Dear Reader,

It’s been an exhilarating quarter century! That’s how long Triago has served private equity investors and fund managers. We’ve helped the former find fund investments and execute secondary sales; we’ve aided the latter forge strong links with a diversified, devoted base of global investors. We’ve also counseled limited partners and general partners on broad issues of strategy and market positioning – hardly surprising given PE’s remarkable adaptability and its growing diversity.

Thanks to exceptional performance, PE assets under management in everything from buyouts to credit strategies, throughout the world, have grown over 160-fold to $4.9 trillion since our team came together in 1992. I personally believe PE assets will more than triple by the time we hit the next quarter century’s halfway point.

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

Sincerely,

Antoine Dréan • Triago Founder and Chairman
ad@triago.com

SNAPSHOT

Double-digit returns help fundraising...

Private Equity Net Asset Value Change – Global

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<tr>
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</thead>
<tbody>
<tr>
<td>Large BO</td>
<td>+18.0%</td>
<td>+24.2%</td>
<td>+15.8%</td>
<td>+3.9%</td>
<td>+4.8%</td>
<td>+16.2%</td>
</tr>
<tr>
<td>MM BO</td>
<td>+9.2%</td>
<td>+11.9%</td>
<td>+16.1%</td>
<td>+5.6%</td>
<td>+3.6%</td>
<td>+14.6%</td>
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<tr>
<td>VC</td>
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<td>+18.7%</td>
<td>+16.3%</td>
<td>+7.8%</td>
<td>+2.9%</td>
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<td>Special Sit.</td>
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<td>+11.1%</td>
<td>+5.1%</td>
<td>+1.3%</td>
<td>+4.8%</td>
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</tr>
<tr>
<td>Energy</td>
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<td>+5.8%</td>
<td>+9.1%</td>
</tr>
<tr>
<td>Average</td>
<td>+9.7%</td>
<td>+16.4%</td>
<td>+14.1%</td>
<td>+2.6%</td>
<td>+4.0%</td>
<td>+11.9%</td>
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</table>

...even as net cash for reinvestment drops.

Secondary prices approach par...

Fund Types Sold on the Secondary Market
Pricing Relative to Net Asset Value

<table>
<thead>
<tr>
<th>STRATEGY</th>
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<tbody>
<tr>
<td>Large BO</td>
<td>95%</td>
<td>97%</td>
<td>96%</td>
<td>88%</td>
<td>89%</td>
<td>93%</td>
</tr>
<tr>
<td>MM BO</td>
<td>94%</td>
<td>96%</td>
<td>88%</td>
<td>88%</td>
<td>89%</td>
<td>93%</td>
</tr>
<tr>
<td>Venture Capital</td>
<td>88%</td>
<td>88%</td>
<td>17%</td>
<td>17%</td>
<td>17%</td>
<td>17%</td>
</tr>
<tr>
<td>Tail-End &amp; Fund of Funds</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
</tr>
<tr>
<td>Average</td>
<td>93%</td>
<td>93%</td>
<td>93%</td>
<td>93%</td>
<td>93%</td>
<td>93%</td>
</tr>
</tbody>
</table>

...but GP valuations appear conservative.

Secondary Funds: Exit Premium to NAV for Firms Sold LTV
Sale Price Expressed as Multiple of Net Asset Value

<table>
<thead>
<tr>
<th>LTV</th>
<th>Percentage of Firms Sold Within Specified Range</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt;1.0x</td>
<td>17%</td>
</tr>
<tr>
<td>1.0x-1.1x</td>
<td>33%</td>
</tr>
<tr>
<td>1.1x-1.2x</td>
<td>9%</td>
</tr>
<tr>
<td>1.2x-1.3x</td>
<td>11%</td>
</tr>
<tr>
<td>1.3x-1.5x</td>
<td>9%</td>
</tr>
<tr>
<td>&gt;1.5x</td>
<td>20%</td>
</tr>
</tbody>
</table>

AVERAGE x NAV = 1.22x

1Triago studies cover 96 firms sold within the last twelve months by funds bought on the secondary market. LTV stands for Last Twelve Months.

ANALYSIS: RECORD FUNDRAISING
Annualized fundraising to hit $561 billion, distributions moving to four-year low

ROUNDTABLE: FUND RESTRUCTURING
Restructurings lose their negative image as they breathe life into investments

PRIVATE EQUITY BLOG
Credit funds are a strategic priority for many GPs, PE firms will go public if Trump’s tax plan works, Corporate cash may drive multiples higher, Seven years of stable secondary pricing, More LPs are seeding new GPs
On Track for a Fundraising Record

Commitments to PE funds could reach an unprecedented high, as distributions fall to a four-year low.

With $232 billion raised in the first five months of 2017 - including a first quarter record of $148 billion - private equity is on pace to set an all-time high for fundraising. If the rhythm holds, investors will commit $561 billion to PE funds globally in 2017, in everything from buyouts to debt strategies. That would be nearly 14 percent more than the $494 billion collected last year and would edge out the all-time record of $557 billion in 2008.

Despite that 2008 high-water mark for classic fundraising, annual PE capital commitments have been hitting record heights for years, due to the rise of shadow capital. These are monies committed to PE through co-investment, direct investment and separately managed accounts; all non-fund structures that can make life tough for managers - particularly small and mid-sized ones - since they generate low to zero fees.

With shadow capital included, 2008 was already eclipsed by commitments in 2015 and 2016. Even though shadow capital declined some 11 percent year-on-year to $38 billion in Q1 (mostly due to declining direct investment from cash-strapped sovereign wealth funds in oil exporting countries), combined classic and shadow monies should set a new record in 2017. Annualized, $713 billion will be earmarked for combined commitments this year, 5 percent more than 2016’s $677 billion record.

New commitment highs are occurring when distributions from realized fund investments have been falling for nearly two years. A total of $95 billion was returned to investors in the first three months of 2017, almost 10 percent lower than in the same period last year and down some 29 percent from June 2015’s all-time quarterly peak of $133 billion. Annualizing Q1, $380 billion will be distributed to investors in 2017, marking a four-year low. Less cash back usually means less reinvested. Yet recent distribution declines - tied to four years of meager fundraising and slow investment following the financial crisis - are being made up for by growing allocations. Low interest rates, slow global growth and private equity’s track record of uncorrelated double-digit returns have led investors to allocate an ever larger share of their capital to PE for the past two years.

Still, fundraising is not easy. An all-time high of 3,039 PE funds are targeting a record $1 trillion, up 4 percent and 3 percent respectively since December 2016. Bain & Company notes total fundraising targeted in 2016 exceeded capital raised by a factor of 2.4 times. Meanwhile, Triago estimates that average fund size and the typical commitment to a fund have respectively increased 74 percent and 47 percent in five years. As investors lower overall fees through shadow capital commitments, they are investing more with fewer managers, seeking greater efficiency and higher returns. In this environment, small and mid-sized managers escape competition via specialization, large managers significantly increase assets under management, using mammoth-sized funds and low margin separate accounts, while fundraising for generalists is difficult.

Secondary market volume year-to-date through May is up 11 percent year-on-year at $16 billion, but quarterly figures, running at $10 billion in both Q1 and the soon-to-be-concluded Q2, fell 17 percent from 2016’s busy Q4. With pent-up demand at an apex, Triago expects a very busy second half, sending 2017 volume above 2015’s record $40 billion. Capital held for secondaries by specialist vehicles, funds-of-funds and in-house institutional investors is well over $100 billion, not including leverage – often equal to 50 percent of equity in secondary deals.

Average secondary pricing in 2017 year-to-date stands at a 5 percent discount to net asset value, narrowing from 9 percent a year ago. But discounts and premiums still offer plenty of value due to conservative valuations; a Triago study covering 96 firms sold within the last twelve months by funds bought as secondaries shows that the average exit has been at a 22 percent premium to recorded net asset value.
The Triago Roundtable

Shedding a Negative Image

Restructurings offer welcome liquidity and breathe new life into investments.

As fund restructuring takes its place in private equity’s mainstream, it’s losing its reputation as a Hobson’s choice for incumbent investors. Accounting for some 5 percent of secondary market activity a decade ago, restructuring - the collective transfer of PE fund ownership from one group of investors to another - is now more than 20 percent of annual volume. Our participants, all specialists in wholesale ownership change, as well as in the buying and selling of individual fund stakes, deconstruct restructurings’ bad rap, and explain why it’s increasingly seen as fair to all.

**WM:** There are four characteristics that we look for as a secondaries investor in a fund restructuring. One, we seek an incumbent management team with a strong track-record and no issues of team unity. Two, the portfolio must offer long-term growth – we are looking for strong companies with significant value creation potential. Three, our acquisition price, not the original net asset value, must be the benchmark for future GP performance payments. Management also has to invest a significant portion of their net wealth in the restructuring. Finally, uninvested capital or fresh commitments must be sufficient for add-ons and new investments. To have every chance of success, restructurings require the same flexibility as primary fundraisings. In our experience, roughly 80 percent of GP-proposed restructurings don’t actually meet these four criteria; their logic is to reset carry and fees for the GP, despite performance prospects that usually merit fund liquidation.

**TK:** The extent to which assets either require more time to mature or need more investment to fulfill their potential is critical for justifying a restructuring from the perspective of an LP. Restructuring can also be very logical for LPs when there’s little prospect of performance-related compensation [carry] for GPs, particularly when the latter continues to collect annual fees from the former. Restructuring in these cases creates an escape hatch for investors who might have to wait years to see portfolio exits, and resets fund life and carry so that manager interests are brought back in line with those of investors.

The last point seems to contradict the idea that the track record should be strong in order for restructuring to make more sense than liquidation. David, could you address that?

**DA:** There are grey areas that don’t neatly tick all the boxes that Wouter describes – some successful transactions involve poor track records or underwater carry. Underperformance may be attributable to exited companies and what you’ve got left are assets with good prospects. You may also have a formerly mediocre GP team that’s been reduced to its top performers. Equally, transactions may involve the spin-out of exceptional members from a weak franchise. I’d add that
wholesale ownership change can occur without restructuring in the classic sense, i.e. without changing carry, fees or injecting capital. That’s why I prefer to talk about ‘whole-fund liquidity solutions’ and not ‘restructurings.’ The latter term is often considered pejorative, given early examples involving zombie funds [vehicles controlled by managers whose poor track records preclude raising further funds]. Whole fund liquidity solutions encompass the full range of possibilities regarding broad ownership change.

Can conflicts of interest, particularly for the incumbent GP, be avoided or neutralized in these deals?

**TK:** In restructurings of the type that David just mentioned, where ownership changes only in order to give investments time to mature, and where the cash out for investors is offered at net asset value, there typically is no conflict of interest. Yet inherent potential conflict exists when fees, hurdle rates and carry need to be reset. The way to deal with the different economics of buyer, seller, and manager in these cases is through total transparency regarding everyone’s aims. Given diverse views and risk appetites, as long as everything is transparent, it’s possible to come to terms that are satisfactory for everyone.

**WM:** All parties to a restructuring have different aims, but the potential conflict of interest is focused squarely on the GP, who has to approve arrangements attractive to new investors and at the same time safeguard the interests of existing investors. We usually offer LPs the possibility to sell stakes or to roll into the restructured fund. When it’s possible, we even offer incumbents the option to remain in the existing structure. Providing existing LPs this type of optionality significantly mitigates a GP’s potential conflict of interest.

**DA:** Also, today everyone recognizes that there are really four groups of stakeholders in restructurings: the GP, the investor buying into the fund, incumbent LPs who want to sell, and incumbent LPs who don’t want to sell. Five to seven years ago, the idea that existing LPs comprised two groups with potentially divergent interests wasn’t focused on in the same way. The result was a perception that some transactions didn’t treat incumbent investors fairly and therefore required regulatory scrutiny. But over the years these transactions have become ‘self-policied’ - not least by the funds’ limited partner advisory committees - and now virtually all deals that close, offer rollovers that focus on the needs of incumbent investors. Rollovers, it must be said, can increase execution risk for buyers. We look to work only on deals where there’s likely to be a critical mass of sellers.

Why is it that the funds targeted by restructurers are frequently viewed as lousy performers?

**TK:** Much of that has to do with the funds that were restructured in the early days of the post-financial crisis. Many were zombie funds, as David said. To make them attractive for buyers, they were sold at the kind of steep discounts that are just no longer feasible given the lack of dislocation in financial markets, and the now widely recognized need to structure deals with rollover options at or near net asset value.

**DA:** Now you’ve actually got top quartile GPs using restructurings and engaging in all manner of whole fund liquidity solutions. For example, we’ve seen GPs with fantastic performance rolling out, say, their sixth fund, and offering liquidity to investors in their fourth fund, which is in the ninth year of its targeted 10-year existence. That crystallizes gains for incumbent investors and permits them to invest in the new vehicle at the same time. The stigma attached to restructuring is an unjustified stereotype masking a very rich variety of deals.
**WM**: It’s worth considering that, as I said, 80 percent of potential restructurings are pursued by lower quality managers. That explains much of the stigma. Yet the 20 percent of potential restructurings that actually get done - over $10 billion annually - tend to involve higher quality GPs and funds. Some of the funds that get restructured have had real issues, like one or two investments that failed. But generally, the remaining portfolio companies have performed well and continue to show significant potential.

**TK**: Our take is that the story has not been fully told regarding the performance of restructurings - it’s only been about five years since they started on a large scale. Restructurings tend to be longer duration than investments in individual LP stakes because there’s so much more potential value creation to be built. They’re also relatively higher-risk investments for the same reason. Collectively, all of this means that the variance between the performance of the best and worst restructurings is generally much wider than what you find in the individual LP stake market. There might be some very big winners and some very big losers ultimately. But the logic of restructurings is compelling, as the ever larger sums being committed to funds specializing in such deals indicates.

**DA**: We’re seeing some great early results from deals we did four or five years ago. But over the last 12 months or so we’ve seen some strategy drift from groups that have not historically been active in this market. With pressure on returns in the traditional secondary market, less experienced buyers are now closing deals in the whole fund space. These transactions are great if you know what you’re doing, but we’ve passed on a number of those now getting done. Only time will tell how they will perform. That said, over the long term, the much greater complexity involved in bringing whole fund solutions to fruition implies that competition will remain incredibly limited versus the market for traditional LP stakes. That argues in favor of great returns for groups experienced in whole fund solutions.

**WM**: No. We measure value creation potential using the same tools as direct investors in companies. Whether that results in a price that’s a premium or a discount to net asset value doesn’t matter to us. Over time, we’ve never found a correlation between buying at discount and outperformance.

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**TK**: The best estimates I’ve seen are that restructurings account for 20 percent-plus market share and I certainly don’t see that getting smaller. The likely long-term global economic context of low interest rates is generally favorable for private equity, so it’s highly probable that sustained competition for assets and the longer hold periods that logically follow are here to stay. That means sustained demand to restructure funds set to outlive their targeted life, and very possibly an even bigger market share.

**DA**: I see a virtuous circle in this market. Although buyer appetite for whole fund solutions will fluctuate in the short-term depending on where we are in the economic and asset class cycle, growing numbers of LPs are recognizing the virtues of these deals. Over the long-term, this will lead to even the biggest GP firms engaging in whole fund solutions, in turn making even more LPs comfortable with them.

**WM**: I agree that the secondary market overall will grow significantly as a function of rising primary fundraising and increased recognition of the value of liquidity. But I don’t think the market share of restructurings will grow too much from today’s level. The popularity of restructurings really correlates with periods of sanguine economic projections. When the global economic outlook is on balance positive - as it is today - a relatively high percentage of secondary deals are restructurings. But when there’s economic dislocation, or recession, individual LP stake sales increase, since pricing is more attractive. At the same time, there’s a correspondingly greater risk in restructurings, and so relative volume shrinks. Restructurings, very dependent on value creation scenarios, attract the most capital when people are optimistic.

Even the biggest GPs will eventually engage in whole fund solutions.

*David Atterbury, HarbourVest Partners*

**What is your judgment on the performance of fund restructurings?**

**WM**: Our restructurings have performed well; in many cases better than our purchases of individual LP stakes. That’s usually because there’s more room for value creation in the portfolio companies. Value creation possibilities in a relationship between an investor and a fund manager that are the result of a restructuring are more apparent and easier to underwrite than when you buy a fund interest from an LP, and are not as close to the GP. That’s why as a firm we’ve been pretty long these transactions, relative to the straight trading of LP interests, for about two years now.

**Wouter, has AlpInvest’s outperformance from restructurings been the result of deeper discounts to net asset value than what you get buying individual LP stakes?**

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

Credit Funds are Now a Strategic Priority for Many PE Firms
When PE managers expand product ranges, they are likely to launch a private credit fund. Analysis of creditworthiness neatly complements equity analysis, and extending debt to the same types of companies in which managers invest, keeps PE firms within proven, marketable specialties. Post-financial crisis, lending to the small and mid-sized companies that are the traditional focus of PE filled a lucrative void left by banks, who now service a more select group of larger clients. But private credit funds tripled in size over the past five years to some $475 billion, while average annual returns halved to six percent from 12 percent. The loans are fairly low risk – but that's not the main reason private credit will continue to grow despite the drop in yields. Importantly for GPs and their investors, credit provision offers insight. In an increasingly competitive market, that edge is often critical for profitable equity investment in companies.

Trump’s tax plan could incite private equity firms to list.

Corporate Cash Piles and PE
President Trump’s proposal to tax years of U.S. foreign earnings held overseas if repatriated - a $2.6 trillion cash hoard equal to over half of private equity's $4.9 trillion under management - at 10 percent instead of the going 35 percent rate, could have a profound impact on private equity. Freeing up these funds through a tax holiday would likely fuel a mergers and acquisitions bonanza. The result would be higher purchase price multiples globally for private equity firms, which generally derive fewer economies of scale and cost savings than corporate buyers. But that negative would be offset by a positive, a fantastic seller’s market. Redeployment of the U.S. overseas cash pile into M&A would permit richer, earlier-than-planned exits for many PE portfolio companies, building up investor distributions - at a low ebb due to slim fundraising and slow investment in the years following the financial crisis.

Robust Secondary Market Pricing
Average sale prices in the secondary market for closed private equity funds have held above 91 percent of fund net asset value since June 2010, a remarkable 7-year performance considering the ups and downs of the global economy. Far from the occasional marketplace of the early 2000’s (volume was a mere $3 billion in 2002 versus $39 billion last year), when deals were often discounted fire sales, the secondary market today is a vital tool for managing investor exposure to PE sectors and managers.

Firepower and the unprecedented analytical resources of today’s record-sized mega secondary funds - the current champion is Ardian VII which closed on $10.8 billion last April - and the expertise of a wide community of advisors, should keep pricing relative to NAV high over the long-term, barring severe dislocations to financial markets.

More LPs Seed New GPs
As studies show hungry managers of first-time funds outperforming the typical PE team, and analysis demonstrates the weakening of top-quartile persistence (the ability to follow one top-performing vehicle with further exceptional iterations), growing numbers of limited partners are becoming anchor investors for new general partners. These LPs are also known as bell-cow investors because their substantial monetary pledges, often on the order of 20 percent of the targeted sum, lead other investors to commit capital to the vehicles they back. Anchors get advantages like discounts on annual fees, broad co-investment rights and stakes in the GP’s management company, and thus a share in carry. These advantages have proven especially valuable for anchors in the funds of several highly successful, and now big, GPs.
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