THE TRIAGO QUARTERLY

September 2012

Dear Reader,

Ten years ago the private equity world was a simpler place. Largely North American and European, it was an industry with plenty of relatively low-hanging fruit.

The new normal emerging in our industry is more complex. The peak fundraising volumes of the credit bubble are not returning, though levels may soon hit a new equilibrium, as private equity's dry powder overhang recedes. Returns can no longer be driven just by leverage, and investment opportunities are cropping up in new geographies, specializations and structures. Against this background, the corollary of a shakeout among GPs may prove to be consolidation in one form or another for LPs. Explicitly or implicitly, all of the items in The Triago Quarterly strive to address the challenges of private equity's emerging new normal.

As always we hope the information found here will help you make informed decisions.

Sincerely,

Antoine Dréan
Triago Founder and Chairman
ad@triago.com

INSIDE

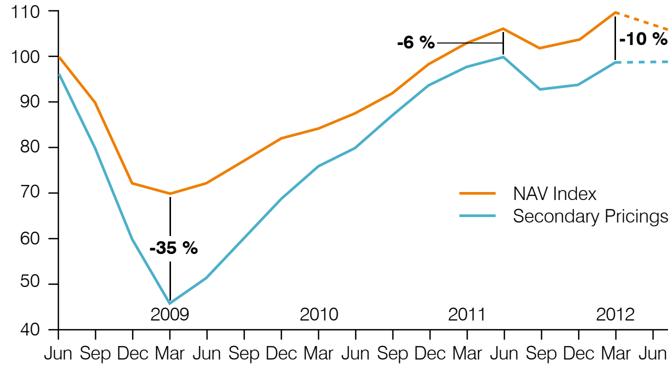
SNAPSHOT

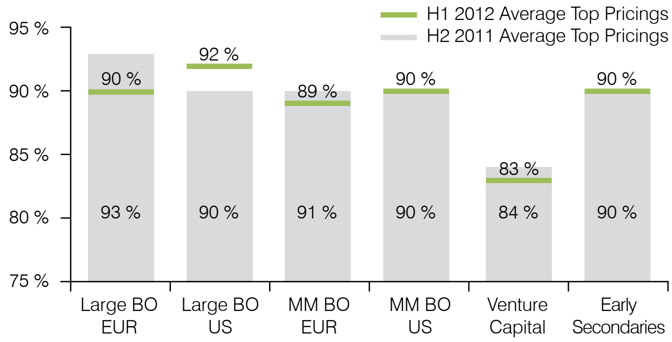
Q1 NAV IS A TOUGH ACT TO FOLLOW…

Net Asset Value Evolution

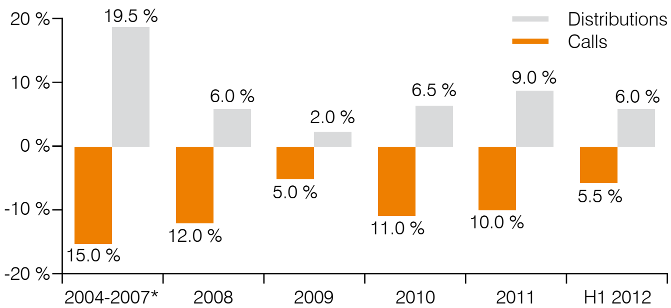
STRATEGY	FY 09	FY 10	FY 11	Q4 11	Q1 12
Large BO	+11.9%	+27.0 %	+2.5%	+0.8%	+8.9%
MMBO	+7.6%	+21.5 %	+4.4%	+2.3%	+5.5%
VC	+3.0%	+10.2 %	+8.1%	+0.7%	+3.8%
Special Sit.	+9.3%	+20.6 %	+0.5%	+2.0%	+6.5%
Energy	+9.7%	+15.9 %	-4.3%	+1.1%	+3.0%
Average	+10.7%	+20.2 %	+4.1%	+1.5%	+6.3%

…AS SECONDARY PRICING HOLDS FIRM…





…AND INVESTORS RECEIVE NET CASH.



* Annual average

Source: Triago's proprietary data

Market Snapshot Analysis: The New Normal

Net asset value holding-up despite volatility; dividend recaps and secondaries provide net cash for LPs; fundraising to improve as bottlenecks persist.

After rising an impressive 6.3 percent in the first quarter, helped by gains for listed comparables of portfolio companies, average private equity fund net asset value looks set for a small decline. The reason: quarterly value of listed comparables fell through June, with investor confidence hit by the Euro-zone sovereign debt crisis.

Relatively modest growth for net asset values - part of a new normal in the industry - is likely in coming quarters. In June, following several years of strong gains, fueled by cost cuts and efficiency improvements, quarterly earnings growth in the U.S., the world's largest private equity market, registered the weakest increase in three years, up 0.3 percent for publicly listed companies, according to Bloomberg. This indicates that bottom-line-only productivity gains may be relatively tapped out for the average private equity portfolio company. With the world facing drawn-out deleveraging, the strong revenue growth that could most plausibly lead to sharp appreciation in quarterly net asset value for the typical private equity fund seems unlikely in the foreseeable future.

After quickly climbing to a post-financial crisis high of 9.3 times EBITDA in December, the average quarterly purchase price multiple for middle-market leveraged buyouts plummeted 22 percent through March, then soared 14 percent to 8.3 times EBITDA in June, according to Standard & Poor's Leveraged Commentary & Data. Volatility in purchase prices will probably continue as GPs scramble to spend what Triago estimates is $193 billion in leveraged buyout commitments expiring over the next 16 months. That's the biggest capital bulge ever set to expire in such a short time frame.

A flipside of the bulge: if today's difficult deal-market persists, growing numbers of limited partners will earmark more for fundraising than in the recent past, using windfalls in expiring commitments. Triago believes this may help annual fundraising volume return to a sustainable range of $300 billion to $400 billion as soon as 2013. That's in line with ten-year fundraising averages, but less than half the peak annual sums collected during the 2005-2008 credit bubble. The expected fundraising increase still implies that a significant percentage of the record 1,900 private equity funds currently targeting $800 billion will fail to meet goals, especially if fundraising launches swell next year. In 2013, growing numbers of GPs are likely to miss fundraising targets, as a small, but growing percentage adopt deal-by-deal structures. For 2012, Triago estimates fundraising should reach $265 billion, a 15 percent increase over 2011.

First-half distributions to LPs from private equity investments equaled 6 percent of committed capital, while calls to finance portfolio purchases equaled 5.5 percent. Given the record amount of expiring dry powder over the next 16 months, Triago believes calls will amount to 11 percent in 2012, versus distributions of 10 percent.

Interestingly, the positive distribution/call ratio in the first half was powered by dividend recapitalizations, with many arranged by GPs looking to return cash to LPs before launching fundraising campaigns. S&P LCD counts more than $28 billion in dividend loans arranged year-to-date through July, on pace to virtually match 2007's annual record of $49.3 billion.

$193 billion in commitments will expire over 16 months - the largest amount ever in such a short time frame.

Volume in the secondary market for private equity funds is set to top $30 billion in 2012, beating last year's record $25 billion. Propelling the gain: dry powder held by secondary specialists and the secondary pockets of funds-of-funds rose 12 percent year-to-date through August to $56 billion. The average top bid in the secondary market is holding at a 10 percent discount to March net asset value - a level generally attractive to both buyers and sellers - even as many expect NAVs to decline slightly in the second quarter.

Much of the money raised through the secondary market is being redeployed to new fundraisings, while banks selling out of private equity funds for regulatory reasons account for roughly a third of sellers. Going forward, a recent rise in secondary directs may grow in importance. Close to their ten-year end-of-life deadlines, 2003 and 2004 funds hold 75 percent of total value in unrealized investments, with LPs increasingly eager to cash out en masse.

Roundtable

Mettle-Testing Times

Faced with Europe's sovereign debt crisis, private equity investors may be losing their bearings.

Not correctly weighing up the likely danger of loss versus the potential for gain means many private equity investors are missing out on European opportunities. At least that's the consensus of three industry experts - one GP, one LP and an academic - invited by Triago to consider the impact of Europe's sovereign debt crisis on private equity investing. For them, the principles of successful private equity investing are immutable: buy assets that will thrive in good and bad cycles, actively manage them to navigate difficult times and forget volatility caused by macro difficulties. A suitable motto for our panel could be a slightly amended version of U.S. Civil War admiral David Farragut's battle-winning exhortation before a weak Confederate enemy: "Damn the torpedoes! Full speed ahead!" It would just start with "Damn Europe's sovereign debt crisis!" Time will tell if that's as good advice for LPs and GPs as the original version was for the Union navy.

TRIAGO: How out of favor is Europe with private equity investors?

Alastair Gibbons, Senior Partner at Bridgepoint Capital: In the United States, the world's largest private equity market, attitudes towards Europe are the worst I've ever known. If you are trying to interest U.S. LPs in a European offering, you are facing a herculean task. Many have a blunt view of Europe and tar everything with the same brush. There is far more acceptance among European LPs that the sovereign debt crisis will not result in Armageddon, or anything faintly resembling it. There is a much greater understanding among European LPs of the differences that exist within the region and of the real opportunities on offer. Outside of the U.S., non-European investor views are moderated, but still weighted towards the extreme we see among U.S. LPs.

Francesca Cornelli, Chair of the Finance Faculty and Academic Director of the Coller Institute of Private Equity at the London Business School: I would add that a lot of what we classify as negative attitude, particularly among non-European investors, is actually LPs and GPs abdicating on decision-making - taking no view at all regarding how they should invest for fear of being wrong. They are not approaching the situation rationally, weighing odds, disentangling differences between countries and types of investments, and evaluating each private equity opportunity on merits. Doing nothing out of fear is a suboptimal reaction. But it is a common mode of behavior when investors face financial crisis.

David Allen, Managing Director of private debt at the Canadian Pension Plan Investment Board: Much analysis of Europe's situation is clearly crude and emotional, particularly in North America. If you were looking at the U.S. from Europe, focusing on financially distressed states like Mississippi, Michigan or California, you might be too scared to invest in the U.S.. Yet that hypothetical is not happening. That's partly because there is less history in the Euro-zone than in the U.S. of a healthy and functioning economy with a handful of weak states within it. Still, for us, it makes no more sense to avoid private equity in Europe because of troubles in a handful of peripheral countries than it does to avoid private equity investment in the U.S. because of some state solvency issues.

TRIAGO: How should private equity investors factor in the potential dangers of Europe's sovereign debt crisis when considering investments?

AG: Well, for the most part, macro-economic issues and market volatility should not impact a good general partner's ability to produce superior long-term returns. To put this in context, Europe in crisis should be no less attractive to investors than China, today's hottest destination for private equity investors. China is a nascent market, with very few proven private equity teams, while prices paid for companies are relatively high. European deals are lower priced, and they occur in an environment characterized by long-term transparency and good governance. There are many experienced private equity GPs in Europe whose track records show that they are used to getting double-digit annual returns throughout low and zero growth economic cycles. Private equity investors who fear fallout from the sovereign debt crisis more than they appreciate Europe's long-term positives, may miss out on some of today's best investment opportunities.

FC: Adding further weight to Alistair's point that investing in Europe is relatively safe, is research, some carried out by us at the London Business School, demonstrating that private

Marc Tyler Nobleman

equity performance in emerging markets is more negatively impacted by macro crisis than it is in developed markets. The basic financing facilities that keep companies going on a daily basis, and that permit private equity entry and exit, often completely disappear in emerging market crises. Ecosystem breakdown is much rarer in developed markets.

DA: Actually, we are seeing that for talented GPs, the current sovereign debt turmoil in Europe is a moment when antennae for bargains are extended to the maximum. Good general partners in Europe are using the sovereign debt crisis to zero in on countries, industries and companies that offer exceptional value. That value is there not just because some investors are avoiding Europe; it's there because transformation and reform are underway. Examples of significant change are the flexible labor laws recently approved by the governments of Italy and Spain. The crisis increases the appeal of investment in Europe, provided you can find the right GPs.

TRIAGO: A lot of recent analysis paints a picture of virtual stalemate in European private equity deal-making, with buyers and sellers far apart on pricing. Is there much deal flow?

AG: We see a respectable volume of deals being done in European private equity. Banks are lending and GPs are raising significant amounts of debt, keeping deal flow going. We recently sold a company in France for a double-digit EBITDA multiple in a deal that saw a private equity purchaser raise half the purchase price in debt. That is a good price and a significant amount of debt for a market that has supposedly stopped in its tracks. The one caveat about today's market is that if you are going to buy or sell a company it had better be top quality. If it is a mediocre company, it will not attract debt funding.

FC: Yes, reports of the demise of private equity deal-making in Europe are greatly exaggerated, in large measure because of misconceptions. Take the example of the initial public offering market and handwringing over its closure in Europe. IPOs have never been an important exit route for private equity investors in Europe, even though they have historically been important for private equity investors in the States. Much of what you hear about the health of European private equity is alarmist, rather than accurate.

DA: What we are seeing from investing in private equity portfolios and lending to private equity purchasers, is that investment and debt volumes are about half what they were last year.

TRIAGO: A record number of private equity funds focusing on Europe should see investment periods end over the next twelve months. Does that mean European private equity purchases are about to rise sharply?

FC: Lots of dry powder facing expiration doesn't, on average, lead to broad waves of purchasing. It results in lots of firms bidding for the same obvious deals. Since there is near-record dry powder globally, it's entirely plausible that we'll see increasingly over-crowded bidding processes, not just in Europe, but in all markets where private equity firms are active. There is a danger that this could push up purchase price multiples in Europe and elsewhere.

> *"We like GPs focusing on the biggest of Europe's troubled nations - Italy and Spain."*
>
> **David Allen,**
> **Canadian Pension Plan Investment Board**

DA: In addition to lots of dry powder, there is an equally impressive backlog of companies worldwide that GPs need to exit in order to build credible track records ahead of fundraising. That points to a significant volume of secondary buyouts, where GPs sell assets to one another, over the next 12 to 18 months. Secondary deals should account for a higher share of private equity transaction volume in Europe than elsewhere because trade buyers feel less incentive to buy and sell in Europe's troubled environment.

AG: I see higher volume and more secondary deals, but I don't subscribe to the view that deploying dry powder will drive prices higher in Europe. U.S. based investors, whether trade buyers or private equity firms, are likely to be largely absent from Europe for quite a while, keeping price pressures in check.

TRIAGO: What private equity strategies would you identify as among the most and least promising in Europe?

DA: First off, it's difficult to take advantage of the kind of opportunistic investments that surface in crises via funds that structurally can only follow a narrow investment strategy. Given the level of regional opportunity, the European mezzanine debt market is overcapitalized. Mezzanine is done at unattractive prices for buyers and I don't see that changing. Distressed investment also looks overcapitalized. A lot of capital has been waiting as long as three years for European banks to liquidate attractive assets, whether it's high quality corporate loan debt, or buyout equity. Yet prices are too high when banks and other supposedly distressed investors sell. There's also excitement about debt refinancing for existing buyouts and other companies with challenged balance sheets, but you've got too much competition. We like GPs heading right into the mouth of the crisis, particularly those focusing on the biggest of the troubled nations - Italy and Spain - who are looking broadly for equity investments, not debt.

AG: There has been a lot of competition driving high pricing in the Nordic region. We think there is better value there, and generally in Europe, in the lower middle market, where it appears a lot of investors fear to tread. I agree that some of the most attractive buyout candidates today are in the peripheral countries experiencing the worst of the sovereign debt crisis. For example, we see more attractive deal flow in Spain right now than in Germany, despite the healthier macro environment in Germany. That said, everything in private equity is a micro play, meaning that the right GP should be able to find good investments whatever the sector or geography.

FC: I think one popular European sector where private equity investors are not being sufficiently cautious is financial services. You've got many GPs starting to do deals in this area and an important number gearing up for deals, yet it is far from clear whether private equity's conventional tool kit for corporate improvement will work here. Complex balance sheet decisions have to be made in an environment of intense regulatory scrutiny and disclosure - elements that can make these investments harder to handle, and less predictable, than buying and improving industrial or retail businesses. Geographically, I would agree that the best opportunities are likely to be in Spain and Italy. Human capital and infrastructure in these two countries are excellent. These factors are often not given enough weighting in private equity investment decisions.

TRIAGO: What are the options for hedging or protecting a portfolio against a euro collapse and how useful are those options for private equity investors?

FC: Well, there are not really any practical ways to use derivatives to hedge long-term investments and this is probably one reason why we see so many investors immobilized by their fear of the downside, choosing to avoid investing in Europe altogether, rather than properly analyzing where good investment opportunities exist and where they don't. Logically, choosing GPs with a flexible, proactive approach to investment is a hedge in itself.

DA: GPs should make sure that any company bought is protected by the nature of its business and by its balance sheet. Companies with euro revenues should, for example, have their debt in euros, not in dollars. If there are significant expenses of any kind in dollars on the company level, a good GP will want a stream of existing or developing revenues in dollars. We are actually witnessing a worrisome trend where some European acquisitions are being financed with dollar debt. That could cause some real losses, since some of that debt is not offset with dollar revenue.

AG: GPs have to give themselves as much headroom as possible on a company level to protect themselves from underperformance tied to Europe's troubles, whether we are talking about a euro collapse or just slow, long-term economic growth. That means not leveraging to the max, making sure you've got flexible debt covenants, having lots of cash on hand, tracking possible scenarios two to three years out, and planning options as carefully as possible. What I would emphasize is that seeking control of investments is absolutely essential in an unpredictable, slow-growth market like Europe. Very often by the time we sell a company the original business plan has been radically changed to take account of shifting events and circumstances. As a GP, you've got to be really flexible in a tough macro environment.

Private Equity Blog

A round-up of issues and challenges for limited partners and general partners.

LP CONSOLIDATION

Today's resource divide in private equity between big and small LPs is likely to lead to LP consolidation in one form or another. Many LPs don't have the resources to vet a GP universe going from North American and European to global, to optimally co-invest or direct-invest, or to achieve the leverage necessary to win separate accounts. David Denison, president & CEO of the $166 billion in-assets-under-management Canada Pension Plan Investment Board, essentially made these points when he observed at a recent London luncheon that the U.K.'s public pension sector, with over 100 separate local government investment funds, each managing average assets of $2.4 billion, lacked the scale necessary for an increasingly complex long-term private investment universe. There are good arguments against force-combining for nimble LPs with honed skills. However, consolidation will come with a vengeance if the benefits of scale become more evident via returns.

> *U.S. PE strategies accounted for 57 percent of global fundraising in H1, up from 50 percent in 2011. Elsewhere, only Central Europe market-share increased.*

DEBT WALL SHRINKING RAPIDLY

Recent forecasts of an imminent spike in bankruptcies at private equity-owned companies look alarmist given progress cutting the leveraged debt wall. Since January, the amount of leveraged loans due by the end of 2015 has fallen some 50 percent to about $90 billion, according to figures from Standard & Poor's Leveraged Commentary & Data. The lion's share of that, due in 2014, has plummeted to $59.5 billion from $112 billion in December, falling 14 percent in just the first two weeks of August. Meanwhile, in Europe, nearly a third of all leveraged loans in the first half were used for refinancing purposes, on pace to set an annual record.

U.S. FUNDRAISING MARKET-SHARE UP

With emerging markets seen as getting ahead of themselves after rapid fundraising growth last year, and as Western Europe's sovereign debt crisis shakes nerves, fundraising market-share for U.S. strategies rose in the first half of 2012, at the expense of most other regions, according to the Emerging Markets Private Equity Association. EMPEA statistics, covering eight global areas and compiled from a range of sources, including their own emerging markets data base, show U.S. fundraising accounted for 57 percent of the total in the first half, up from 50 percent for all of 2011. Only one other region, Central Europe, saw market-share increase in the first half, going to 3 percent from 1 percent. With the long-term trend towards global investment, this year's U.S. gain may be short-lived. Over ten years, combined fundraising share for U.S. and Western European strategies has declined to 82 percent from 92 percent.

INSURERS BUYING SECONDARIES

Interestingly, insurers who have been touted as a major potential source of secondary sales volume, given the expected high reserve requirements of Solvency II, remain net buyers in the private equity secondary market, and are likely to remain so in the future, even after the introduction of Solvency II in 2014. Under Solvency II, reserve requirements are expected to vary based on the portfolio structure of each insurer. Even though reserve requirements on private equity investments will rise under Solvency II, the perspective of low interest rates and relatively slow global growth means insurers will almost certainly continue viewing private equity as one of the few asset classes where returns will be high enough to meet liabilities.

FUNDS-OF-FUNDS DRY POWDER BULGE

About 11 percent, or $12.5 billion, in committed capital remains unspent in funds-of-funds from the 2007 and 2008 vintages, the two biggest fundraising years ever for this category. Watch for the bulk of that money to go to secondaries. Given the goal of investing unspent capital before standard 5-year commitment periods end, and the importance of cashing out LPs within the standard 10-year fund-of-funds life cycle, it is reasonable to assume that two-thirds of this money, or $8 billion, will be spent in the private equity secondary market by the end of 2013. Since due diligence is easier than with blind pools and duration is shorter, a number of 2007-2008 fund-of-funds managers intend to spend all of their remaining dry powder on secondaries.

Contact

AMERICAS
499 Park Avenue, 20th Fl.
New York, NY 10022, USA
Tel.: +1 (212) 593-4994

EUROPE
1 boulevard de la Madeleine
75001 Paris, France
Tel.: +33 (0)1 47 03 01 10

MIDDLE EAST & ASIA
DIFC, The Gate, Level 15
PO Box 50 6681, Dubai, UAE
Tel.: +971 4401 9525

www.triago.com