CLOSING DEALS IN A CRISIS

November 2020

Overview

Private equity investment activity showed a small rebound in Q3 as investors continued to operate within the constraints posed by the COVID pandemic. However, it was still materially down versus the same quarter last year, particularly as many large cap private equity managers struggled to execute deals in the current environment. Meanwhile, as in Q2, the small end of the market showed most activity. At the same time, private equity managers are clearly waiting for better conditions to exit portfolio companies given that exit activity this quarter was at its lowest level in years.

Paul Newsome

Head of Investment Solutions, Private Equity

Key Points

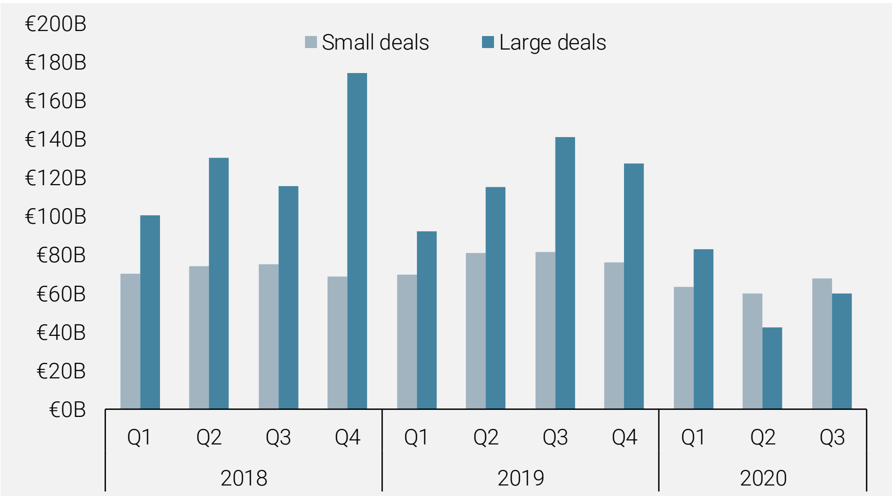
1. Private equity investment activity rebounded in Q3 but remains materially down vs. the prior year, driven by a slump in large cap deals. However, small deal activity remains resilient.
2. As demonstrated by our own investment activity, we believe that the small and mid-market is currently enjoying particularly attractive dealflow.
3. In the last six months, Unigestion contributed EUR 454m to investments.

Small deal activity remains resilient

The global aggregate value of private equity deals closed during Q3 2020 was EUR 128bn, a 24% increase on Q2 but still 43% down on the same quarter last year[1]. North America and Europe showed similar increases (15% and 20%, respectively) but, for both regions, this was around 50% down on Q3 2019. Meanwhile, APAC showed a very healthy 54% increase in activity versus Q2, representing an 11% increase on the same quarter a year ago.

Investment activity in small and mid-market companies (defined as deals less than EUR 500m in enterprise value) continues to show more resilience than large cap deals (deals greater than EUR 500m). Although the aggregate value of large cap deals completed in Q3 was 43% up on Q2, it was still 58% down on Q3 2019. Meanwhile, small and mid-cap deal activity was only 17% down on Q3 2019.

Figure 1: Small vs. large deal activity



[1] Pitchbook, October 2020.

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Given the amount of dry powder available for large cap deals, it is almost a certainty that activity at the large end of the market will eventually catch up. Indeed, although fundraising overall is trending lower versus last year, the average fund size closed is noticeably up. For example, in Europe, the average size of funds closed in Q3 was a record USD 1.7bn[2]. However, with more dry powder chasing fewer deals, it is likely that prices for large cap deals will remain high for the foreseeable future.

Meanwhile, at the small end of the market, we think that the current dynamics remain favourable for investors given that less capital is being raised and more deals are being done. Indeed, given the amount of dealflow, small and mid-market managers are able to keep the bar high and target companies which have performed well in the current environment. In fact, we are benefiting from this dynamic in our direct fund, Unigestion Direct II. Since the pandemic began, we have been able to close five deals. Three of these deals were closed in Q3 – Infobip, Evaluate and Avania – which are discussed later in this document. The common thread across these deals is that they are resilient small and mid-market companies playing long-term investment themes which have only been accelerated by the current crisis.

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How can we close deals in this environment given the various constraints in place? In several cases (e.g. Avania and Evaluate), we already know the companies well as they are existing portfolio companies of our investment partners so we have been able to observe their development closely. In addition, our investment partners are based in the same countries as the companies, so they are able to do on-site due diligence where relevant. Finally, we are still able to do our usual in-depth due diligence virtually through video conferences, expert interviews and thorough desktop modelling and analysis.

Global exit activity continued to post declines. The global aggregate value of exits in Q3 2020 was EUR 48bn, 72% down on the same quarter last year. As exit processes can typically take several months, it is likely that the pandemic and the initial wide-scale lockdowns are still having a delayed effect on activity. Now that GPs are seeing that portfolio valuations have largely been holding up, we may now see exit activity begin to pick up again.

One exit option that has lately attracted a lot of attention has been the use of special purpose acquisition companies (SPACs). A SPAC is a "blank cheque" shell corporation designed to take companies public without going through the traditional IPO process. The pandemic has caused this exit method to become much more popular given the increased uncertainty of performing an IPO in this environment. In the first nine months of 2020, US SPACs raised USD 42bn — 44% of all public offerings in the US[3]. A merger between a company and a SPAC can take about four to six months to complete, compared to an IPO which can take 12 to 18 months or longer. Furthermore, the valuation of a merger with a SPAC is pre-negotiated whereas the pricing of an IPO is set on the day before the listing.

In September, we benefited from this exit method when our portfolio company, Chargepoint (a global leader in electric charging vehicle stations), agreed to be acquired by a listed SPAC. The transaction values the company at USD 2.4bn and our holding will be locked up until Q2 2021 (although we can exit through a secondary sale in the meantime). At the current share price, our investment in Chargepoint will deliver over a 5x cost to our investors. Chargepoint has particularly benefited from the transition from petrol/diesel to electric vehicles. This trend has been steady even during the current pandemic. For example, in

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[2] Preqin, October 2020

[3] Financial Times

the UK, while overall new car registrations in September 2020 declined by 4% versus the prior year, electric car registrations increased by 184%.

The calm in the storm

In early April, we reported to clients our first assessment of the expected impact of the COVID-19 crisis on our funds and mandates by assessing the situation of the portfolio companies representing over 80% of the NAV of each programme. For each company, we considered both the impact on value and the financial headroom. Based on this deep analysis, we prepared our clients for a potential down valuation of our investment programmes in the following quarters in the range of 10% to 25%. It turned out that we were on the conservative side as valuations have fallen in some cases by up to 13% but in most cases have stayed flat or even positive.

Throughout the crisis, we have continued to monitor our programmes closely and have been on top of the developments in portfolio companies by maintaining regular contact with investment partners. In September, we conducted the COVID-19 impact analysis once again and presented the outcome to clients. Overall, we saw an improvement in our portfolios with the percentage of companies in the “high” and “medium” impact categories reducing by 15%. Furthermore, the percentage of companies which were considered to have “tight financial headrooms” reduced from 10% to 7%. However, in the majority of these cases, there are robust plans in place to support the companies through the crisis, even if the current second wave worsens.

This is a strong validation of our theme-driven investment strategy and the resilience of the business models in which we invest. Bike24, the leading e-commerce bicycle retailer in Germany, experienced a tremendous increase in demand during the crisis, driven by cycling being more popular during lockdown as well as a convenient way to avoid public transportation. As a result, Bike24’s valuation increased from 1.0x in Q4 2019 to 1.7x in Q2 2020.

Another success story is Jane Iredale, a US premium make-up and skincare producer, which distributes its products mostly through professional channel accounts, such as salons/spas as well as dermatological and other medical facilities. Those channels faced a massive loss of sales when the facilities had to close down. Thanks to a pro-active management team, the online channel janeiredale.com was further expanded and the company restructured, keeping the company on budget for the year. The company was marked up to 1.1x in Q2 2020 from 1.0x.

We believe that these examples highlight the attraction of small- and mid-market companies. Such companies are resilient in their own right thanks to strong market positions, management and financials, and are able to implement their growth plans irrespective of market conditions.

Unigestion Private Equity Activity

During the crisis, the private equity team of Unigestion has closed on some exceptional investment opportunities. From April 2020 to September 2020, Unigestion contributed EUR 454m to investments. We have closed commitments to three new primary funds, covering North America, Benelux and Scandinavia. In addition, we completed four new direct deals and four secondary transactions. In the same time period, Unigestion received distributions of investments of EUR 86m.

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Figure 2: Investment Activity from April to September 2020

Investment Type	Contributions	Distributions
Primaries	EUR 262 million	EUR 75 million
Secondaries	EUR 144 million	EUR 12 million
Directs	EUR 48 million	-

Source: Unigestion, October 2020.

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In July, we closed a direct secondary transaction in two high-growth break-out portfolio companies. The first company is Blue Ocean Robotics, a developer of mobile professional service robots. For example, these robots are used as cleaning robots to reduce the risk of virus transmission at London Heathrow Airport by using ultraviolet rays to kill viruses and bacteria. The other company is Bellabeat, a holistic women's healthtech developer, which sells fashionable smart jewellery and associated apps. The company has around 1.6 million subscribers.

In August, we invested in Infobip (www.infobip.com), a communications platform service provider to major enterprises to help manage and execute customer communications across multiple channels (SMS, email, WhatsApp, etc.). For example, the company enables banks and financial institutions to automatically send one-time passcodes by SMS to customers when logging into their online accounts.

The company, headquartered in the UK but with a global customer base, is the leader in its segment and is seeing revenue growth at over 30% per year.

In September, we committed to Vance Street III, a US, lower mid-market buyout fund. Vance Street Capital is based in Los Angeles and invests in mid-sized companies in North America that provide high-tech, mission-critical products and services to blue-chip clients in the healthcare and industrial sectors. The firm typically makes investments of USD 25 to 50 million in family businesses or spin-offs that require professional management, operational improvements and strategic leadership.

In September, we invested in Avania (www.avaniaclinical.com), a full-service Clinical Research Organisation ("CRO") which supports medical device companies in such areas as preclinical and clinical trials, regulatory approval and commercialisation. This company is the only pure-play medical device CRO with a global offering. The medical device CRO market is growing at over 11% p.a. but is highly fragmented, thus offering the opportunity for the company to grow further through strategic add-on acquisitions.

In the same month, we invested in Evaluate (www.evaluate.com), a provider of commercial market intelligence for the pharma industry. Evaluate has developed a platform to streamline access to accurate, transparent commercial intelligence, supported by personalised, expert guidance and customised offerings. Over the past 20 years, it has become the go-to provider for market forecasting for new drugs. Indeed, its client base includes every single Top 25 pharma company and its revenues are 100% subscription-based with a net client retention rate of over 100%.

We also closed a secondary single asset restructuring in Ivanti (www.ivanti.com), a global mid-market leader in IT enterprise software. The company provides mission critical software that enables employee access to company applications and data, and to devices such as smart phones, tablets, desktops and laptops. Ivanti is the largest consolidator of mid and lower mid-market enterprise IT software companies, with a management team well versed in acquisition and integration. For that reason, the transaction includes an undrawn component to be used for acquisitions.

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