunter, et cetera, that are doing that today in some form, or other banks. So just like a levered buyout, these things are starting to have that same sort of impetus, understanding that what you have to be careful with is obviously the amount of leverage, the terms of that leverage, specifically the rates associated with that leverage, and what ultimately is going to be the potential that you're putting equity at risk where normally historically these things were pretty much all equity.

Geoff Cockrell ([18:23](#)):

Are there any kind of new and innovative products being developed in this arena?

Chris Lawrence ([18:28](#)):

So, I think a couple things have been happening structurally, which is we talked about the larger end of the market. I think what you've started to find is the people that are actually putting up the most equity and leading the deal, doing the diligence, doing the pricing, have started to separate themselves from what they get as far as return in a preferred return scenario versus those that come in from a syndicate perspective. You're starting to see a little bit of that bifurcation of who's doing the

work is actually going to make sure that they get a little bit better than the deal than the other guys who come in after the fact to ride the coattails, for lack of a better term. Nothing wrong with riding the coattails, but you just need to know how far behind you sit the preferred investor and or potentially debt.

(19:08):

That has started to move into the system here over the last three to four years, and I think it's just something to be cognizant of when you're looking at the larger scale of these transactions.

Geoff Cockrell (19:16):

Historically, I would have thought my experience has been that the secondary market tended to be larger buyers deploying this either as a specific strategy or as you've mentioned, some sub strategy within a broader private equity book. To what extent from where you sit doing deals in the middle market, lower middle market, to what extent the buyers in the secondary are still like that? Or is it a more democratized group of buyers such that maybe smaller family offices or other smaller institution investors are participating, or even direct individual investors? Who are the buyers in these?

Chris Lawrence (19:52):

Yeah, so great question. So up at the upper scale now, it's become institutional. So there are actually funds, multi-billion dollar funds that have been raised specifically for GP-led transactions, Geoff. There's folks that actually will only do single asset CVs and they've raised three, four, five billion. I think ICG probably raised the most their latest round, and obviously Lexington's in there along with the guys over at Carlisle and the rest. So I think everybody's got their sleep. Now, down here in the lower middle market it's still more of a specialist game. There are people that actually, like ourselves, who are raising these specific verticals that are going into, I want to go after in the case of Labyrinth, we want to use our liquidity solutions to go after this type of profile of business for working with general partners. The idea for most secondary funds that are smaller in nature still have that portfolio construction where maybe two thirds is LP-leds, or 70% or 80% is LP-leds, and then they use this 20% sleeve for the GP-leds.

(20:48):

That's still occurring today with the idea that maybe that 20% can add a little bit more alpha or money multiple to an overall IRR focused view. So specialization's coming, you'll see it in verticals. I mean, the issue today I see a lot of is we now specialize not only in just general terms of secondaries, but now you have credit secondaries, you got real estate secondaries, you have infrastructure secondaries, you have only GP-led single asset secondaries. So, that specialization in private markets is here and it will continue to grow. It happens more right now at the macro level than it does

necessarily at the smaller, lower middle market, which I think is still an interesting place for growth for managers like ourselves.

Geoff Cockrell ([21:28](#)):

Are the investors in that arena, especially on the lower middle market one, principally committed funds or are there rules for independent sponsors or similar kind of structures?

Chris Lawrence ([21:37](#)):

Yeah. So we're actually, we've been an independent sponsor in some respects so there is the role for that. There are people that have raised dedicated funds for that, that have institutional investors that will range from small insurance companies. Pensions don't necessarily see how it could be, depending on the size of that pension maybe, it's maybe too small for them to put a big ticket to work on a 300 or 400 million dollar specialized manager, but make no points about it. There is plenty of room for investors down here on the institutional side that like this area of the market, and we're seeing activity in that. Because down here, lower middle market, Geoff, we're not dealing with five or six major intermediated transactions per quarter, we're probably dealing with that at worst every two to three or four or five weeks, because the number of funds, obviously south of 500 if you want to think about it from a fund size, is much more voluminous than it is at the tall end of the big buyout guys.

Geoff Cockrell ([22:30](#)):

Chris, I want to thank you for coming on the podcast. This is certainly an interesting, evolving and emerging arena that I have to think we're only going to see more of, both driven by market dynamics but also just as this being an emerging asset class. But thank you a ton for coming on and giving everybody a little taste of what that looks like.

Chris Lawrence ([22:49](#)):

Appreciate it, Geoff. Thanks for your time.

Voice Over ([22:52](#)):

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