The Rapid Evolution of Long-Term Funds

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TresVista

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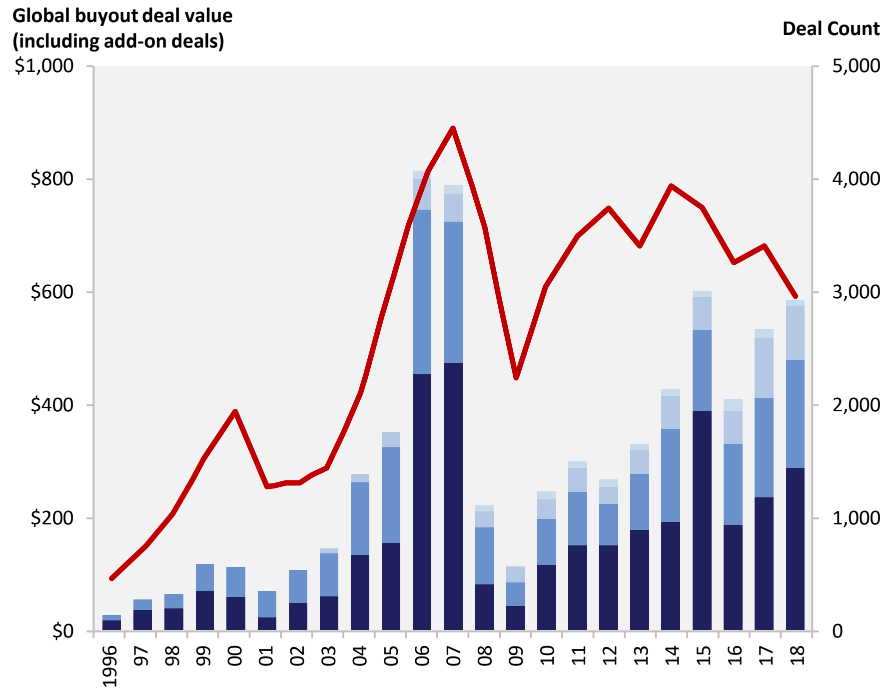
Private Equity Going Mainstream

- The Net Asset Value in Private Equity (PE) has grown more than sevenfold since 2002, twice as fast as global public equities
- In the US, PE-backed companies rose to about 8,000 in 2017 compared to 4,000 in 2006, a 106 percent increase, while publicly traded firms fell by 16 percent from 5,100 to 4,300 (and by 46 percent since 1996)
- Capital flows into PE has been rising for years. Large investors that previously stayed away are increasingly allocating to private markets, to diversify their exposure to global growth
- At the same time, investing this capital has become increasingly difficult
- Stiff competition between PE buyers and elevated levels of dry powder have created a challenging market for investors, impacting valuations, and creating a particularly expensive market, especially in the US
  - Dry powder in the PE ecosystem continues to accumulate – the total stands at nearly US$1.5 trillion at the end of 2019
  - Valuations have increased – the average purchase multiple in US LBOs increased 35% to 11.5x trailing EBITDA over 2010-2019
  - Competition and rising asset prices have constrained overall deal count. Global PE deal at the end of YTD Q3 2019 stood at its lowest level in five years, at just short of 2,500
- Within this backdrop, some sponsors have leaned towards long-hold funds and permanent capital holding companies
- This enables PE funds to hold onto profitable companies for longer, giving LPs the ability to deploy capital into attractive investments for long periods of time, and for many, to reduce reinvestment risk and better match their assets with their liabilities



	1996	97	98	99	00	01	02	03	04	05	06	07	08	09	10	11	12	13	14	15	16	17	18
Add-on count percentage	9	17	25	25	27	33	29	27	28	29	29	33	36	36	37	41	40	40	45	48	48	49	42
Add-on value percentage	14	16	16	15	20	16	8	11	12	17	10	11	13	21	12	25	21	14	31	43	21	25	23
CAGR (17-18)				22%					9%				-4%					-53%					-13%

■ North America ■ Europe ■ Asia-Pacific ■ Rest of world — Total count

Private market investment activity has gone from alternative to mainstream over the last decade

Source: McKinsey, Bain & Co., CNBC, Partners Group, Mergermarket

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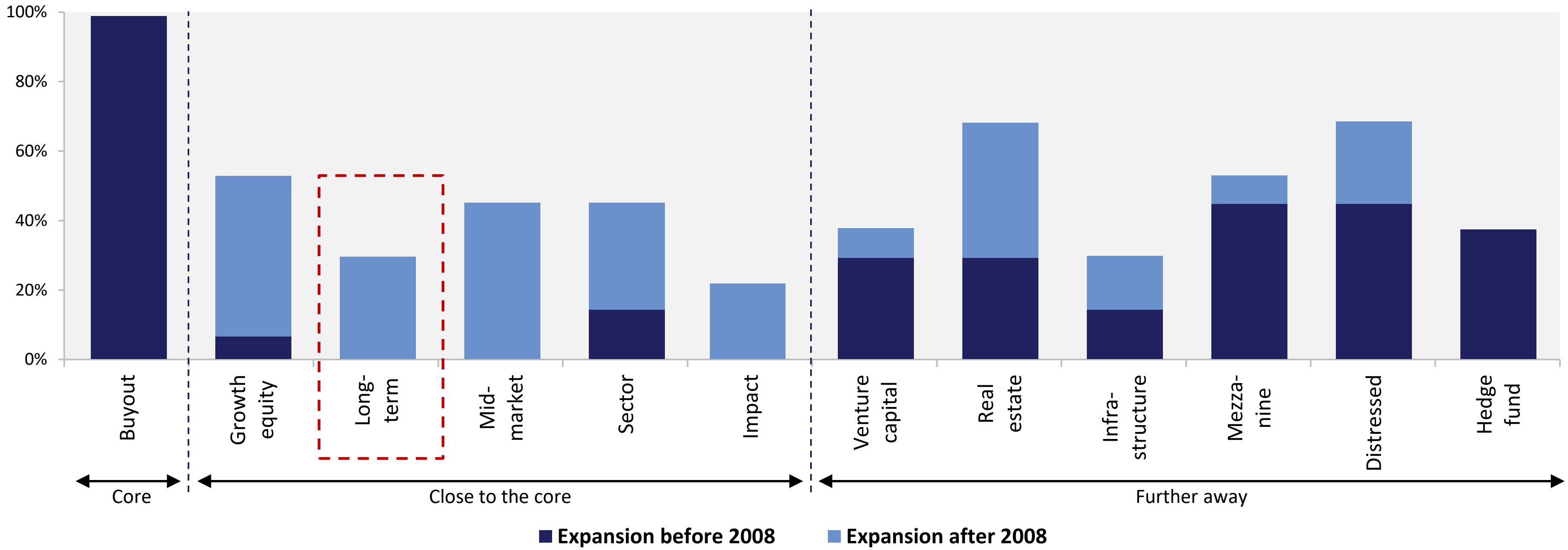
PE Expansion – Moving Beyond the Core

Distribution of PE firm expansion, by strategy and timing (based on a representative sample of 13 multi-asset PE firms in US and Europe)



- LPs are constantly looking for new ways to invest with the firms they favor, while GPs are expanding their menu of offerings
- The number of funds per firm has increased steadily since the beginning of the current cycle, as GPs take careful steps beyond their core. The average number of funds per firm stood at 3.9 in 2018, compared to 2.9 in 2008
- Significant expansion in activities have been seen in these three areas –
  - Sector-focused pools of capital
  - Growth equity funds
  - Long-duration funds
- The proliferation of products and financing structures make evident that private markets' is maturing

Against the backdrop of heady growth, private markets have started to show more signs of a maturing industry

Source: Bain & Co.,

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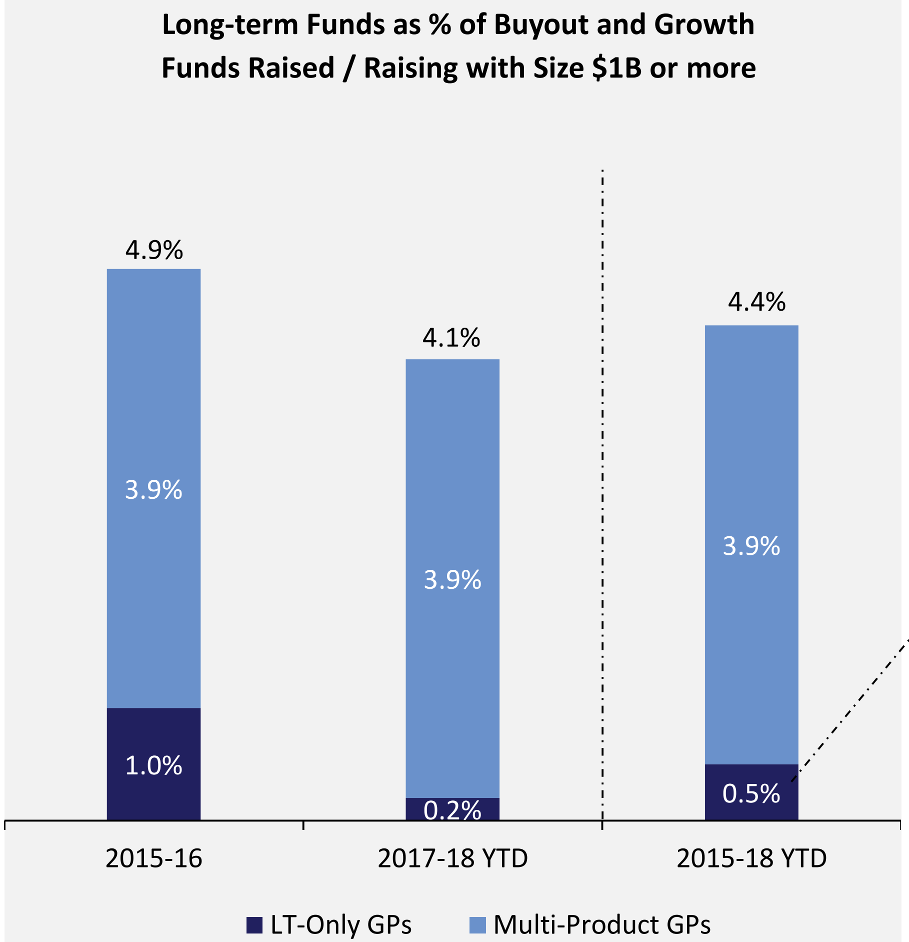
Long-term Funds' Capital Raising (2015-1Q'2018)



Source(s): Preqin (May 2018); Private Equity International; GP's Websites; Private Equity Wire

Long-Dated Funds (Vintage, Final/Target Fund Size in USD)

Multi-Product GPs

$32.7B

- CVC Strategic Opportunities (2015, $4.4B)
- Carlyle Global Partners (2016, $3.6B)
- Blackstone Core Equity Partners (2016, $5B)
- KKR Core Investment Strategy (2018, $8.5B)
- BlackRock LT Private Capital Fund (2018, $10B)
- 21 Aberdeen Standard Investments (2018, $1.2B)

Long Term-Only GPs

$4.4B

- Castik EPIC I (2015, €1B)
- Altas Partners Holdings I (2016, $1B)
- Core Equity Holdings I (2017, €1B)
- Cove Hill Partners Fund I (2017, $1B)
- Altas Partners Holdings II (2019, $3B)

Source: S&P Global

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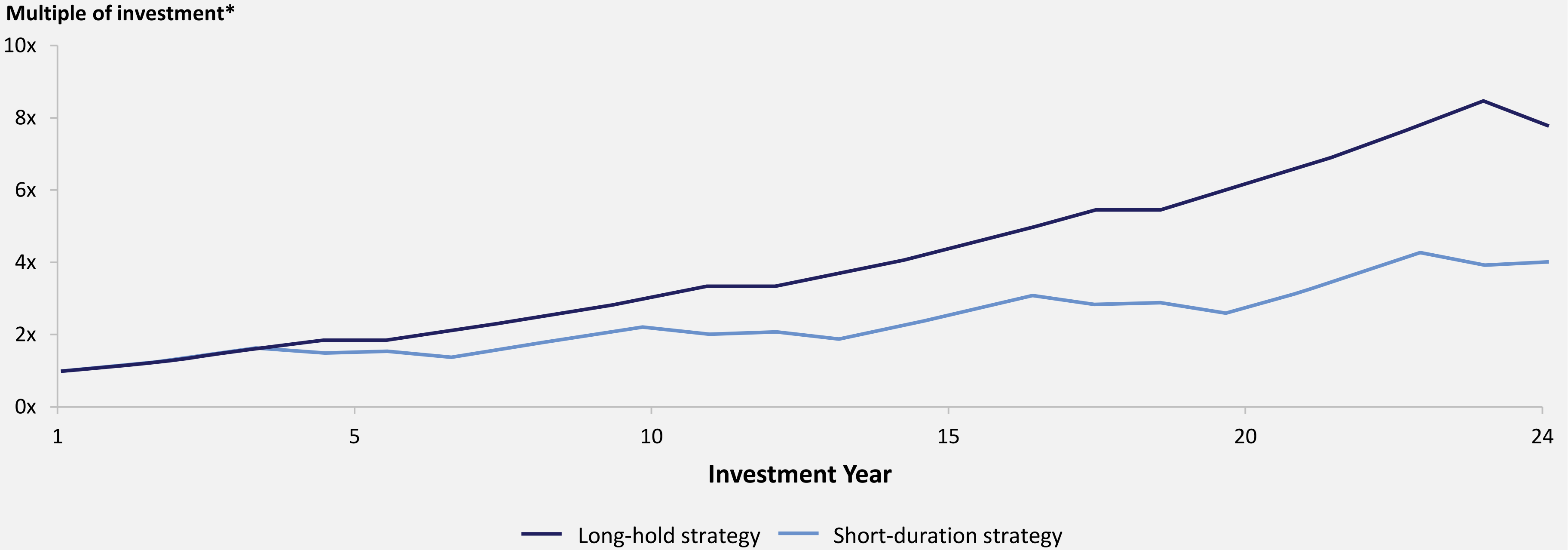
Long-hold vs Short-duration

Long-term funds can generate significantly higher returns when compared to a short-duration strategy



Source: Bain & Co. Analysis

- According to a study by Bain & Co., the long-hold strategy outperformed the short-duration strategy by almost two times on an after-tax basis
- The model assumes that a long-term fund exited after 24 years, while the typical buyout fund sold four successive companies over the period
  - Assuming the portfolio company performs in an equivalent manner during this period, the outperformance is due to the elimination of transaction fees, deferring capital gains taxation, and keeping capital fully invested

Businesses targeted by long-term funds tend to be healthy, mature companies with stable cash flows. Along with stronger downside protection, returns stem predominantly from the compounding of capital over time

Source: Bain & Co., Callan LLC

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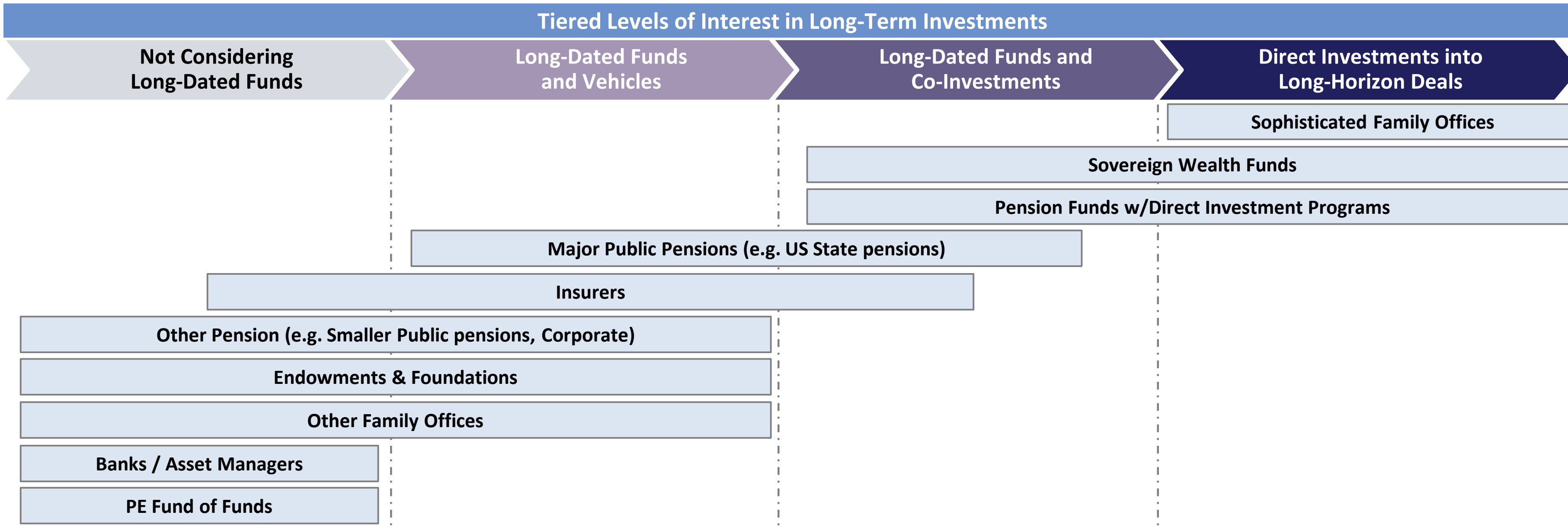
LP Perspectives



- Long-term funds offer many LPs a product to better match the duration of their liabilities
- Avoiding quick flips of businesses, investors in private equity, which are often invested in multiple funds, can avoid being charged relatedly: when assets are bought by one fund and sold to a peer
- **Advantages**
  - Lower transaction costs, such as taxes and consultant fees, associated with buying and selling businesses
  - Fewer distractions for portfolio company management
  - Fully invested capital over longer periods and with less time waiting to be reinvested
  - Deferred taxation of capital gains, allowing capital to compound over time
  - More flexibility on the investment horizon, allowing funds to sell an asset at the optimal time
  - Access to companies looking for patient capital, such as founder-led businesses focused on growth

Long-term funds can give investors access to an opportunity set that may not fit the parameters of those typically found in traditional private equity funds

Source: [INSEAD]

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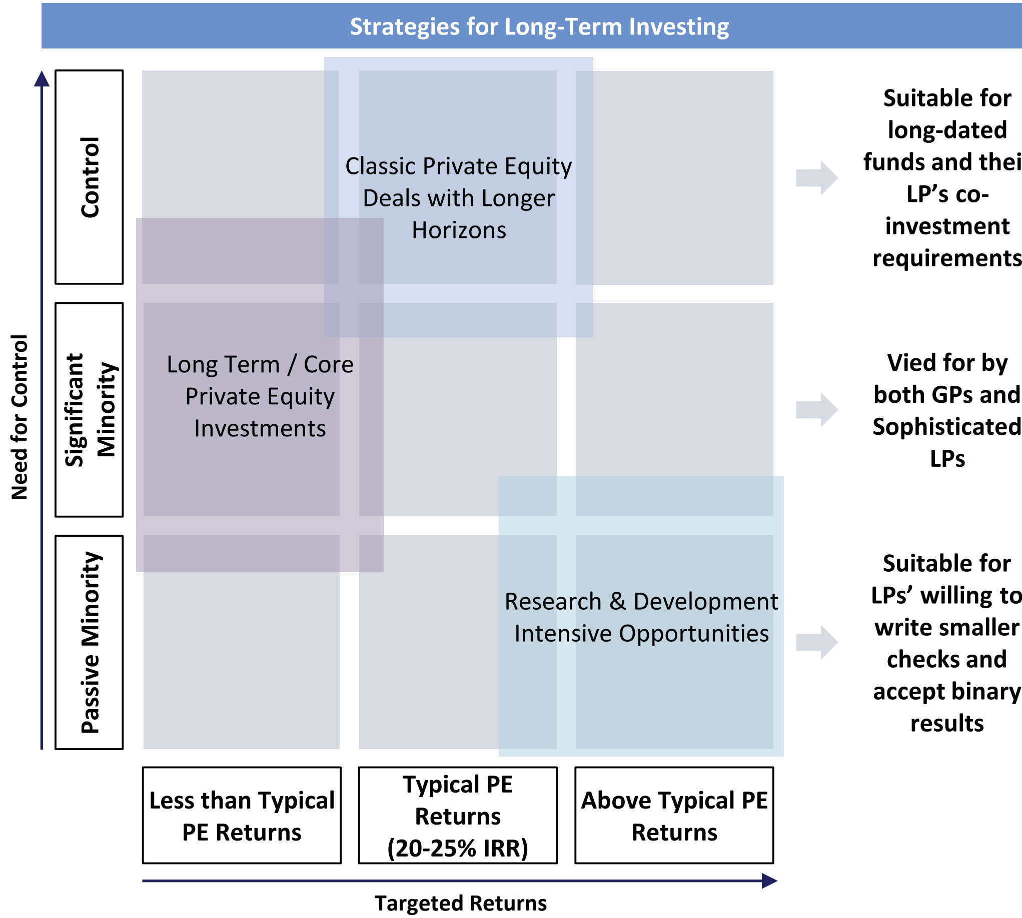
GP Perspectives

- With attractive targets increasingly harder to find, GPs can see the value of holding onto high-quality companies for as long as they keep generating value
- Not all assets reach their full potential within the traditional buyout firm's time frame of three to five years. Many are held by a succession of PE owners over a 15- or 20-year period, generating value all along the way
- Extending a fund's holding period allows PE firms to better align with the longer investment horizon of the likes of sovereign wealth funds and pension funds
- With such a strategy, GPs can access a larger pool of target companies, and allow for flexibility on exit timing with fewer distractions
- A 2019 survey by Mergermarket/Dechert LLP found that over 75% of PE firms surveyed had already established a long-term fund (26%), or were considering it (51%)
- The proportion of firms considering a long-term fund moved up significantly from 32% of respondents in a previous version of the survey
- The top reasons for considering/establishing a long-term fund were mentioned to be – expanding the pool of available investment targets (30%), and aligning interests with LPs (27%)



Long-term funds are increasingly becoming a firm fixture on the GP agenda

Source: INSEAD, Mergermarket/Dechert LLP

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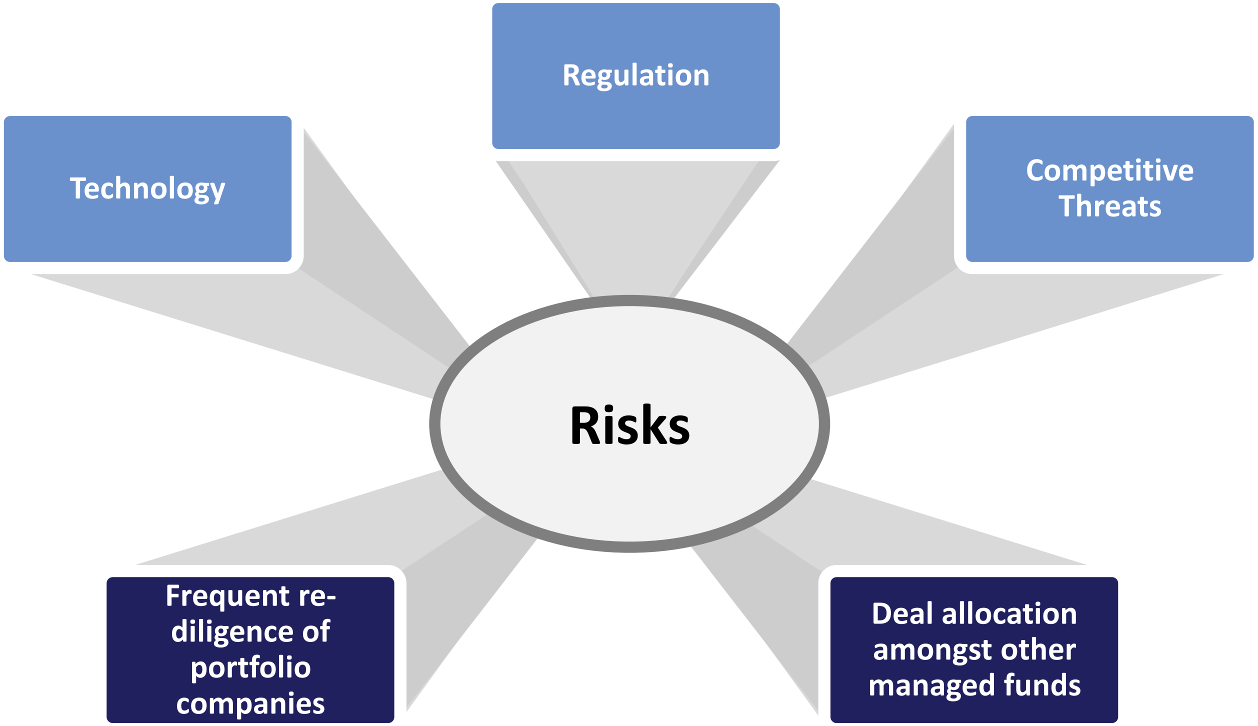
Risks - Some Factors for Consideration



Long-dated funds may not prove suitable for investors that use private equity primarily for return enhancement, and expect a high level of distributions within a 5-10 year investment horizon

Source: Callan LLC