DECEMBER 2020

THE TRIAGO QUARTERLY

Dear Reader,

For all the heartache of the present, we've done much better than simply muddle through the current crisis. Efforts to develop vaccines in record time will hopefully pay off in mass inoculations, while major fiscal and monetary stimulus is keeping the global economy stronger than we dared hope during the darkest days of 2020.

How private equity is dealing with Covid-19, and most encouragingly learning from it, is the overarching theme running through these pages. And the outlook is bright, much like the broader prospects for 2021. As Pantheon Ventures' Helen Steers, one of our roundtable participants notes, one of the most intriguing and potentially far-reaching developments of the past year is a closer alignment of the profit motive and social impact. The more seamless that connection becomes, the better.

As always, we hope the information found here helps you make the right business and investment decisions. To all, we wish health and happiness over the holidays and a joyful 2021!

Sincerely, The Triago Team

ANALYSIS: THE FLOOD GATES SWING OPEN
With so much PE activity put on hold by Covid-19, 2021 could set records

ROUNDTABLE: COVID-19
How the crisis is transforming PE forever

PRIVATE EQUITY BLOG
PE's big opportunity in mid- and small-caps, Portfolio diversity becomes a priority, Lower distributions and relative plenty, Early secondaries fail to take off, LP-stake appetite is stoked by shortage

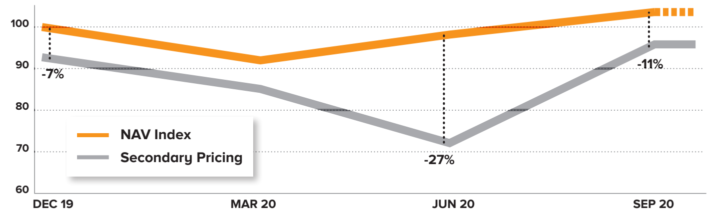
A V-SHAPED RECOVERY (SO FAR)

Private equity distributions are the immediate challenge.

Values rebound above pre-crisis levels...

Evolution of PE Fund Net Asset Value & Secondary Pricing

(excludes GP-led secondaries)

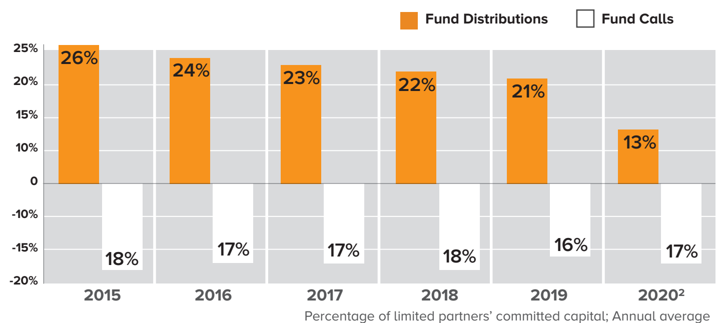


...with fundraising picking up strongly.

Global Private Equity Fundraising[1]

	Q1	Q2	Q3	Q4	FY
2019	$180B	$189B	$204B	$228B	**$801B**
2020	$195B	$152B	$167B	$206B[2]	**$720B[2]**

But slow exits challenge LP ability to commit...

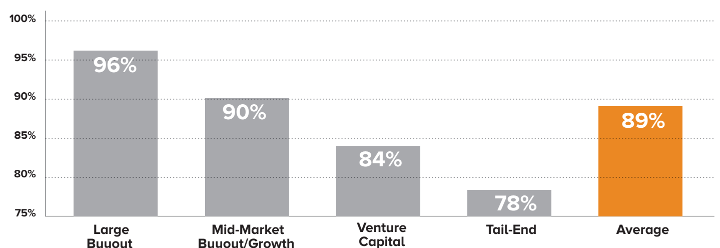


Percentage of limited partners' committed capital; Annual average

...as attractive secondary sectors invite sales.

Fund Types Sold on the Secondary Market – H2 20[2,3]

Pricing Relative to Net Asset Value (excludes GP-led)



1 Includes activist funds in Buyout, Venture Capital, Growth, Real Assets, Distressed/Turnaround, Secondaries, Credit, Funds-of-Funds and all closes, first to final.

2 Preliminary estimate.

3 Energy funds excluded since no sales over relevant period.

The Flood Gates Swing Open

With so much private equity activity put on hold by Covid-19, 2021 could set fundraising and secondary records.

By Q2 of this year, PE net asset values were just a hair's breadth from pre-crisis levels. By the end of Q3, both net asset values and prices for PE funds sold on the secondary market were above pre-crisis marks (see first graph on p. 1). The overall economic recovery from Covid-19 may well prove grinding and slow, but so far the rebound for private equity is V-shaped. The 9-months it's taken for two of the most important indicators of private equity's health to soar past pre-Covid 19 highs compares to a 24-month recovery from the lows of the global financial crisis (more on the GFC in our June Market Analysis).

PE fundraising has held up remarkably well with $720 billion raised for a broad range of PE strategies in 2020, according to our preliminary estimates (see second graph on p. 1). That's some 10 percent below last year's level and just 5 percent below the average for the previous five years, a period of fundraising success without equal. A disproportionate percentage of commitments went to large, brand-name groups, representing a flight to the familiar at a time when due diligencing managers has been sharply curtailed by travel restrictions.

But the exceptional capacity of smaller, usually more specialized managers to respond rapidly to the pandemic's challenges and to take advantage of short windows of buying opportunity, has been recognized by investors (see our roundtable on p. 3). The relative dearth of commitments to smaller managers and the growing divide between the record purchase price multiples for large-cap firms – highly influenced by sky-high values for publicly-quoted comparables – and relative bargains among more cash-strapped mid- and small-cap firms is heralding a significant fundraising swing – already noticeable in this year's fourth quarter – to smaller, more specialized managers in 2021.

In PE, the economic uncertainties tied to Covid-19 have arguably taken their largest toll in the pace of realized investments. As PE groups stepped back from portfolio company sales processes, evaluated the vulnerabilities of their portfolio companies and shored up their finances, the number of exits dropped sharply. At the same time, purchases continued apace, particularly as larger companies sold off divisions, and mid-sized and smaller companies welcomed transactions as a means to bulk up both equity and debt financing in the face of the crisis. The result: capital distributions to PE investors from portfolio company sales this year fell below capital calls to finance new investments for the first time since 2011 (see third graph on p. 1), leaving many PE programs cash negative.

With many investors eager to increase allocations to PE and economic challenges in many sectors and regions likely to open up exceptionally attractive buying opportunities, the distribution/call mismatch could leave some short of capital just when they want to overweight private equity. Net-cash negative positions for many programs should, however, provide impetus for portfolio cleanups using the secondary market.

With PE fund net asset values rising to 106 percent of the pre-crisis mark after a relatively modest 8 percent write down in Q1, and certainties growing regarding sustained monetary and fiscal support for economies and effective vaccines, volume in the secondary market soared to $50 billion in H2, following an H1 total of $21 billion. But in 2020, for the first time a majority (52 percent) of annual secondary market volume was accounted for by GP-led deals. They put large sums to work in one go in a market with few LP-stake offerings. Total volume of $71 billion in 2020 trails last year's record of $83 billion, when 36 percent of deals were GP-led.

Attractive pricing for sellers in a number of categories, in particular large leveraged buyout funds – currently at 96 percent of net asset value, just shy of the 98 percent five-year annual average – (see graph 4 on p. 1) should lead to a resurgence in LP-stake sales in 2021, very possibly a new volume record for secondaries, and fresh cash for primary commitments, which may also rise to record levels. Even heavily out of favor sectors – notably energy, where Triago has seen no secondary sales in H2 2020 – are likely to get a relative boost over the coming year as specialists and the secondary pockets of funds-of-funds seek to deploy $153 billion in unspent capital earmarked for secondaries.

Covid-19: Changing Private Equity Forever

Social impact takes center stage and launching new funds gets more complex.

Our roundtable participants have a range of views regarding Covid-19's changes. But all say private equity will reach new levels of popularity and employ resources more effectively - whether in the form of rolled-up sleeves or slimmed-down expertise - as a result of the crisis. There's also a conviction that social impact is finally coming into its own as a serious investment consideration. Our participants describe an industry that's more intensely competitive with increasingly specialized fund teams, big groups getting larger, and the bar rising for new entrants. As they see it, Covid-19's economic fallout will keep asset prices high, while managers traditionally focused on volatile public markets cast a covetous eye on newly popular, resilient and high-fee private equity.

JIM STRANG
Chairman of Europe, the Middle East and Africa at Hamilton Lane

HELEN STEERS
Partner and Head of European Primary Investment at Pantheon Ventures

RAINER ENDER
Head of Private Equity at Schroder Adveq

How will Covid-19 transform private equity? Is the crisis permanently changing how people invest in private equity?

HELEN STEERS: In at least three ways, yes. From day one, managers with exceptional levels of expertise and staffing in digital technology, business operations and capital markets proved more adept than traditionally resourced rivals at taking defensive actions; they also shifted earlier to being acquisitive. That's hugely increased the appeal of staffed-up and specialized managers. The second big impact is commitment to environmental, social and governance [ESG] best practice. For years, environmental impact has been a key criterion for investments, while good governance is a byproduct of private equity's alignment of investors, managers and portfolio company executives. With the suffering caused by Covid-19, commitment to the "S" – social impact – is coming into greater focus. It's leading to far-reaching measures to improve the wellbeing of portfolio company employees, and the communities in which companies operate. Finally, there's greater remote due diligence. We've learned – permanently – how to prioritize travel.

JIM STRANG: Niche expertise within specialties is coming to the fore. Healthcare, for example, is a mile wide, but during the crisis the most rapid, effective reactions have come from funds focused on very particular types of healthcare companies. Going forward, we're likely to see managers concentrate on much more acutely honed areas of expertise than was the case pre-Covid-19. While specialist street cred has been reinforced, the most effective responses to crisis-driven operational challenges have not been dependent on costly in-house armies. The strength of top managers is asking the right questions and then, frequently, bringing in effective outside resources to deal with an issue. Managers win when they efficiently use the options at their disposal, given a particular set of circumstances.

RAINER ENDER: We'll see the proportion of assets allocated to private equity rise to unprecedented levels as a result of the crisis. As with the global financial crisis, disruption will prove more damaging to the passive, public market holdings of investors than to their activist, invest-for-control private equity holdings. Private equity has always been more focused on next generation business models – the secret sauce dividing outstanding investments from mediocre ones. Covid-19's fallout is highlighting this. Lastly, Covid-19's uneven effect across industry sectors – for example, healthcare versus leisure or

even within sectors, i.e. vaccine producers versus retail dental clinics – and Covid-19's staggered impact from Asia to North America, means there will be a new emphasis on creating highly diverse private equity portfolios, across strategies, sectors and geographies. The days of investing two-thirds of your portfolio in North American buyout are over.

Covid-19 is putting the emphasis on creating highly diverse portfolios.

Rainer Ender, Schroder Adveq

On balance, will the crisis offer opportunity to smaller managers and first-timers, or will it simply reinforce the trend towards consolidation and ever greater fund sizes?

JS: Whenever there's an economic crisis – regardless of the origin – there's a reshuffling in private equity, typically with the strong getting stronger. With Covid-19, some of the ablest larger groups will pull away from the pack, doing what they do now on a larger scale. There will be opportunity for smaller managers and new managers, but securing it will be tougher. That's due to the increased sector expertise managers will have to display and the greater competence they'll need to rally resources – whether that's the broader internal assets Helen referred to, or the more flexible outsourcing I spoke about. All of this implies growing cost and time devoted to both fundraising and operating. Outside of big brands, it will take more meticulous marketing to convince investors to commit and it will – in one form or another – cost more to shepherd and grow investments.

RE: We're likely to see a cycle that will first favor big groups and then later smaller groups. Investors are struggling to get money out the door because of Covid-19 travel restrictions and the inability to carry out due diligence. In the short-term that's leading to large investments with big, familiar brand-name managers. But it's leading to a situation where too much money is chasing too few opportunities at the large end of the market. In the medium-term this will create spinouts from large groups and new opportunities for smaller managers and first-timers.

HS: I'd say Covid-19 stacks the deck for top-tier quality. Superior managers, regardless of size, with impeccable track records and – crucially – very desirable offerings given the current context, have managed to close in record time. Managers in sectors negatively affected by the crisis and those lacking resources to quickly deal with challenges have seen their growth thwarted and their survival threatened. As time passes, there will be an increase in spinouts, especially from troubled teams. As noted, emerging managers will be more nimble and more sector focused, while developing areas such as sustainability and ESG will experience disproportionate growth. Private equity's remarkable characteristic – driven by how its incentives operate – is that the best fund managers continually learn lessons and reinvent themselves on a stronger base.

To return to a subject briefly raised by you, Rainer, to what extent will the crisis impact private equity's appeal, particularly versus the stock market?

RE: The lion's share of investors that we're talking to at the moment are raising their allocations to private equity, particularly investors like insurers who've traditionally limited their exposure to illiquid investments. With risk-free interest rates dropping to less than 1 percent in North America and to less than 0.5 percent in Western Europe and no prospect of higher rates in the foreseeable future, every basis point of potential private equity outperformance is more highly prized. Combined with the low volatility we're seeing versus the stock market, that's neutralizing illiquidity concerns. Most investors' risk/return models indicate that they should have a lot more invested in private equity.

HS: It's worth recalling that the heightened attraction Rainer is talking about is happening against a background where the number of public companies has dropped some 50 percent over the last 20 years, with the typical listed company older, larger and slower growing than was the case two decades ago. At the same time, private equity is becoming increasingly growth-oriented and

diversified – thanks to those specialists we've mentioned. This is true even in a formerly cost-cutting-focused strategy like buyouts. Investors are seeking higher long-term growth than listed stocks can provide; inevitably that means investing more into private equity, including buyouts.

JS: I agree with Rainer and Helen. I'd highlight that stock market volatility when contrasted with the amazing resilience of private equity is one of the most effective arguments in favor of PE investment. Studies show that over the entire history of private equity, only a small percentage of buyout funds – the category's core strategy – have actually lost money.

Will the crisis affect how public market asset managers develop private equity and could there be consequences for PE's existing managers and investors?

HS: Moves by traditional asset managers into private equity will only be accelerated by the heightened attractiveness of PE in the Covid-19 era. But, public market-focused asset managers have been developing high-margin private equity internally, buying private equity managers or creating partnerships with PE general partners for a while now. That's been driven by the expanding revenue share within traditional asset management of low-margin, high-performing passive index investment and the crowding out of more profitable, actively managed stock funds. Partly in anticipation of heightened competition, private equity managers are increasing their financial muscle by going public; while others are broadening the areas in which they compete by offering PE expertise to retail investors. Our firm, for example, offers investment products designed principally for the U.S. defined contribution pension market.

JS: For all that large traditional asset managers may want to get into private equity because of Covid-19's acceleration of trends, they face exceptionally tough prospects breaking into the established, institutional end of the market. Rather than engaging in aggressive acquisition campaigns or trying to build up complex organizations from scratch to break into a super competitive marketplace where clients are already well served, they're more likely to expand by meeting largely unfulfilled – and as Helen implies, highly promising – retail investor needs. Retail investment in private equity is at an embryonic stage and it's spottily served, but its potential is absolutely enormous, with trillions of investment dollars as the prize.

> Moves by asset managers into PE will be accelerated by Covid-19.
>
> *Helen Steers, Pantheon*

RE: I agree that the current crisis has enhanced private equity's pull for traditional asset managers. But as the head of the acquired and now fully integrated private equity arm of a diversified traditional asset manager, I think there's a topic we've missed here. That's the ability of a global cross-asset manager to be a highly creative and efficient one-stop shop for investors. As investors diversify across asset categories and geographies, the number of their financial relationships can reach unmanageable proportions. For managers that successfully combine traditional and alternative asset operations, the ability to be the principle partner for such investors is a huge opportunity.

How will Covid-19 impact the use of leverage in private equity?

JS: The short answer is not much. That's because the type of leverage offered today and the institutions providing it have changed dramatically since we faced the last truly dire downturn, the global financial crisis. Today, most debt is provided by sophisticated private loan funds – not banks – which have largely remained calm and kept credit spigots open. Moreover, the covenant-lite leverage that accounts for the vast majority of credit now, gives companies and their private equity managers greater flexibility to deal effectively with challenges than was the case during the GFC. There are relatively new forms of leverage – preferred equity and net asset value loans – that are being used by fund managers and portfolio companies to generate liquidity. Such leverage represents an unknown frontier that hasn't been fully stress-tested, but the evidence so far is that it's useful and working smoothly.

HS: Keep in mind that the big reason leverage has remained sheltered from crisis and freely available is because the world's central banks began lowering interest rates and buying corporate credits of all types on an unprecedented scale. Pricing and volatility for leveraged loans threatened to spin into meltdown in early March, but central banks engaged in massive – highly welcome – coordinated action to supply global credit markets with liquidity.

RE: Covid-19 has clearly prolonged a period of easy credit that began with the GFC. One of the biggest challenges resulting from that for private equity managers and their investors is continued asset price inflation and, most likely, even higher purchase price multiples.

PRIVATE EQUITY

BLOG

A round-up of current trends and issues for general partners and limited partners

PE's big opportunity in the mid- and small-cap sectors

Purchase price averages expressed as a multiple of corporate cash flow are at all-time peaks, according to data providers. But averages in the Covid-19 era mask stunning diversity, especially among mid- and small-cap companies starved of government largesse. Recent studies from the Bank for International Settlements and others indicate that the loan and bond guarantee programs driving today's credit boom disproportionately benefit large firms with revenues of $1 billion or more and access to syndicated credits. Mid-sized and small companies – frequently not adequately serviced by banks – increasingly face a credit crunch, creating opportunities for private capital to provide equity and debt at attractive terms. Indeed, many companies are finding that to negotiate the complexities of cov-lite loans from private credit funds, it helps to have a PE firm in their share capital. The prospect of exceptional PE deals should help drive record fund commitments in 2021.

Diversity across sectors and regions comes to the fore

One of the lessons of Covid-19 is that diversity in portfolio construction pays. As Rainer Ender, Head of Private Equity at Schroder Adveq, says in our roundtable on the crises' impact (see p. 3), "the days of investing two-thirds of your portfolio in North American buyout are over." Investment volumes and values have arguably never shown greater variety across industries and geographies than they have this year, with some sectors like venture capital experiencing record fundraising, and others like real assets seeing decades-long lows. If fundraising builds to the record heights we expect in 2021, one of the biggest beneficiaries may well be Asia, which came out of Covid-19's darkest days early, and where regional powerhouse China is the only major economy in the world projected to end the year with a bigger economy than the one it started with.

Distributions and relative plenty

Don't put too much faith in averages. While the mean distribution returned to investors in 2020 from realized PE investments dropped to 13 percent of total committed capital (see fourth graph on p. 1), from a five-year annual average of 23 percent, quite a few managers returned record sums to investors, notably those focused on the broad sectors of healthcare and technology (underlining the importance of portfolio construction diversity). And 2020 wasn't really so terrible for distributions. In the global financial crisis and its wake, when virtually all asset categories were slammed, distributions dropped to just 2 percent in 2009 from a pre-GFC 5-year annual average of 19 percent. Distributions post-GFC returned to double-digits only in 2012 when 12 percent of investor commitments were generated by asset sales, producing the first cash surplus for PE programs since 2007.

Early secondaries nipped in the bud

In our June report, we noted an uptick in secondaries involving closed PE funds that were only 5-20 percent drawn. Because discounts apply only to invested capital, these early secondaries could be a relatively painless way to close with buyers, even at steep markdowns. Well, despite the blip, early secondaries volume never became significant (though post-GFC such deals amounted to 45 percent of 2009's $9 billion in secondary volume – the latter, half the previous year's turnover). With the economy supported by massive monetary and fiscal stimulus, net asset values dipped for only one quarter before bouncing back and hauling up secondary prices. Lower levels of distributions relative to calls have set the stage for a strong rise in secondary sales, but in a normal rather than a dislocated market, and notably, so that investors can stay allocated (and allocate more) to what we expect will be some very good PE vintages.

The appetite for LP stakes is stoked by shortage

Annual volume in the secondary market for limited partner stakes fell 36 percent, while volume for GP-led transactions actually rose by 23 percent in 2020, according to Triago's preliminary estimates. As we note in our market analysis commentary on p. 2 (more on pricing and volume there), GP-leds allowed investors this year to put large sums to work in a market characterized by few LP-stake offerings. Heightened competition has seen exceptionally tight pricing for GP-leds (frequently par or better) and a hankering among buyers for the lower risk and shorter duration of LP-stake offerings. As one major secondary buyer recently told us: "our appetite for classic limited partner stake deals has never been higher." This should be music to the ears of limited partners looking to make up distribution shortfalls with some secondary market portfolio pruning.

www.triago.com

OUR OFFICES

TRIAGO EUROPE
5 rue Scribe, 75009
Paris, France
Tel: +33 (0)1 47 03 01 10

TRIAGO AMERICAS
499 Park Ave.
25th FL New York, NY
10022, USA
Tel: +1 (212) 593-4994

TRIAGO UK
20 North Audley Street
London W1K 6LX, UK
Tel: +44 (0)203 196 0660

TRIAGO MIDDLE EAST AND ASIA
DIFC – Emirates Financial Towers
PO Box 506681, Dubai, UAE
Tel: +971 4 433 1009

TRIAGO

In the Americas, Triago is registered with the SEC and is a member of FINRA/SIPC.

In the United Kingdom, Triago UK Limited is authorised and regulated by the Financial Conduct Authority.

In Europe, Triago is a member of the CNCIF, approved by the AMF.

In the Middle East, Triago is regulated by the Dubai Financial Services Authority.

The opinions, estimates, charts and/or projections contained herein are as of the date of this presentation/material(s) and may be subject to change without notice. Triago endeavors to ensure that the contents have been compiled or derived from sources that we believe are reliable and contain information and opinions that we believe are accurate and complete. However, Triago makes no representation or warranty, expressed or implied, in respect thereof, takes no responsibility for any errors and omissions contained therein and accepts no liability whatsoever for any loss arising from any use of, or reliance on, this presentation/material(s) or its contents. Information may be available to Triago or its affiliates that are not reflected in our presentation/material(s). Nothing contained in this presentation constitutes a solicitation, recommendation, endorsement, or offer to buy or sell any investment product.