KEYNOTE INTERVIEW

Mid-market secondaries thrive despite volatility

During periods of market dislocation, mid-market secondaries can be a compelling strategy for investors to consider, says Matthew Sparks, a managing director at Northleaf Capital Partners

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Q How would you describe the current secondaries landscape, and what are the principal drivers of activity on the buyside and sellside?
The year started with what was probably the largest-ever quarter for the secondaries market to date, with very strong activity in both LP-led and GP-led transactions.

A lot of that volume was driven by the fact that there is an increasing number of investors using the secondaries market to actively manage their portfolios, and we're seeing experienced secondaries sellers returning to the market on a systematic basis. As we came out of the first quarter, new tariff policy announcements from the US administration created volatility in financial markets and significant uncertainty for companies.

The resulting disruption caused a pause as both buyers and sellers thought through how to approach the secondaries market and tried to determine what the new outlook would mean for pricing.

Fast forward to early May, and there is a bit more certainty as trade deals are negotiated. We expect to see a slight decline in pricing compared to the first quarter as we experience a softer M&A market and weakening consumer sentiment. However, the market appears to be functioning normally again with an increase in activity into the second half of Q2.

Q What challenges and opportunities are presented by the market environment today? How might it impact dealflow and pricing?
The secondaries strategy has historically been an all-weather strategy, and during times of dislocation, you can

find very attractive opportunities. Market volatility will likely limit exit activity and continue to impact distributions from private equity funds. Investors are experiencing this in their portfolios and are looking to the secondaries market as a tool for providing liquidity. We expect the market will see strong volume through 2025 with compelling opportunities for secondary managers.

In terms of pricing, we may see pricing shift downward, and that could slightly offset the market forces driving increased dealflow. One reason the first quarter was so buoyant was that pricing was nearing 2021 levels, which meant more price-sensitive buyers were willing to come to the market to trade. Moving forward, we still expect to see attractive optical pricing levels driving activity, and the challenge will be to navigate the uncertainty and volatility that still exists.

There is a potential for tariff policy to continue to shift over the coming weeks and months, creating a real challenge on the buyside as investors try to think through and understand the implications as they price deals.

Q Why are mid-market secondaries a good strategy in times of dislocation?

We anticipate that there will continue to be attractive opportunities in mid-market secondaries. Regardless of the market environment, mid-market buyers who approach secondary opportunities by taking a bottom-up approach, building up the analysis at the company level, are well positioned. Being able to underwrite at the company level helps to identify both the opportunities and challenges dislocation presents.

On the one hand, secondary managers can identify the companies and sectors that they feel are going to be more insulated with stronger growth. On the other hand, mid-market companies tend to be more domestically focused compared to larger market assets, which have global supply chains and global revenue bases. Therefore, it is arguably easier to assess tariff exposure with a mid-market asset, and often that exposure is limited.

Also, mid-market companies typically have more levers for value creation compared with the larger market. They tend to be acquired at lower purchase price multiples and use more modest leverage. Given their size, they are also typically nimbler and faster to react to changes in policy and macroeconomic dynamics, which positions them well in times of market dislocation.

Q How do risks and returns shape up in the mid-market versus other secondaries strategies?

We believe you can generate a higher return in the mid-market because it is more inefficient. In the larger market, buyout funds have a significantly larger number of LPs, so many investors have information on these funds and their assets. In the mid-market, funds tend to have fewer investors, which limits the knowledge base for these companies.

Firms that specialize in the mid-market and have built strong relationships with fund managers are well-positioned when portfolios and assets are being sold on the secondaries market. This focus and access create an information advantage. With fewer participants operating in this segment, there is an opportunity to dig deeper into a portfolio and develop a more thorough understanding of the underlying assets.

Q What should investors consider when trying to access the mid-market?

First and foremost, LPs need to look for a manager that has the network and relationships in the mid-market. Information creates opportunity in this market, and so, for example, groups that have an active primaries program with relationships and investments across the market have a clear edge.

It is also helpful to work with managers that have broader platforms. We find that managers with multiple asset classes focused on the mid-market allow the manager to have more touchpoints with sponsors and to build relationships, generating dealflow.

Ultimately, a mid-market manager that generates significant dealflow can be selective and zero in on the opportunities that are going to provide the best risk-adjusted returns. Lastly, having a broad reach is useful, which includes being able to invest globally. An international presence can be a differentiator in providing investors with additional diversification.

Q How do you see the mid-market opportunity evolving over time?

We see the mid-market opportunity continuing to grow in the secondaries market. We really think about two variables driving secondaries volume. The first is the amount of private equity net asset value, which currently sits at over $3 trillion and continues to grow as investors increase their commitments to the asset class and sponsors hold assets for longer.

The other component is the turnover rate, so how often sellers access the secondaries market. We know that this rate is increasing. Last year, ~40 percent of LP sales were completed by new sellers in the secondaries market, so there are still people learning and adding this tool to their toolkit. Those sellers may become repeat sellers and more sophisticated players, which will further fuel market growth.

The recent volatility has certainly resulted in a softer M&A market, and when there is a softer M&A market and fewer private equity distributions, investors will look to the secondaries market to provide liquidity in an illiquid asset class. That is a bit of a hedge that keeps the secondaries market functioning as an important part of the overall private equity ecosystem, and that is why we expect this strategy to continue to do well across market cycles. ■