Private Equity Funds of Funds and Secondaries Case Studies: The Full Guide

How to Prepare for the "Hottest" Buy-Side Roles

PE Funds of Funds and Secondaries

Even though **traditional private equity** has not been doing well, a **few related fields** have been "on fire" recently.

One example is **secondary investing**, or buying/selling stakes in existing PE funds and their portfolio companies.

PE Funds of Funds and Secondaries

Since it has attracted so much interest, we released a new **PE Funds of Funds and Secondaries course** recently.

In this tutorial, I'll share the key **case study principles** and a few simplified examples from the course.

PE Funds of Funds and Secondaries

For the files and resources, go to:

https://breakingintowallstreet.com/kb/financial-sponsors/funds-of-funds-case-studies/

Why Funds of Funds and Secondaries?

- **Motivation 1:** Existing PE firms need to raise **new funds**, and you may have to evaluate potential investments in them

- **Motivation 2:** Limited Partners (PE fund investors) often need liquidity and/or rebalancing and sell their stakes for this

- **Motivation 3:** General Partners (PE firm professionals) often want to retain high-quality assets for longer (or, more cynically, they cannot sell them currently)

- **So:** Roles related investing in *new* and *existing* PE funds and assets have become quite popular

Why Funds of Funds and Secondaries?

- **Primary Deals:** Investing in *new* PE funds from existing firms

- **LP-Led Secondary Deals:** Buying stakes in *entire* existing PE funds

- **GP-Led Secondary Deals:** Buying stakes in *existing, individual* portfolio companies (or a single company)

- **Co-Investments:** Investing in a *new* portfolio company alongside the PE fund

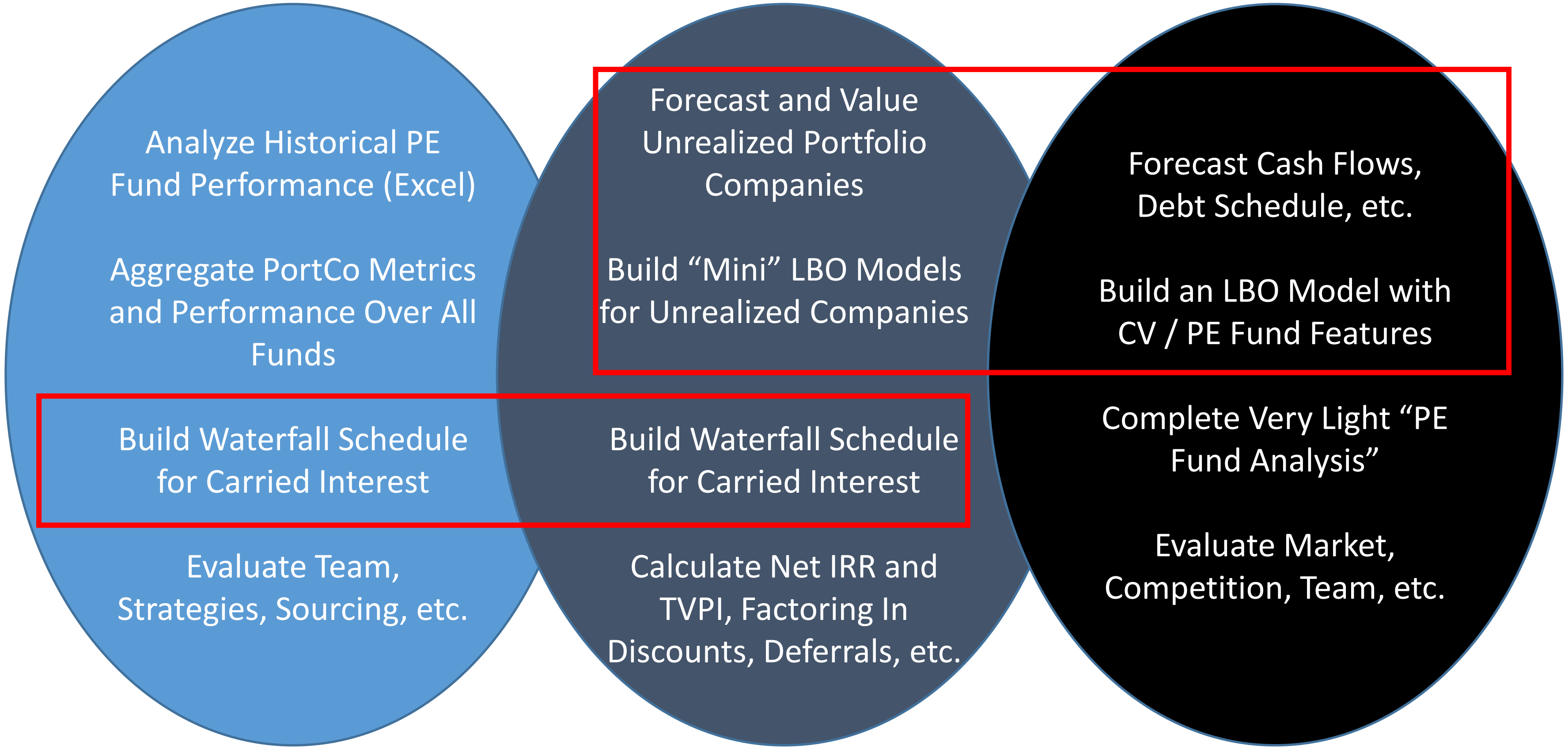
Why Funds of Funds and Secondaries?

- **Case Study Expectations:** Varies but the general guidelines are:

Primary Deals (Investing in NEW PE Funds)

LP-Led Secondary Deals (Buying Stakes in Existing PE Funds)

Co-Investments and GP-Led Secondary Deals (Investing in Individual Companies)

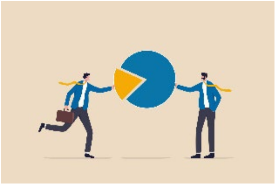


Why Funds of Funds and Secondaries?

- **Primary Deal Case Studies:** Mostly about analyzing the **historical fund data** and portfolio company performance and assessing consistency and stability of the returns

- **LP-Led Secondary Case Studies:** Forecast cash flows and valuations for remaining portfolio companies and determine price required to earn IRR of XX% and TVPI of YY

- **GP-Led Secondary and Co-Investment Case Studies:** Like standard LBO models, with a few “twists,” such as GP alignment, Accrued Carry Rollover, etc.



Plan for This Tutorial

- **Part 1:** Primary PE Fund Investing (Funds of Funds) **6:58**
- **Part 2:** LP-Led Secondary Investing (Secondaries Firms) **11:29**
- **Part 3:** GP-Led Secondaries and Co-Investing (Both Firm Types) **14:11**

Part 1: Primary PE Fund Investing

- **Case Type #1:** Simple calculation exercise where you calculate metrics such as the Gross MOIC, Gross IRR, Net IRR, Total Value to Paid-In Capital (TVPI) and Distributions to Paid-In Capital (DPI)

- **Case Type #2:** Evaluate a PE firm's historical funds and make a yes/no recommendation for a new fund

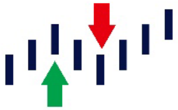
- **Excel/Modeling:** Mostly using functions like XLOOKUP, SUMIFS, SUMPRODUCT, FILTER, etc.

- **Complexities:** Could give you a **waterfall schedule**, which requires more modeling know-how

Part 1: Primary PE Fund Investing

- **Point #1:** Consistency, stability, and distribution of hist. returns

- **Point #2:** Clear "edge" over other funds (deals, sourcing, etc.)



- **Point #3:** Ways to mitigate or explain the risk factors

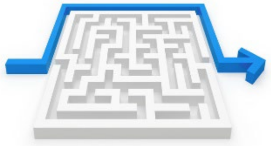
- **Common Scenario:** Returns that "look good," but raise concerns once you drill down (industry, deal type, unrealized vs. realized)

- **Practice:** Some endowments/pensions, such as CalPERS and CalSTRS, may disclose their data, but tough to find otherwise

Part 2: LP-Led Secondary Investing

- **Scenario:** “Here are the remaining portfolio companies, their financials, valuations, and business plans”

- **Your Task:** Forecast the cash flows and exit multiples/dates for each one to determine the exit proceeds



- **And:** Factor in any **bid discount** paid for the LP’s stake, deduct Carried Interest from the investment profits, and factor in Management Fees in more advanced cases

- **Your Value-Add:** Mostly “sanity checking” the GP’s assumptions and pushing back on the more aggressive ones

Part 2: LP-Led Secondary Investing

- **Process:** Create a cash flow forecast with the upfront price, including any discounts or deferrals, the exit proceeds, and both types of fees, and sensitize it to assess the returns

- **Recommendation:** "Yes" if you can achieve the targets reasonably in different cases (e.g., 20% Net IRR and 2.0x TVPI)

- **Practice:** Take 3-4 public companies you follow, create "quick LBO models" for them, and determine the *overall price* that lets you achieve something like a 20% Net IRR

Part 3: GP-Led Secondaries and Co-Investing

- **TL;DR:** Mostly traditional LBO modeling tests with CIMs or annual reports, investor presentations, etc.

- **Co-Investments:** May create case to challenge GP's assumptions; may build complex ownership or co-investment alignment tests; may do some fund-level analysis

- **GP-Led Secondaries:** GP must roll over Accrued Carry, which converts into an effective equity stake in the continuation vehicle (CV); additional/new Carry in the CV and Management Fees; possible tiered promotes in the exit

Part 3: GP-Led Secondaries and Co-Investing

- **Practice:** Use any of the existing LBO modeling tests or templates on this site and practice using it for a public company you follow

- **Ideal:** Add some of these co-investment or GP-led features, such as a test for GP alignment (e.g., does the GP contribute 5 – 10% of its committed capital for this single deal, and does it truly “need” to offer it as a co-investment?)

Recap and Summary

- **Part 1:** Primary PE Fund Investing (Funds of Funds)

- **Part 2:** LP-Led Secondary Investing (Secondaries Firms)

- **Part 3:** GP-Led Secondaries and Co-Investing (Both Firm Types)