SE Asian GPs spot big promise in continuation funds amid pandemic drag

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Fund managers in Southeast Asia are betting big on continuation funds as they seek to maximise asset values in a challenging environment created by the COVID-19 crisis.

A continuation fund is designed to acquire assets from an existing fund by the same general partner (GP) that is nearing the end of its lifespan. Under this structure, GPs offer existing limited partners (LPs) the option to take their money back or double down on the portfolio and continue with the asset. To put it simply, continuation funds are a rebranding of GP-led secondaries.

Earlier this month, Malaysia-headquartered Navis Capital Partners closed its Navis Asia Green Loop Fund at $450 million, to make secondary acquisitions of five undisclosed portfolio companies in its Navis Asia Fund VI.

DealStreetAsia has learnt that APAC secondaries private equity platform NewQuest Capital Partners is close to making an investment in the Navis fund. This, however, could not be independently verified with Navis Capital Partners, while NewQuest declined to comment on the development.

Meanwhile, Vertex Holdings–led Vertex Legacy Continuation Fund Pte Ltd commenced operations last year in December. The vehicle had a net asset of $81.9 million by the end of last year, highlighting a burgeoning trend on how PE firms have started creating liquidity by acquiring their own portfolio companies.

Liechtenstein-based financial group LGT is said to have backed this continuation fund, which invested in parenting community platform TheAsianParent, and online grocer HappyFresh, according to DealStreetAsia's DATA *VANTAGE*.

The fund also held a portion of Vertex's shares in Southeast Asian super app Grab, the Secondaries Investor publication reported. When contacted, Vertex Holdings declined to comment on the story.

"The beauty of [continuation funds] is the possibility for the managers to stay in certain assets for the right period, and to maximise the full potential of an investment," said Alexandre Schmitz, managing partner and head of APAC at Capstone Partners.

The strategy is coming into play, as the global COVID-19 pandemic hit investment timelines and exit potential.

Earlier transactions of this GP-led structure in the region included a single-asset deal by Coller Capital's CIP VII in an Australia-based education business via a continuation vehicle managed by Baring Private Equity Asia in April 2019. The asset was transferred from Baring's 2007-vintage Fund VI, Coller said on its website.

In 2018, Singapore-based Basil Partners closed its third fund, which was "formed through a complex restructuring and secondary acquisition of" a digital services portfolio, the firm had then mentioned. The transaction was anchored by NewQuest and European PE firm Committed Advisors.

"These [continuation] vehicles allow profits to be crystallised, while still offering further upside and longer-term ownership," opined David Lowery, senior vice president and head of research insights at Preqin.

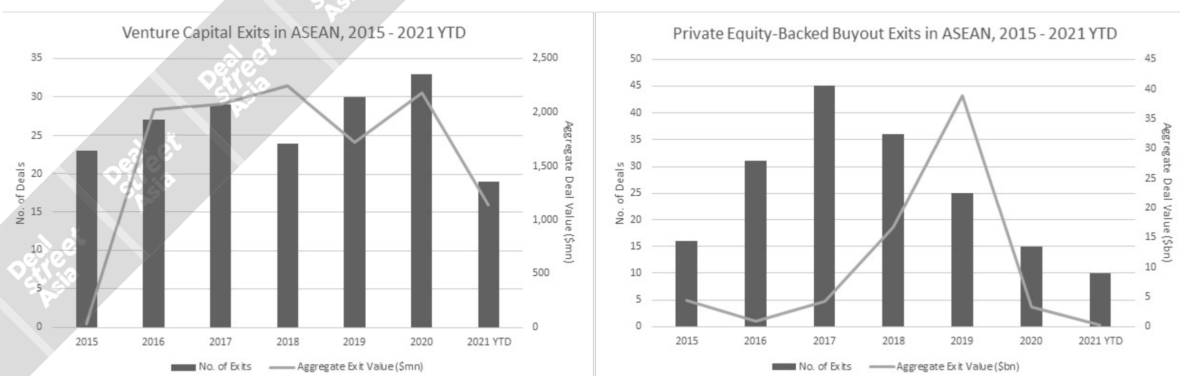
As a type of secondaries, the continuation fund strategy allows fund managers to retain stakes in highly prized assets, "especially in a competitive market where they are particularly hard to source," added Lowery.

Alternative for liquidity

"The market in 2020 was dislocated. A number of GPs looked at the exits they were trying to achieve in 2020, and decided to seek alternative liquidity opportunities for their portfolio," said William Yea, a Hong Kong-based principal at Coller Capital.

Preqin's Lowery noted that in some cases, GP-led restructuring could be used as the exit environment is structurally weak.

Preqin data indicate that venture capital exits in Southeast Asia this year might be on track to catch up with 2020 performance, which grew 10% in the number of deals and over 26% in exit value. But PE-backed buyout exits are worsening.



PE and VC exits in Southeast Asia. Source: Preqin.

The way Yea sees it, however, the formation of continuation funds, is driven more by how managers wanting to hold on to well-performing assets for a longer period.

"It all comes down to what could happen in the next 3-5 years for the assets that the GPs currently manage. They will be looking to create the next leg up in terms of value, and achieve their expected exit [returns]," he added.

Soma Ghosal Dhar, founder of Candor Asia Advisor, a Singapore-based secondary private equity advisor, suggested that the popularity of continuation funds should not be perceived as a result of a worsening exit environment.

"The stigma around secondaries has gone away fully and completely, as people understand that it is a tool for GPs to secure liquidity, instead of an admission of failure. It shows that the market is maturing," she said.

In addition, according to Ghosal Dhar, there have always been cyclical factors weighing on exits by the traditional PE funds. And the continuation fund model represents a new kind of capital to address the needs of both GPs and LPs.

"The whole effort is to make the market a bit more liquid, and provide more options for better timing and returns," she added.

Globally, improvement in investment returns has been seen in recent secondary funds. 2018-vintage private equity secondary funds recorded 28% median net IRR, the highest amongst funds tracked since 2005, showed Preqin's Secondary Market Update H1/2021.

In Southeast Asia, continuation funds are seen as an opportunity to tap the region's growth trajectory.

"Southeast Asian companies, particularly the ones with institutional backing, have seen significant growth. Private equity funds typically have holding periods of five to seven years, while these companies can continue to grow at 20% or more for over a decade. As a result, more and more GPs would want to see these companies grow at 20-25% for additional time until the companies are ready for logical exits," noted Amit Gupta, partner at NewQuest.

Tech multiples

Most of the continuation fund activities in Southeast Asia have been in the tech sector through Malaysia's Navis, which operates generalist funds, marks an exception.

In terms of secondaries, tech investments often have the capacity to generate outsized returns at quicker exit velocity.

Take Indies Capital, for instance. The firm invests in secondary shares of tech firms across Southeast Asia. Its targeted $80-million Indies Strategic Technology Fund II aims to back technology companies "often at meaningful discounts to current valuations", while the exit market for the region's first wave of unicorns is taking shape, it said in July.

Indies' first fund features three decacorns, five unicorns and five centaurs (tech firms with valuation of more than $100 million) in its portfolio, namely Grab, Bukalapak and aCommerce.

"When you look at most of the investments related to internet businesses, the underlying businesses have benefited from the pandemic. In that context, most of the continuation funds are backing quality assets that are stronger today than three years ago," Schmitz asserted.

Gupta from NewQuest added: "A lot of funds in the region with fund sizes of between $100 to $250 million have exposure to new economy sectors. Therefore, more GP-led deals will happen as these funds approach the end of their life."

Now with more SPAC transactions coming to Southeast Asia, and a handful of M&A activities in the region, there's a "very rosy outlook" for the tech sector, Ghosal Dhar opined.

LP perspective on visibility

If the continuation fund model enables existing LPs to choose between cashing out or doubling down on the portfolio, it gives new LPs the comfort of evaluating the upside of an already established asset.

"You know exactly the type of assets you will have in the portfolio of the continuation funds, meaning you only buy the winners," noted Schmitz. "The risk is by essence lower than in a primary fund."

Given the incumbent GP's familiarity with these companies, investors of continuation funds have more visibility about how the assets can grow and deliver returns.

"This is not to say that a $200-million revenue company would not be attractive enough for buyers. But if you can grow that $200 million into $350-400 million, you would achieve much better multiples at exit," added Gupta.

At the same time, investors should also be noted to judge these GP-led opportunities as standalone items. "No two GP-led transactions are exactly alike," said Coller Capital's Yea.