ONWARDS AND UPWARDS

August 2021

Overview

In the first half of 2021, private equity investment activity was at its highest level over a six month period since records began four decades ago. To some extent, this was driven by a large pipeline of deals which were delayed in 2020 due to the pandemic. However, it also reflects continued positive investor sentiment as recent private equity performance has shown remarkable resilience. Similar to 2020, the small end of the market has been the driving force of this investment surge. On the other side of the coin, exit activity is almost back to pre-COVID levels. However, distributions overall are continuing to lag capital calls. This mismatch is a key driver behind the continued growth in the secondary market, as some investors require alternative exit routes as a way to bridge the liquidity gap.

Small deal activity leads the charge

The global aggregate value of private equity deals closed during H1 2021 was EUR 452bn, 51% up on the first half of last year[1]. Activity was strong in all regions with North America (+58%) posting the highest increase, given that the fall in this region had been most dramatic in the first half of 2020.

Notably, investment activity in small and mid-market companies (defined as deals with an enterprise value of less than EUR 500m) accounted for most of the growth. The aggregate value of small and mid-market deals increased by 78% in the first half, compared to 25% for large deals. This was a phenomenon universal to all regions.

Since the onset of the pandemic, small and mid-market private equity firms have been quick off the mark and have taken advantage of opportunities in niche sectors which have shown greatest resilience. In 2021, at the large end of the market, there have already been some eye-catching headlines such as the acquisition of medical supply giant Medline for USD 34bn by Blackstone, Carlyle and Hellman & Friedman (the largest buyout since the GFC). However, while large firms have been busy working on deals since mid-last year, they are yet to close a significant number. This is because large deals typically take longer to carry out the due diligence, negotiate and structure than small deals, especially during a time when travel is restricted. Nevertheless, we would expect large deal activity to pick up in the latter part of this year.

Paul Newsome

Head of Investment Solutions, Private Equity

Key Points

1. Small and mid-market deals were the main drivers of record investment activity in H1, but we expect large deal activity to pick up in H2.
2. The secondary market is on track for a record year as investors look to meet their liquidity needs either by selling LP stakes or, more commonly in the last year, exiting through GP-led transactions.
3. In H1, we committed EUR 338m to investments, including EUR 111m invested in 9 secondary transactions and EUR 151m invested in 6 direct co-investments.

[1] Pitchbook, July 2021.

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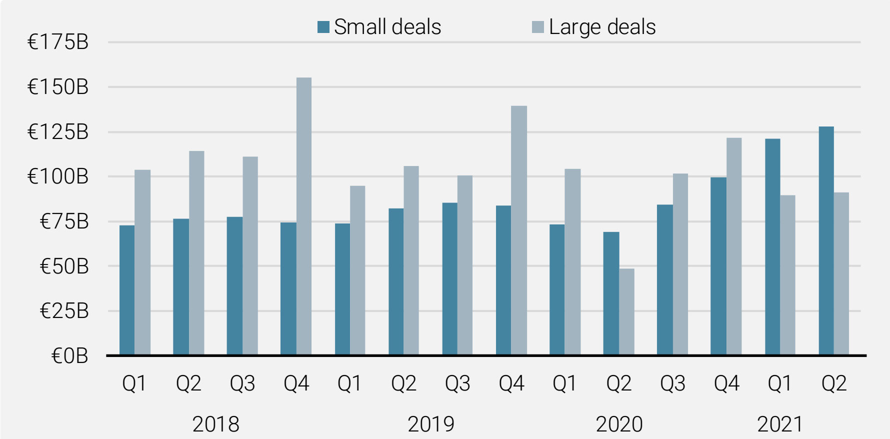
Figure 1: Investment Activity by Deal Size (EUR bn)



Source: Pitchbook. Data as at July.2021

In the last 12 months, Unigestion Direct II has made 11 investments. Given the high number of deals we are seeing, we have been able to invest in high quality small and mid-market companies playing our key investment themes at attractive valuations. We have become adept at conducting rigorous due diligence on these companies through virtual management meetings, expert interviews and thorough desktop modelling and analysis.

In June 2021, we closed an investment in Stronger, a Danish womenswear brand in the niche Athleisure market. Driven by our Personal Well-being theme, the sector is growing at over 15% per year. With our investment partner, Polaris, the value creation plan is to continue its international expansion, upgrade the company's supply chain and implement best-in-class ESG practices (such as the use of recycled materials and carbon emission reduction).

After a slump in 2020, exit activity is now back to pre-COVID levels. The global aggregate value of exits in H1 2021 was EUR 323bn, 74% up on the first half of last year and exactly in line with H1 2019[2]. North America (+93%) saw the biggest increase but activity was also robust in Europe (+48%) and APAC (+40%).

The IPO market was particularly red hot in the first half of the year. Across markets globally, H1 2021 saw the highest ever public market issuance volume, which includes IPOs and follow-on offerings, at USD 916bn[3]. In fact, June 2021 was the busiest single month for US IPOs since August 2000. The boost in volumes can be attributed to a number of factors, principally a high quality pipeline backlog (due to COVID) and positive IPO aftermarket performance. Across the private equity market, there have been a total of 456 IPOs, the highest number in more than a decade. However, this still only accounted for 18% of all exits by number, given that most PE exits are via trade or secondary sales.

Despite the resumption of exit activity, overall distributions back to investors are unlikely to match the elevated capital drawdowns they will be making given the heightened investment activity. Consequently, we estimate that investors in aggregate for 2021 will see negative cash flows from their private equity programmes for the third year running.

"Given the high number of deals we are seeing, we have been able to invest in high quality, small and mid-market companies playing our key investment themes at attractive valuations."

[2] Pitchbook, July 2021

[3] Goldman Sachs, July 2021.

This explains why the secondary market continues to be extremely active and is on track for its biggest ever year. Desiring liquidity from more mature investments, many investors are either selling LP stakes or, more commonly in the last year, exiting through GP-led transactions.

In our latest secondary strategy, Unigestion Secondary V, we have been benefiting from this trend. In the last nine months, we have closed 11 GP-led transactions across the US, Europe and APAC. As a reminder, our secondaries strategy is to focus on small transactions of concentrated portfolios, often just 1 to 6 companies, with attractive valuations and where we have excellent visibility on the portfolio through a strong relationship with the GP.

Through tailored GP-led transactions, we can target high quality companies aligned with our investment themes and where there is substantial value creation potential through either organic growth or add-on acquisitions. This is demonstrated by our latest investment in Unigestion Secondary V, a single asset restructuring of ABC Design, led by Invision, a small and mid-market GP focused on the DACH region whom we have known for over 11 years. ABC Design is the leading brand for baby products such as strollers and car seats in the DACH region. The company showed impressive growth in 2020 (+26%) but still has further growth potential. For example, although ABC Design is present in more than 40 countries, over 80% of its revenues are generated in its home market, Germany.

Emerging alpha

In 2020, the pandemic made it very difficult for new private equity managers raising their first or second fund to catch the attention of investors. As widely reported, most investors focused on re-ups with their established GP relationships.

We are now seeing a pent-up supply of these emerging managers coming to the market with their new funds. Emerging managers have attracted the interest of investors for many years, becoming a dedicated investment strategy for many. The space has also been gaining momentum thanks to an increase in PE professionals desiring to set up new firms, a strong macro tailwind, and the preference of many investors to diversify their exposures away from the larger funds currently forming the core of their private equity exposure.

In the past, these emerging managers were typically formed by former investment bankers or the like. Today, it is more often spin-out teams of larger and well-established players, or family offices with proven track records and significant experience. These teams have a strong entrepreneurial drive and desire for greater control of the investment strategy, but also see an opportunity to focus on more specialist strategies and exploit new market niches.

We see a number of attractions in backing emerging managers:

1. Access to specialist strategies: Emerging managers typically launch funds with specialist strategies consistent with their track record. They may be sector specialists with specific themes (e.g. Healthtech, Foodtech, Enterprise Software, etc.) or strategy specialists (e.g. Buy & Build, Growth, Complex Buyouts, etc.). This focus on specialist strategies with highly experienced teams can drive outstanding returns with downside protection.

2. Ability to minimise the Total Expense Ratio (TER): Committing to first time funds, in particular for investors with the ability to cornerstone funds and support GPs with best practice coaching, allows for various special terms to be negotiated. These may include staggered carry schemes, short duration funds, cornerstone/first closer discounts, or fee-free co-investment rights. On a total cost basis, the final fee load can be significantly reduced relative to standard market terms.

"In the last nine months, we have closed 11 GP-led transactions across the US, Europe and APAC."

3. Priority access to co-investments: Emerging managers typically offer more co-investments than larger, established managers. Often, these can be negotiated up front, for example, by combining a commitment in a GP's fund to a co-investment in the first one or more portfolio companies. There may also be an agreement on a target ratio of fund commitments to co-investments or simply a right of first refusal for any co-investment opportunities that may arise. As well as reducing the TER, a high ratio of co-investments can reduce the blind pool risk by allowing investors to diligence a deal, and ensure faster deployment of capital.

4. Access to successor funds: Committing to promising emerging managers early on is the best way to ensure future allocations. The combination of strong returns and moderate fund sizes means that access to these rising stars will be severely restricted for LPs wanting to jump onto the bandwagon at a later stage. Some of the best known small and mid-market managers today became difficult to access for new investors by the time they were raising their second or third fund, given their early success.

At Unigestion, we have historically committed over EUR 1.4bn to first or second funds of emerging managers, representing c40% of all our primary commitments since 1996. Not only have such managers become some of our most enduring and rewarding GP relationships but they have historically driven significant dealflow for our direct and secondaries strategies. To date, eight of the 12 investments in Unigestion Direct II and eight of the 11 investments in Unigestion Secondary V came from investment partners who began as emerging manager relationships for us.

"Today, emerging managers are more often spin-out teams of larger and well-established players, or family offices with proven track records and significant experience."

Unigestion Private Equity Activity

In the first half of 2021, the Unigestion private equity team committed EUR 338m to investments. We have closed five new primary funds of EUR 77m. In addition, we completed nine secondary transactions totalling EUR 111m, and closed six direct co-investments of EUR 151m in total.

In April, we committed to Cow Corner I on behalf of Emerging Manager Choice. Cow Corner is a buy & build specialist focusing on highly resilient and high-growth companies, providing typically B2B or B2C mission critical, non-discretionary professional services in the UK.

At the time of closing, the Fund had made four investments. More recently, Cow Corner invested in The Learning People, an online education player providing training for people willing to enter or reskill in order to work in the IT sector, which is hiring the most in the UK.

During the second quarter, Emeram I, a GP-led deal which we completed in 2019 for our secondary programmes, exited two companies. Emeram sold Matrix42 (www.matrix42.com) in April to the private equity firm Corten Capital Investment, resulting in a gross TVPI of 4.5x. Matrix42 is a global provider of innovative solutions for digital workspace management. Used by more than 5,000 customers worldwide, Matrix42 automates mission-critical IT and business support processes, license and cloud expense management, and related enterprise workflows. The exit generated proceeds of EUR 16.4m.

In June, Emeram exited Meona (www.meona.de) to the private equity firm Trill Impact, resulting in a gross TVPI of 2.7x and 31% gross IRR. Meona is a provider of clinical software, which is used by universities and hospitals to digitise their processes. The exit generated proceeds of EUR 4.9m.

In May, Unigestion Direct II closed a co-investment in LMG Holdings (www.lmgholdings.com), the leading provider of ignition interlock devices, which prevent a vehicle from starting if operators have an unacceptable amount of alcohol in their system. Our investment supported the acquisition of Scram Systems (www.scramsystems.com), an add-on for LMG Holdings.

LMG Holdings is a mission driven business providing offenders with a way to keep their jobs and remain integrated into society, and benefits from legislative and political tailwinds seeking to reduce the cost and rates of incarceration in the justice system. As such, the business delivers clear ESG benefits.

In May, Unigestion Direct II also closed a co-investment in Stronger (www.strongerlabel.com). Stronger is a Swedish direct-to-consumer Athleisure company with a broad portfolio of training/fitness/casual wear clothing for women, with tights and leggings being their core and bestselling products.

The company has a clear position in the market with a differentiated brand image centred around female empowerment, healthy lifestyles and leisure - not performance-oriented nor associated with a particular sport.

In the same month, we committed to Pollen Street IV, a fund focused on financial and business services in the UK and Europe. Pollen Street makes controlled investments in financial services businesses across lending, payments, technology, insurance and wealth management.

Downside protection is characterised by long-term customer relationships, a strong recurring revenue base and cash flows, and a technological platform with intellectual property rights.

In June, we completed a single asset restructuring in ABC Design (www.abc-design.de). ABC Design is a leading brand for baby products, such as strollers, car seats and accessories, in the DACH region.

The company is managed by Swiss-based Invision. Thanks to our strong relationship with the fund manager, we obtained exclusive access to the deal. ABC Design sees continuing growth driven by increasing birth numbers and increasing disposable income among parents.

Also in June, Priveq V, one of the Nordic funds in Euro Choice VI (EC VI), exited two companies generating gross proceeds of EUR 8.8m. One company is Omegapoint (www.omegapoint.se), a Swedish IT services firm specialising in secure digital transformation and cyber security with a market leading position in Sweden. The transaction resulted in a gross TVPI of 5.2x and 52% gross IRR. The other company is ILT Education (www.inlasningstjanst.se), a leading supplier of educational tools for schools and preschools, with a focus on digital audio and visual-assisted learning solutions. The transaction resulted in a gross TVPI of 5.6x and 49% gross IRR.

In the same month, Unigestion Direct II closed a co-investment in Nesperta (www.nesperta.com). Nesperta is the Polish market leader in the sector of innovative UV nail polish products, with its main brand Semilac accounting for more than 25% of market share in Poland.

The UV nail care segment is expected to outperform the traditional polish segment, thanks to increased durability and superior colour expression. The company's key competencies are in product positioning, marketing and omni-channel distribution.

Unigestion Direct II also closed a co-lead investment in Deeper (www.deepersonar.com). Deeper is the global leader in the niche market of castable sonars for anglers with ca. 80% market share worldwide. Castable sonars are used by anglers in freshwater fishing to observe fish and monitor the features of the water basin.

Deeper's brand is very well positioned versus competitors and its operating model is focused on product development, marketing and distribution, while manufacturing activities are outsourced to specialised electronics assemblers.

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Document issued August 2021.