UNIGESTION

THE ART OF SUCCESSFUL EXITS IN A CHALLENGING MARKET

January 2024

Overview

We have now seen two successive challenging years in the private equity industry. With geopolitical tensions spreading from Eastern Europe to the Middle East, continued rate rises in developed markets as central bankers fought persistent inflation and poor public market performance in 2022 leading to lower private allocations in 2023, the past 12 months have been tough. Uneven fundraising and a decline in exits have left LPs short of liquidity. The post-Covid frothiness of 2021 seems a very long time ago indeed.

But for all the gloom at a global level, there are reasons for at least some private equity investors to be cheerful. We have been able to provide our LPs with a different narrative to the broader industry picture, delivering a consistently high level of exits with attractive multiples in both 2022 and 2023. Across our direct programmes, in the last two years we have exited eight investments at an average multiple of 3.6x. In the last year alone, we have increased the DPI of our mature direct funds (2015 and 2016 vintages) by 0.44x, around six times higher than the median of peer funds. In aggregate, across directs, secondaries and primaries, we have delivered over USD 2bn back to our investors over 24 months.

This is not by chance. It is the result of a robust, systematic investment process which has a laser-like focus on identifying the potential market leaders of tomorrow and involves our investment teams plotting a clear path to exit from the moment they embark on the due diligence process.

Quick exit? Not so fast….

A rising tide may lift all boats but, as Warren Buffet once said, you can only see who is swimming naked when the tide goes out. As the New Year gets under way, it is clear that 2023 was the worst year for exits in more than a decade, dropping sharply from their peak in 2021. Given that aggregate assets under management (AUM) in the industry has increased three-fold in the last ten years, exit activity as a proportion of AUM is at its lowest since the GFC.

Data from Preqin (see chart 1 below) shows that private equity exits were worth USD 439bn globally in 2023, down from USD 485bn in 2022 and over USD 800bn in 2021. Net cashflow has also been subdued, at 88% in 2023, up from 68% in 2022 but still well below the levels investors would expect. In addition, the number of IPOs saw a further decline in 2023 – down from 1,415 in 2022 to 1,298 in 2023, with proceeds dropping 33% from USD 184.3bn to USD 123.2bn, according to Ernst & Young.

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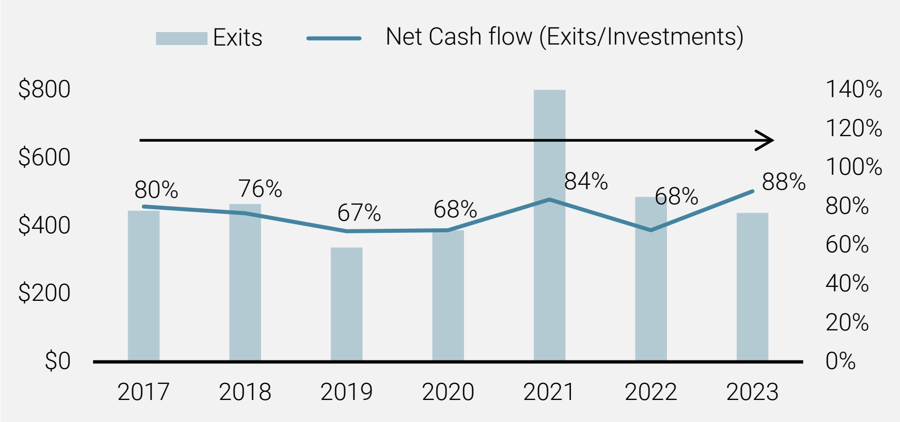
Key Points

1. 2023 was the worst year for exits in more than a decade and the bar will remain high
2. But liquidity is being generated, and at attractive mutliples, for those companies meeting strict criteria and we have been able to continue returning cash back to our investors
3. Active portfolio management using secondaries provides additional opportunities – an area in which we have been active for over 20 years

Chart 1. Private equity exit activity (USD bn)



Source: Preqin as at January 2024. Buyouts only

Exits have become more challenging overall for four key reasons:

1. Persistently high interest rates - financing costs are high for would-be buyers
2. Inflation, although falling, remains at historically high levels – profit margins of many companies are squeezed making them less attractive to buyers
3. Recession risk remains high globally – buyers are particularly steering clear of more cyclical sectors
4. Supply chains are under stress due to geopolitical uncertainties – buyers would rather wait for more stable conditions

This environment has not just affected the ability of private equity owners to sell their holdings at attractive premiums, but also prospective buyers, who have been delaying their acquisition decisions until there is more clarity.

The bar for exits is very high and we believe only companies meeting strict criteria can be sold at attractive multiples.

So what of 2024? Given many managers sat on their hands in 2023 in the hope exit conditions would improve, firms will be under increasing pressure to monetise investments and return more capital to investors this year. Many will see funds come to the end of their terms and PitchBook analysis suggests that if the current pace of exits continues, 2017 vintages, for example, are on course to reach maturity with up to 26% of invested capital still locked into assets instead of being distributed to investors.

Leverage is also an issue that may pressure some firms into sales at less attractive valuations. Some firms finance buyouts with loans that can reach maturity six or seven years after a deal is completed. A big proportion of debt (from deals done six or seven years ago) is likely to mature in 2024 and may need to be refinanced at significantly higher rates, if it is possible to do so at all in these more difficult times. Those that are unable to refinance will be forced to take other measures to address liquidity needs, such as through net asset value financing or GP-led secondaries.

During 2023 an increasing number of managers turned to net asset value (NAV) financing as a means of providing liquidity to their investors. While NAV financing can be a useful tool for GPs in the short term, helping them do deals quickly, they inevitably add to existing leverage in funds and can eat into total equity returns so GPs are typically efficient about clearing them as quickly as possible. In the current market conditions, this may not be so easy and investors should be alert to any build-up of leverage in funds. GPs must be upfront with investors on financing arrangements, not only that they are being used, but why, how much is left to repay and, by when.

So, 2024 is likely to see an uptick in exit activity with some managers being forced sellers. However, given market conditions remain unsettled, and geopolitical uncertainty will increase in the face of numerous elections taking place, including in the US and UK, there is the likelihood that valuations will be challenged and performance will be under pressure as a result.

Those that can, do

While the overall industry picture is one of poor liquidity, the figures mask some clear differences between GPs. It is worth, in particular, separating out the contrasts between large cap GPs and those of us operating in the mid and small cap space.

The dearth of IPOs, for example, is much more of an issue for the larger industry players, who tend to seek IPOs for a large proportion of their exits. IPOs are not a route we typically seek – around 60% of our exits take place with strategic buyers while sales to other private equity firms account for most of the balance.

Interest rates may also be less of a concern in the mid cap arena. Large cap GPs are more likely to use leverage because financial engineering makes up a greater proportion of returns than for smaller deals, where operational enhancements and growth usually drive most of the returns for mid and small cap players.

But it is at the company level that the difference is really made. While the environment is tough, companies can and are being sold - and at attractive multiples. What is required for private equity firms to achieve this holy grail?

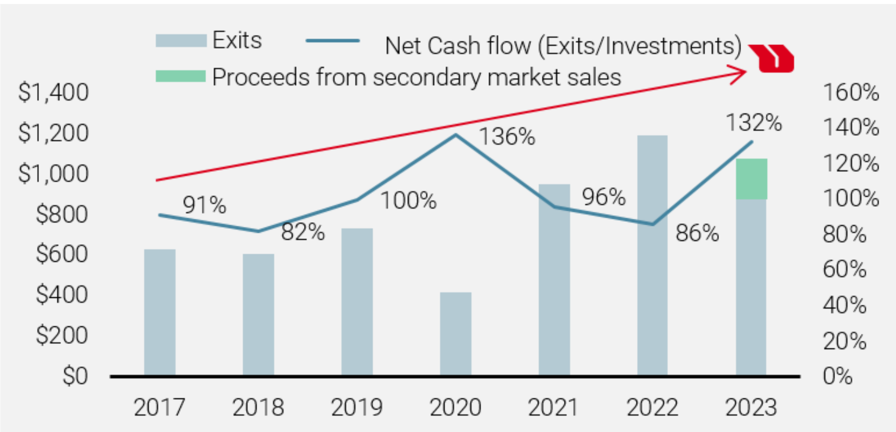
We believe the following criteria are important for target companies:

1. Theme-driven, resilient growth
2. Leading company in its sector, leading to strong market position
3. Mission critical offering - customers cannot do without it
4. High EBITDA margin and cash conversion, giving a buffer in case of difficult times
5. Strong balance sheet with limited leverage

In fact, companies with the above features will stand out even more in a tough environment than in better times and thus attract greater interest from buyers.

These factors, combined with the ability for Unigestion to be an active owner, are a core part of our investment strategy, which we call "targeting the market leaders of tomorrow". Our strict adherence to these principles enabled us to achieve our highest level of exits in 2022 and maintain the pace in 2023 (see chart 2). Furthermore, the DPI for our direct strategy over the past year has increased by an average of +0.44x, compared to an average of +0.07x for GPs overall, according to Preqin.

Chart 2: Unigestion exit activity (USD m)



Source: Preqin as at January 2024

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We apply these principles across all of our strategies: direct investments, secondaries, emerging and established managers, and climate impact investments. The result has been portfolios of attractive characteristics: (i) robust returns driven by sustainable growth, (ii) performance uncorrelated to both the public market and large cap private equity, (iii) low risk and volatility and (iv) liquidity throughout the cycle.

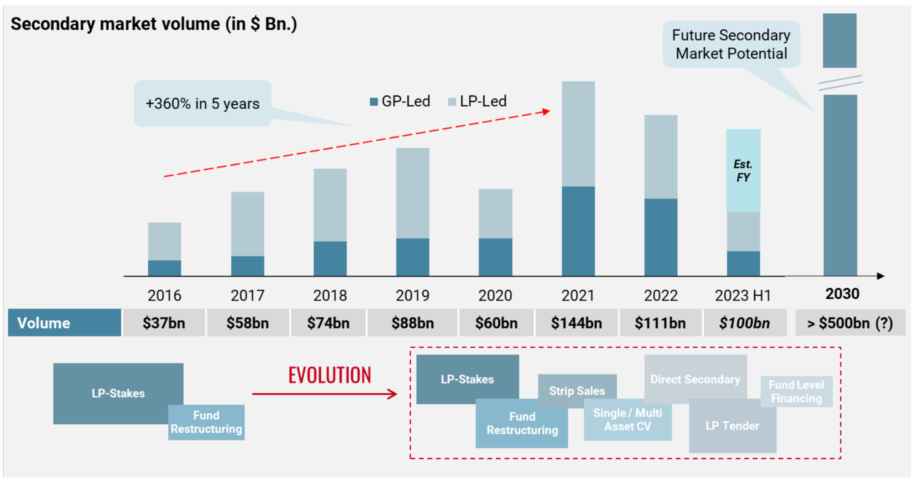
By being so laser-focused on these attributes at the point of investment, we find that potential buyers, be they large corporates or other private equity firms, ultimately want to own our portfolio companies - irrespective of the macro environment.

Active portfolio management

Planning for the exit at the point of investment is not the only solution: for almost 20 years, we have been taking an active approach to portfolio management during the lifecycle of our funds, creating additional liquidity for our investors through secondary sales.

This part of the private equity industry has ballooned alongside the wider growth of the private equity industry in recent years. As chart 3 shows, over the past six years we have seen the volume of global secondary transactions rising from USD 37bn in 2016 to USD 111bn in 2022 and volumes are expected to continue growing at a compound annual growth rate of 20% to 30%.

Chart 3: Unprecedented transaction volume growth

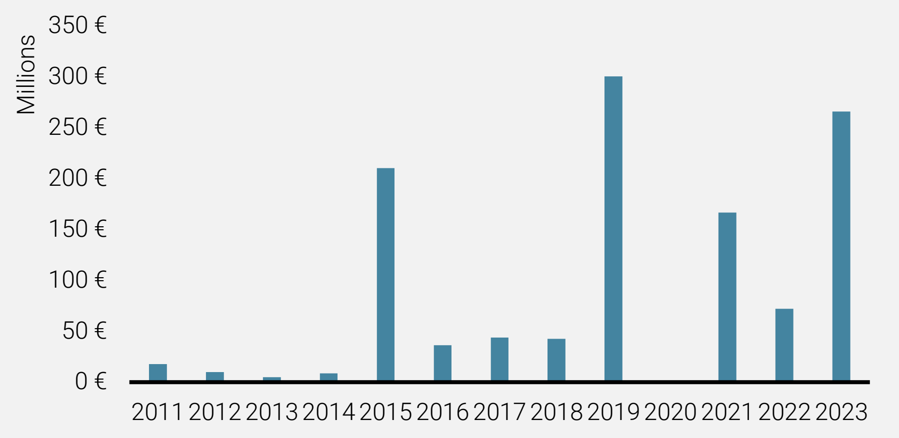


Source: Greenhill - Global Secondary Market Review, as at 30.6.2023.

By moving into the mainstream, secondaries are providing an increasingly attractive exit route and source of liquidity for GPs and LPs, enabling private equity managers to take a more active approach to managing their portfolios over the life cycle of a fund.

While GPs are catching on to the benefits of using secondaries to create additional liquidity, it is something we have been doing for 20 years. During 2023, we sold EUR 266m of portfolio investments through secondary sales while in 2015, exits via secondaries totaled EUR 210m. And it is not just single investments: we are able to package up a number of portfolio investments creating significant portfolios which can then be auctioned off to the larger secondary players leading to potentially attractive realised gains for our investors.

Chart 4: Secondaries sales carried out by Unigestion (EUR m)



Source: Unigestion as at 31 December 2023.

How to achieve premium exits in practice

So how have we been exiting companies from our portfolios in practice? By remaining focused on seeking the market leaders of tomorrow, we have continued to achieve exits throughout the challenging environment of the past two years and the pipeline for 2024 remains highly positive. Some examples of our exits are highlighted below.

Case study – Tapi

Tapi

Strategy: Directs

Region: Global

Transaction: sold to Stirling Square Capital Partners in February 2023 for EUR 320m, 5.0x cost

Angle: Tapi is a global leader in the high-growth, premium bottle closures market with production facilities in Italy, France, Mexico and Argentina. We invested in the company alongside Wise Equity in 2017 when the company had revenues of EUR 35m. Thanks to investments in production capacity and efficiency as well as M&A activity (the group notably acquired Les Bouchages Delage in 2019), Tapi's revenue has almost quadrupled since we initially invested.

TRANSPOREON
A Trimble Company

Case study – Transporeon

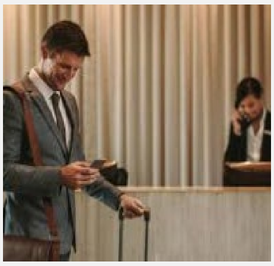
Strategy: Directs

Region: North America

Transaction: sold to Trimble in April 2023 for USD 2bn, returning 2.5x cost

Angle: Transporeon is a leading European freight connectivity SaaS platform which provides applications to support a global network of more than 150,000 carriers and 1,400 shippers and retailers with an integrated suite of IT tools. Since our investment in 2019, the business has shown strong growth. The sale followed a competitive process with interest from multiple parties (both private equity and trade).

Case study - Guestline



Strategy: Directs

Region: UK

Transaction: sold to Access Group in July 2023, returning 2.8x cost

Angle: Guestline is a UK-based provider of mission critical software for the hospitality sector. Guestline serves a broad customer base, spanning leading independent hotels, multi-property groups, and delivering a leading end-to-end, distribution, hotel property management and guest experience system that unlocks more revenue, guest satisfaction and agility. This is another good example of the resilience of a market leader. During COVID, the hospitality sector overall suffered but given the mission criticality of the offering, the company was able to limit the impact and then thrive on the COVID recovery.

Case study - Polyplus

Strategy: Secondaries

Region: Europe

Transaction: sold to Sartorius for 3.8x cost

Angle: Polyplus is a global leader in transfection reagents and plasmids, which are key components in the manufacturing of viral vectors used in cell and gene therapies and other advanced medicinal therapeutic products. The unique position within the gene therapy value chain and the high margins attracted us to the transaction, while the close relationship with the lead investor gave us access to this global niche leader. After a 3-year holding period, the company was sold to a listed strategic buyer.

Case study – Costal Waste & Recycling

Strategy: Secondaries

Region: North America

Transaction: sold to Macquarie at 4.8x cost

Angle: Coastal Waste is a vertically integrated waste management company in South Florida in which we invested in Q3 2021. We were initially attracted by the strong tailwinds, the predictable revenues of long customer contracts, a highly aligned and experienced GP and, importantly, a visible pipeline of acquisition targets. In April 2023, after less than two years, the company was sold to an infrastructure fund.

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Case study – Avania

Strategy: Co-Investment

Region: Europe

Transaction: Sold to Astorg for 3.3x cost

Angle: Avania is a full service Clinical Research Organisation ("CRO") for medical devices in which we invested in 2020. The Company is the only pure play medical devices CRO with a global offering in a highly fragmented and strongly growing market. Driven by aforementioned market growth, Avania's leading positioning, the experienced management team as well as a dedicated buy-and-build strategy, led to strong interest during the sales process in Q2 2022. Eventually, Astorg was chosen as preferred buyer and Unigestion invested alongside Astorg to benefit from further growth potential.

Conclusion

Private equity investments are, by their nature, illiquid but investors are prepared to lock their capital up for longer to achieve premium returns.

However, investors would typically expect a steady flow of liquidity throughout the life of an investment and even make further commitments to funds on the assumption that the distributions from prior investments will fund the drawdowns to these new commitments. Thus, the continued slow rate of exits relative to the large outstanding NAV will be a significant concern.

However, not all GPs are created equal. There is liquidity for private equity investors who have attractive portfolio companies with the right set of criteria.

Furthermore, smart portfolio management, by tapping into the sophisticated secondaries market, can enhance the flow of steady cash back to investors.

So, even when the tide goes out, there is a way for investors to be sure that they have their bathing suits on and are the first ones back to the beach bar!

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