THE PE MARKET BOUNCES BACK

May 2021

Overview

In many ways, the private equity market displayed remarkable resilience in 2020. After a temporary blip in Q2 2020 following the onset of the pandemic, the market burst back into life. Q1 2021 was similarly robust driven, in part, by positive investor sentiment. Private equity investment activity in Q1 was more or less on a par with the same quarter in 2020. However, while North American activity was stable, Europe recorded a sharp drop offset by a big increase in APAC. Similarly, Q1 exit activity was much healthier in North America than in Europe. Meanwhile, despite acquisition prices falling back marginally in 2020, investors remain concerned about the current high-priced environment. Average prices are at 12.1x EBITDA for large cap deals and 8.8x EBITDA for small and mid-market deals, a decline of around 1x EBITDA respectively versus a year ago . As private equity investors pile into the sectors which have shown greatest resilience during the last 12 months, it seems unlikely that prices will fall further in the near term.

Paul Newsome

Head of Investment Solutions, Private Equity

North America revives, Europe lags

The global aggregate value of private equity deals closed during Q1 2021 was EUR 173bn, 3% down on the same quarter last year[1]. While activity in North America (+4%) and APAC (+34%) showed strength, Europe (-32%) suffered its weakest first quarter in five years.

Meanwhile, thanks to healthy exit activity in North America in Q1 (+30%), the global aggregate value of exits was EUR 100bn, an increase of 14% on the same quarter last year. Activity in Europe (-9%) and APAC (-24%) was more lacklustre.

As confirmation that investors remain enthusiastic about the asset class despite dwindling distributions in some areas, USD 203bn was raised in Q1 2021 by private equity managers, the strongest first quarter since the GFC[2]. North American-headquartered managers accounted for almost 70% of this total, considerably higher than the region's average share of around 50% over the last five years.

Overall, it is clear that the North American private equity market has quickly regained full speed while Europe and APAC are still going up the gears. Nonetheless, despite or maybe because of these differences, a variety of interesting investment opportunities are coming from each region.

For example, given the comparative dearth of liquidity in Europe, fund managers may be more focused on maximising distributions for their investors through full fund or multi-asset restructurings or creating alternative funding solutions such as sidecar funds where existing investors are maxed out. In the US, with fewer concerns over liquidity, fund managers prefer the rifle shot approach of targeting single asset

Key Points

1. While global investment activity has rebounded strongly, significant regional disparity is creating a range of different opportunities.
2. Demand for GP-led deals is driving record secondary inflows. Several of our GP-led deals closed since Q2 2020 are already showing strong performance.
3. In September 2020, we closed the first deal of our latest secondary programme, a single asset restructuring of a US enterprise software company that has delivered a 2.5x valuation uplift as at Q1 2021.

[1] Pitchbook, April 2021.

[2] Preqin, April 2021

Read more of our latest investment thinking online: www.unigestion.com/insights continuation funds which allows them to maximise the value of their best performing portfolio companies.

In February 2021, we closed a single asset restucturing of a US company with a diversified portfolio of leading over-the-counter pharmacy brands. It benefits from having an asset light model with high organic growth across its brands, strong cash generation and broad distribution channels.

Meanwhile in Europe, we recently backed M80, a Benelux small and mid-market manager, who required additional capital to support their existing portfolio of companies across the Consumer, Healthcare and Business Services sectors, as well as selective new deals, through the creation of a sidecar fund.

On the direct side, a number of our European investments noteably have a key buy-and-build component as part of the investment thesis. In February 2021, we closed an investment in Academia Analytics, a German group of specialty laboratories focused on pathology, hematolgy and human genetics. While the sector has key tailwinds, the market is ripe for consolidation and acquisitions of single laboratories can be made at attractive valuations.

In the US, while add-on acquisitions also feature in the value creation plan, strong organic growth is typically the key focus for target investments. In January 2021, we invested in Excel Scientific, a leading manufacturer of microplate sealing films and foils in North America. The company enjoyed spectacular growth in 2020 fueled by COVID-related demand and expects to continue growing at a high rate given its broader blue chip customer base and the long-term lasting impacts on pathogen testing demand.

We have also seen a number of interesting opportunities coming out of APAC. In February, for our emerging managers programme, we committed to the first fund of a Singapore-based manager, Tower Capital. With Temasek as a key backer, the manager focuses on mid-market companies where there are succession issues, opportunites to privatise and/or the ability to make add-on acquisitions in fragmented sectors. Its first transaction for the fund is the acquisition of two education companies creating a leading English-based tuition provider serving over 24,000 students across 124 centres in Singapore.

In January, we closed a secondary transaction with Avataar, a successful Indian GP, to invest in a sidecar vehicle consisting of five mature, high growth B2B SaaS companies each closing in on USD 100m in recurring revenues. In addition, four of the companies have significant global footprints with blue-chip customers while the fifth company, a logistics platform, works with global FMCG brands.

Overall, as North America, Europe and APAC come out of the pandemic at different rates, we are seeing a rich flow of highly attractive investment opportunities.

"The company enjoyed spectacular growth in 2020 fueled by COVID-related demand and expects to continue growing at a high rate."

Second wind

In 2020, USD 81bn in aggregate was raised by secondary managers, more than three times the amount raised in 2019[3]. However, this was heavily driven by the larger managers. Indeed, five managers accounted for over 75% of the total.

At the current market investment pace, it is likely that 2021 will break the record for the highest amount invested into secondaries. Thus, despite the high amount raised last year, there is little concern that a capital overhang will develop in the secondary market.

[3] Preqin, April 2021

GP-led deals have been the main driver of growth in the secondary market, accounting for over 50% of secondary volume in H2 2020[4]. Why have they become such a key component of the secondary market? Firstly, they allow GPs to give liquidity to investors in a subdued exit market. Secondly, GPs can keep hold of their best performing portfolio companies rather than exit at a sub-optimal time, especially when they believe that there is more value to be created.

Finally, for secondary investors, GP-led deals present an opportunity to invest in a portfolio of one or more mature companies at a point where further growth can be achieved either organically or through strategic add-on acquisitions. Furthermore, secondary investors are well aligned with the GP through the carried interest and, typically, additional GP commitment.

Contrast this to a traditional secondary acquisition of an LP stake. The success of these depend on the ability of a secondary investor to enter into a portfolio when there is still upside remaining and/or the pricing is sufficiently attractive. The GP, who is incentivised to maximise returns for the original fund investors, is largely indifferent as to whether the secondary investor does a good deal or not.

In the last 12 months, the vast majority of secondary deals closed by Unigestion have been GP-led deals. What criteria do we use to assess such deals? Firstly, we seek to back only the best performing portfolio companies, and not those which for example have suffered during the pandemic and need some heavy lifting to get back on track. Secondly, we hand-pick only those companies which have the strongest fundamentals and whose growth are supported by our investment themes.

Thirdly, we need to understand the motivation of the LP base. Typically, in small and mid-market funds, LPs are more motivated by liquidity than price in this environment, especially in cases when most of the value of the fund has already been distributed.

Fourthly, our alignment with the GP is vital. We make sure that the GP puts a meaningful commitment into the deal. Importantly, the performance of the deal should be critical to the reputation and success of the GP, which is typically the case for small and mid-market GPs.

Last, but not least, the price should be attractive. We favour GPs who are conservative with their portfolio valuations. We also seek situations which are more complex and thus attract less competition.

Several of the deals which we have closed since Q2 last year are already showing strong performance. In September 2020, we closed the first deal of our latest secondary programme. This investment is a single asset restructuring of a US enterprise software company which provides employees with secure access to enterprise networks. Since our investment, the company has continued to grow at double-digit rates and has made a sizeable add-on acquisition. Based on this performance, the investment is valued at 2.5x as at 31 March 2021.

Only a small minority of GPs have so far tapped into the secondary market to create liquidity for their LPs or to support their existing portfolio. Therefore, we believe that the continued popularity of GP-led deals will support the growth of the secondary market for some time to come.

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[4] Greenhill, January 2021

Unigestion Private Equity Activity

Below are the highlights of some of the investments and exits that we completed in Q1.

In January, we committed to Capiton VI, a mid-market buyout and growth investment fund with a focus on the DACH region (Germany, Austria and Switzerland).

Capiton is one of the most experienced fund managers in the German mid-market with a history of over 20 years. The firm follows a structured approach to sourcing proprietary businesses at attractive prices via a network of advisors and proactive sourcing in four key sectors: pharma, med tech, industrial automation and sustainable consumption. Capiton pursues systematic value enhancement initiatives through organic growth and its proven buy & build concept.

UNIGESTION EURO CHOICE SECONDARY I

In February, Alpina Partners sold Modula (www.modul-a.com) to US trade buyer Aptean, a global provider of mission-critical enterprise software solutions headquartered in Alpharetta (USA). Modula is an ERP platform for SMEs in the manufacturing sector where Alpina successfully executed a buy & build strategy. The transaction resulted in a multiple of 5.3x and 45% IRR to Euro Choice Secondary I. The exit generated proceeds of EUR 1.7m to the fund.

UNIGESTION EURO CHOICE SECONDARY II

In the same month, Ergon Capital exited SVT (www.svt.de), a GP-led direct secondary in Euro Choice Secondary II, resulting in a multiple of 2.1x and 30% IRR to the fund. SVT is a European market leader in passive fire protection systems and has benefited from increased regulation, strong market growth and a successfully executed buy & build strategy. The exit generated proceeds of EUR 11.3m to the fund.

In addition, Pollen Street Capital agreed the sale of Specialist Risk Group (www.specialistrisk.com), a London-based commercial insurance broker that provides its UK and international clients with specialist insurance services. The company experienced strong growth under Pollen Street's ownership with the execution of ten bolt-on acquisitions, adding material scale and synergy. The transaction resulted in a multiple of 5.1x and 74% IRR to Euro Choice Secondary II. The exit generated proceeds of EUR 5.5m to the fund.

In March, Zennor Petroleum (www.zennorpetroleum.com), the first investment in Unigestion Direct Opportunities 2015 was acquired by NEO Energy Upstream UK. Zennor Petroleum is an independent UK-based oil and gas company engaged in the exploration, appraisal, development and production of hydrocarbons. During our ownership, the company has matured from an early-stage exploration company into a full-cycle E&P player in the UK North Sea. The transaction completion is subject to customary regulatory approvals and is expected to result in a multiple of 2.0x to Unigestion Direct Opportunities 2015, including certain deferred and contingent payments.

In March, we also committed to GCP V, a fund focused on the lower mid-market in the UK.

GCP makes controlled investments in high-value growth companies with proven profitability in knowledge-based services, specialist industrials and technology sectors.

Through a mixture of equity stakes and debt components, GCP aims to provide early returns of capital, reducing the traditional J-curve effect and offering good downside protection.

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