

KEYNOTE INTERVIEW

Structuring deals in an expanding universe



The growth of the GP stakes market is bringing greater optionality and greater need for flexibility when negotiating terms, say Simpson Thacher & Bartlett's [Chris Evans](#) and [Lawrence Natke](#)

Q What's the state of the GP stakes market today, and how has it evolved over the past few years?

Chris Evans: Five years ago, the GP stakes market was considered by many to be a niche market within the asset management transactional landscape. Today, it has become a well-established facet of the private equity industry. Once upon a time, if a GP sold a stake, it had to then go on an apology tour explaining the transaction to its LPs. Today, stakes sales are an established feature of the lifecycle for private market sponsors.

From a buy-side perspective, a number of new entrants have come

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in and changed the landscape of what was once a market with a defined set of buy-side players doing deals programmatically out of commingled funds. New entrants include other fund sponsors raising GP stakes funds, insurance companies, sovereign wealth funds and even traditional asset managers. Certain of those balance sheet-oriented investors are doing stakes deals episodically, while others are doing so programmatically. The balance sheet-oriented investors tend to

look for different things and prioritise different aspects of transactions versus more established commingled fund GP stakes buyers.

On the sellside, the addressable market for GP stakes has expanded downstream. There is a lot more activity in the mid- and lower mid-market, because many of the large-cap private equity, private credit and infrastructure firms have already sold stakes, and sometimes multiple stakes. Stakes investors continue to find attractive opportunities via the GPs already in their portfolios.

Another significant evolution has been the market becoming more of a

Q What's the best way to approach GP stakes term negotiations?

CE: These are long-term partnerships, so they are relationship driven. EQ really does matter. In negotiations and in the terms you push for, it is not about trying to win pyrrhic victories on every point. It's also important to build trust.

LN: I have never seen a stakes investor win a deal purely on legal documents, but we have seen some lose deals because they are not flexible enough. There is an established template for what the legal terms are in these transactions, but the parties should be willing to be flexible within that framework.



continuum. GPs used to think of stakes deals as one binary option, and a control deal as another, with each solving for different outcomes. Increasingly, we are seeing GPs evaluate stakes and control deals as options on a continuum, sometimes sequentially.

Lawrence Natke: Institutionalisation has also been a key element of the market's growth, as GP stakes deals have become more accepted, both from a GP and an LP perspective. We have seen deal terms evolve and become fairly standardised so that there is an increasingly well-defined cadence to how these deals work.

New entrants on the buy-side, both the new GP stakes investment firms and the other strategic investors in GPs, have also meant more variety in terms of what investors are looking for and in terms of outcomes for GPs. Insurance companies, for example,

have the potential to bring something different to GPs from both a financial and strategic perspective.

Q How should GPs think about stakes deals versus non-dilutive deal options?

LN: Sticking with the theme of optionality, there are a lot more solutions available to GPs today. They need to think critically about what they are looking for when doing a capital raise.

If near-term liquidity is the issue, then a GP stake sale may not make sense compared with a preferred equity transaction, for example. A preferred deal would not have the same permanent nature and would not be as disruptive. Conversely, if the goal is to create a partial liquidity event and the GP wants a more long-term relationship with a partner that is going to bring strategic benefits, then a traditional GP stake sale might be more appropriate.

Q What are investors looking for from managers when going into these deals?

CE: It is certainly not one-size-fits-all, and it really depends on the type of investor. A GP stakes investor investing out of a dedicated commingled fund will be looking for GPs that have some of the hallmarks of institutionalisation, with a focus on a durable and repeatable track record, a strategy that has the potential to gain in scale, solid leadership and a viable next generation. They will also be looking for a firm where, from a leadership perspective, there has either been a succession event and the firm has transitioned successfully to the next generation, or the firm has a strong bench of next-generation talent. They want to be a long-term partner to a franchise with long-term growth potential.

Other investors, like sovereigns and insurance companies, are often looking for GPs with highly scalable strategies that will offer deployment opportunities for those investors. There could also be a strategic benefit for the investor in terms of access to opportunities in certain sectors and, of course, co-investments.

LN: Ultimately, what makes these investments different is that investors are underwriting the ability of the people at the GP to deliver. So, ensuring alignment is the highest priority – an investor needs to believe in the team.

The trends in GP stakes investing have mirrored trends in alternatives investment management more generally. So, we have seen a particular focus from investors recently on GPs with an infrastructure or private credit platform, for example.

Q How have the deal issues that arise changed over time? What are the key points of negotiation today?

LN: The biggest thing we have seen over the past couple of years has been

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LAWRENCE NATKE

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CHRIS EVANS

issues brought about by consolidation more broadly. The documents in GP stakes transactions always included provisions to address exit scenarios and change of control transactions but never really contemplated those as likely outcomes. Now, dealing with exit provisions for both investors and GPs has become front of mind.

We have seen some transactions where stakes investors did not feel they

were treated fairly on exit, or where founders felt that investors were asking for too much and trying to hold up transactions that would have otherwise been permitted under the deal. So that has been top of mind on the legal side recently.

Also, we often see provisions in documents that attempt to put other parties into different lanes, and as consolidation blurs lines that previously were more easily defined, those provisions become harder to figure out. We might spend time defining who is a ‘material competitor’ and therefore is not permitted certain information rights, for example. Making those distinctions has become harder as firms have grown and expanded their product lines.

CE: We are seeing a lot of time spent on drag and pre-emptive rights since subsequent control transactions for GPs, especially in credit and real assets, are now seen as a real prospect. Stakes investors do not typically have governance rights – they have minority protections instead – but we have also seen investors arguing for stronger protective provisions in recent transactions.

Q What lessons would you offer to a new GP stakes investor?

CE: The GP stakes investing landscape has become increasingly competitive, which means potential investors need to have very specific shelf space. In other words, your value-add cannot be purely financial, because that is already out there. It is all about the strategic benefits that you can bring to a potential partner in addition to the capital. Additionally, investors’ ability to source bilateral transactions has become a differentiator.

Investors’ value-add can take a number of forms. It might be investor capital through allocations to commingled funds, separately managed accounts or a fund of one. It might be offering distribution capabilities or access to retail distribution, or maybe

offering access to a hard-to-penetrate market, such as Japan, for example. But you have to bring something to the table that is not readily available from incumbent GP stakes investing firms.

LN: It is hugely important to differentiate yourself. A first-time investor pitching a pure capital play won’t cut it because they are competing with existing GP stakes investors and other liquidity providers.

Having flexibility on deal terms is another way to differentiate. Folks that are rigid in their terms can lose out on transactions to others that are more willing to work with GPs on how some of the rights are structured in legal documentation. GPs are looking for an investor that they can trust to be a good partner over the longer term.

Q How do you see the GP stakes market evolving from here, and what does that mean for advisers?

LN: Stakes investments are increasingly recognised as useful tools in the lifecycle of GPs, and we expect that to continue.

There is an ongoing evolution in terms of market participants, in terms of complexity and investment theses. All of that leads to more optionality on the GP side.

CE: GP stakes deals requires a specialist skill set. A strong adviser will have a dedicated team focused on GP stakes, made up of funds and transactional lawyers, as well as tax, employee benefits, regulatory and executive compensation backgrounds. Advisers that understand what each side is really trying to solve for – and who can therefore focus on the handful of issues that truly matter to each side – are the ones that can add the most value for clients on the buy-side and sell-side. ■

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