# THE TRIAGO REVIEW

Dear Reader,

Today's heightened sense of uncertainty is leading to a boom in targeted investment, whether that's co-investment, direct investment, GP-led secondary deals, or pre-seeded funds unveiled by previously fundless sponsors. In a year of records - in fundraising, dealmaking, distributions and overall secondary volume - everyone in private equity is keeping a wary eye on risk. This mirrors a broader new normal as society learns to live with, adjust to and even thrive under a wide range of potential dangers.

Indeed, risk and how it can be minimized in private equity, even as PE achieves new milestones, is a theme running through these pages. It's a motivator for investing outside of classic fund structures, the subject of our roundtable, and it's behind the record levels of targeted investment documented in this review.

As always, we hope the information found here helps you make the right business and investment decisions. To all, we wish health and happiness over the holidays and a joyful 2022!

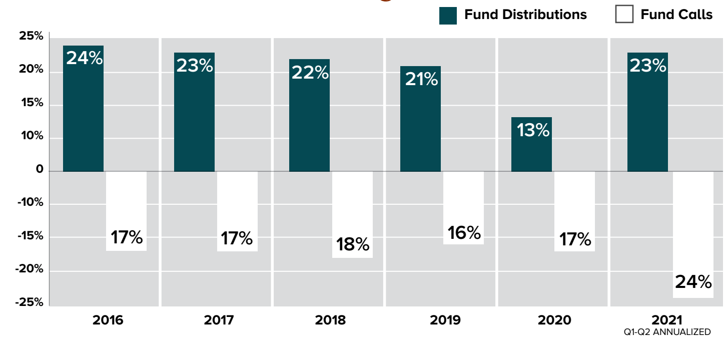
Sincerely, The Triago Team



## AS COVID 19 BECOMES ENDEMIC, PE ADAPTS

With a rise in uncertainty, direct deals become stars.

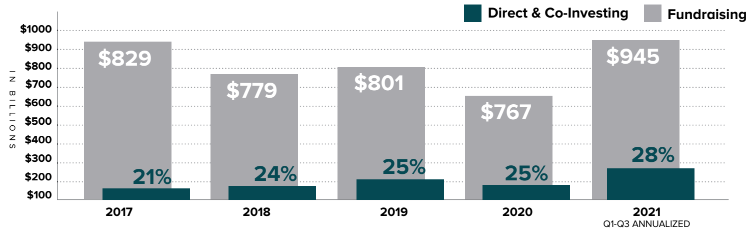
### Deals roar back, feeding calls and distributions.




Percentage of limited partners' committed capital – annual average

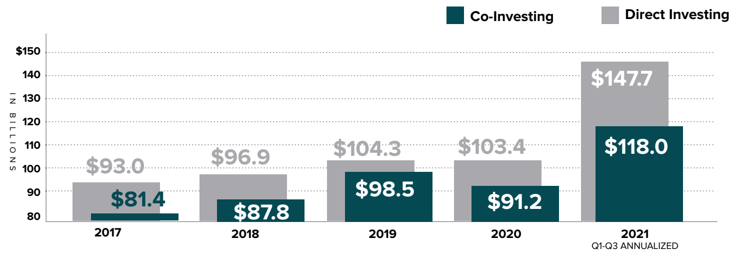
### Fundraising & targeted investment set records…

**Fundraising – Relative Value of Direct & Co-Investment[1]**




### …as directs in particular reach unprecedented heights.

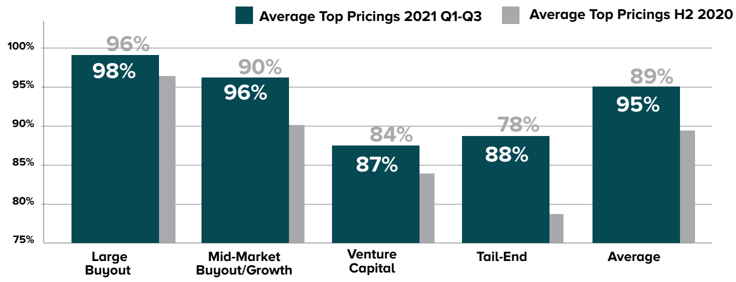
**Direct & Co-Investment – Value Breakdown**




### And secondaries rise on strong NAV appreciation.

**Fund Types Sold on the Secondary Market**

Pricing Relative to Net Asset Value (excludes GP-Led)




1 Fundraising includes funds in Buyout, Venture Capital, Growth, Real Assets, Distressed/Turnaround, Secondaries, Credit and Fund-of-Funds strategies, plus all closes, first to final. Percentages are rounded.

# Private Equity Soars

## Fundraising sets records, but targeted direct deals and co-investments take an unparalleled share of commitments.

Private equity funds are collecting record levels of capital this year on the back of pent-up demand. As Covid-19 transitions from acute pandemic to serious, but more manageable endemic malady, PE funds broadly defined - encompassing strategies in buyout, venture capital, growth, real assets, turnaround, secondaries, credit and funds-of-funds - have gathered a record $709 billion through Q3. This compares to a previous all-time high of $619 billion raised in the first nine months of 2017 and surpasses 2020's $514 billion by 38 percent. For all of 2021, PE funds are on track to gather $945 billion, exceeding 2017's apex by 14 percent and outpacing 2020 by 23 percent (table 2, p. 1). With the final quarter generally the strongest, the fundraising beat could be even bigger.

Despite the record capital collected for classic, "blind-pool" PE funds that for the most part have not yet made investments, the heightened sense of economic uncertainty ushered in by Covid-19 is having a long-term (and yes, slightly ironic) impact on primary commitment, with a more pronounced taste among investors for targeted primaries, whether by co-investment, through separate accounts, or via direct investment - the latter either in alliance with a fundless sponsor or not. In 2021, such investments in companies that investors can analyze stand at a record 28 percent of fundraising, or an absolute all-time high of $199 billion Q1 through Q3 - just shy of 2020's full-year record of $203 billion (table 3, p. 1; roundtable, p. 3).

Especially noteworthy is the amount being committed to directs. Driven for decades by sophisticated investors (think sovereign wealth funds, Canadian pensions and family offices), directs have always taken a larger share of targeted PE than co-investment. Yet in the years running up to the March 2020 lockdowns, co-investment gained as smaller investors sought to dial-up exposure to lower-fee, potentially higher return investments alongside trusted general partners.

That trend has reversed. Veterans with expertise are devoting ever larger sums to directs and growing numbers of limited partners are investing for the first time. That's prompting a higher relative percentage of GPs who spinout to go the fundless route (often with the idea of eventually seeding first-time funds with these transactions, thus continuing to play to targeted investment demand). Co-investment, while hitting records for absolute amount and even market share, is hindered by GPs' need to prioritize investing the dry-powder highs held in funds.

While an exceptional wave of realizations and dividend recaps continues into Q4, it's paralleled by an unprecedented level of acquisitions. This is leading to rough equilibrium in capital called and cash distributed (table 1, p. 1). This implies that frustrated commitment plans and increases in investor PE allocations - not the return of net capital - are behind 2021's sharp rise in fundraising.

Uncommonly strong rises in net asset values in 2021 are adding to investor enthusiasm and driving major price increases in the PE secondary market, with the average NAV up 37 percent in the year through September 30. Indeed, PE is significantly outpacing major stock index appreciation, with the S&P 500 up a relatively modest 28 percent over the same period. The average fund sold as a secondary this year, excluding GP-leds, has traded at 96 percent of trailing NAV, up from 89 percent in H2 2020 (table 4, p. 1). Tail-ends - funds that are more than 10 years old - have seen particularly dramatic price appreciation, rising to 88 percent of NAV from 78 percent.

Secondary market volume for 2021, Q1 to Q3, stands at an unprecedented $79 billion, with a record $46 billion in GP-leds. This outstrips 2020's full-year, $37 billion record for GP-leds (of which some 70 percent transacted in H2 2020). Based on activity in October and November, and the usual end-of-year acceleration in closes, we project record full-year 2021 secondary volume of $113 billion, exceeding the 2019 high of $83 billion and last year's $71 billion. Although the LP stake share of volume has grown every quarter in 2021 (36 percent of Q1's $20 billion, 40 percent of Q2's $29 billion, 46 percent of Q3's $30 billion and an estimated 48 percent of Q4's projected $34 billion), trading levels are running a bit below 2019's record of $53 billion, the last time LP stakes constituted a majority of secondaries (64 percent). With a never-before-matched $243 billion earmarked for secondaries overall, we expect 2022 will set a new volume record.

# The Appeal of Investing Outside of Classic Fund Structures

## Key attractions include the ability to evaluate assets, longer hold periods and freedom from portfolio management bias.

Our definition of 'investing outside of classic fund structures' is broad. It covers co-investment, separate accounts, deal-by-deal relationships, direct investments and continuation vehicles. Calculating market share for all of these PE structures is difficult, yet co-investing and direct investment alone amount to an unparalleled 28 percent of fund commitments this year (see table 2, p. 1). As Hayfin Capital's Gonzalo Erroz notes, investing outside of classic fund structures allows investors "to dig deeper into assets" – that is specific assets, as opposed to the blind pool investing that typifies commitment to a traditional fund. The ability to evaluate assets during highly uncertain times has clear advantages, while committing outside of classic fund structures permits the targeting of especially high returns. But our participants note that a mix of diversified investments - including traditional funds - remains the most efficient path to exceptionally profitable investing.

GISELLE BRIGHT
**Partner at Bregal Investments**

GONZALO ERROZ
**Partner at Hayfin Capital Management**

CHRIS SULLIVAN
**Founder and Managing Partner at Landon Capital Partners**

DAVID FEIERSTEIN
**Managing Partner, Ronin Equity Partners**

**What are the long-term trends contributing to the appeal of private equity investment outside of classic fund structures?**

**GISELLE BRIGHT:** We're investing more these days in long-term holds, whether that's outside of a classic structure or – increasingly – within one. As we've evolved and as the entire industry has become more competitive and sophisticated, it's become evident that it's often better for both limited partners and general partners to hold onto companies that have great potential rather than to see them sold to other general partners. And as noted, we're increasingly seeing classic structures reserving part of their capital for long-term holds, showing how much the phenomenon has gone mainstream in the past three-to-five years. You've also got circumstances where putting assets into longer hold periods reduces risk. Longer hold periods can also come with lower fees. All of that translates into a trend that has legs for the long-term.

**GONZALO ERROZ:** Every opportunity is different, but generally we have a preference for single asset continuation vehicles, co-investments – whether new platforms or add-ons – and investing in fund restructurings [also known as GP-leds], with a small allocation for more traditional private equity primary fund commitments. Investing in those structures, we can dig deeper into assets and into the work that particular general partners carry out. This allows us to be extremely selective, finding opportunities with highly favorable risk-adjusted-return profiles. Vetting a manager's track record is key, but we'll get the best returns by also evaluating concrete opportunities. Investing deal-by-deal provides better understanding of the quality of managers, helping us determine future primary fund commitments.

**CHRIS SULLIVAN:** Having greater visibility into underlying assets is clearly what drove the shift for Landon family commitments from a fund focus to an exclusively deal-by-deal strategy. We also wanted to get away from the portfolio management bias of fund managers. Once managers achieve their targeted returns, instead of maximizing value at portfolio companies, the natural tendency of many is to focus on exiting remaining investments so that they can quickly get onto their next fund raise. That leads to premature sales, driven by a desire to lock in gains and return capital. Investors focused on outperformance will continue to gravitate to direct investments and more flexible investment periods.

**DAVID FEIERSTEIN:** For managers, deal-by-deal strategies have growing appeal in an increasingly competitive marketplace. As a general partner operating deal-by-deal, we can outbid competitors and still generate better gains – we exploit value potential more fully than a classic fund that's under pressure to stick to an investment period. We can use debt more flexibly than managers on a fund-life clock, and we can seek value across a broader range of company sizes. If a deal generates heavy investor demand, the compensation we negotiate can be higher than for classic managers, though the reverse is true as well. Moreover, investors can pick and choose which of our deals they invest in. Studies show that cherry picking managers' deals leads to higher returns. Finally, owners with a bias against private equity funds are also sometimes more inclined to partner with us.

The prince and the princess lived happily ever after on their profits from co-investments, direct investments, GP-leds AND classic fund structures.

**What accounts for the material uptick for non-classic fund investment during the pandemic?**

**GE:** It's driven mostly by the desire of fund managers to optimize their portfolio and pipeline at a time when the pandemic makes it hard to do deals. That complements the growing appetite of institutional investors to invest in specific deals. The pandemic really boosted single-asset continuation vehicles [where a fund asset is sold on to a special purpose vehicle controlled by the same manager]. The deals provide liquidity for some investors, while creating a new opportunity for investment in a specific asset that the general partner continues to manage. Interestingly, fund managers focused on geographies that were hit hard for particularly long periods by the global financial crisis – like Spain – were especially quick during the pandemic to launch continuation vehicles and other non-classic private equity investments. Their experience of extended market dislocation meant they were more primed than others to find alternatives to classic fund investment during the pandemic.

> Operating deal-by-deal, we can outbid competitors and generate better gains.
>
> *David Feierstein, Ronin Equity Partners*

**CS:** The pandemic's uncertainty has made people more wary of committing to the blind pools that define classic private equity fund structures, so direct or highly focused transactions are more attractive. When it comes to direct investing there's also a major factor driving the sales side and that's the tax situation in the U.S. [the world's largest private equity market]. People are eager lock in Trump's lower tax rates given the likelihood of Biden's higher tax proposals coming into force as soon as next year. That's led to an especially rich range of buying opportunities.

**DF:** I agree with Gonzalo and Chris. I'd underline that in a still highly competitive environment, characterized by record flows into private equity investments, it's more critical than ever to consider alternatives to classic fund structures. Using every tool in the chest, and then some, is key if you want to get money invested quickly and buy at an acceptable average purchase price.

**GB:** Yes, we've got record liquidity to invest. But it's hard to deploy that capital, especially given continuing constraints on meetings. In that context, the strategy of investing more through single-asset continuation vehicles with managers we already know and in companies we already know and like, is very attractive.

**What kind of resources are needed to invest outside of classic fund structures?**

**CS:** Here's what I explained to the

Landon family back in 2014 when we set up our firm: if you take the two percent management fee you pay on a portfolio of funds and redeploy it to building your own in-house direct investing team, you can successfully invest outside of funds. It's key to hire professionals with a successful track record of private equity investing. That said, in addition to having the financial resources to put a team together, you also must have the desire to do the extra work required for the management and oversight of such a team. There are many investors who prefer the less strenuous role of picking a portfolio of funds and letting the general partners handle all the administration involved in managing an investment team. That's also much closer to the traditional fund picking skills of limited partners.

**GB:** I subscribe to Chris' view on the resources and commitment needed for direct investing. My firm has sponsored the creation of in-house teams and they've benefited from our financial firepower, the freedom we've given them to do deals and from our brand's leverage. But any time you do this, you have to contend with the almost universal desire of deal makers to increase their economics, launch their own funds and find additional third-party investors. Independent fund structures – despite the highly attractive investment opportunities that exist outside of them – are still the most efficient way to get large sums of money invested in private equity.

**David, could you briefly address Giselle's contention that virtually all direct investors want to launch funds and that funds can be the most efficient way to invest?**

**DF:** Long-term, deal-by-deal is not usually the best proposition for private equity managers, simply because it means you have to fundraise all the time. For us, this isn't an issue because we're doing about four platform deals a year and we have very solid repeat backers who will finance our transaction pipeline. But when we've completed that pipeline, we may well raise a classic fund, expand our team and pick up our deal making somewhat. I don't want to become the standard three-to-five-year investment period guy – fund structures can still crimp investment freedom. We'll want a structure that accommodates the flexibility I spoke about earlier; that means getting commitments from investors who appreciate it and I'd say most of the latter are in family offices.

**GB:** I won't put a number on it, but David's right, the return you aim for outside of classic fund structures should be a lot higher. Co-investments are either low to zero fee, longer term investments are usually lower fee, and when you seed in-house teams the working arrangement has better economics for investors than when you invest in a pure third-party fund. On average, you're sharing more in the upside when you invest outside the classic fund structure. When you're not, your return bar should be higher, given you're probably making a fairly concentrated investment.

> Our goal for direct investments is a minimum multiple of three times invested capital, net of expenses and carry.
>
> *Gonzalo Erroz, Hayfin Capital Management*

**GE:** Everything we've mentioned - co-investments, deal-by-deal relationships, fund restructurings, continuation vehicles - as well as the flexibility David's described as a natural component of deal-by-deals, will be integrated one way or another into a majority of private equity funds over the next decade. The advantages of deals done outside of the classic fund structure are too compelling for both investors and managers to ignore. All of this means that limited partners increasingly require a skill set oriented towards evaluating more sophisticated deals.

**What sort of returns should investors be aiming for relative to classic funds?**

**DF:** Returns should be a lot higher than what a fund structure promises. We've got a return target of three times invested capital on any deal we enter into and we're being conservative relative to what we think is true potential. Chris mentioned the bias towards locking in gains at funds once carry has been achieved; well, that's not a factor in the more entrepreneurial culture of deal-by-deal where we are incentivized to increase the value of every transaction.

**GE:** In most of the buyout fund sector a 12 percent net return has traditionally allowed funds to qualify for top quartile performance. We target a substantial premium for buyout deals outside of classic fund structures, shooting for an 18% or higher net return across investments. We aim for a similar premium to top quartile performance for these kinds of deals in other private equity sectors.

**CS:** Our return goal for our direct investments – the only type we have – is a minimum multiple of three times invested capital, net of expenses and carry. In order to achieve that kind of performance, considerably above the two times invested capital many funds aim for, we do take on proportionately more risk. So, some of our investments may turn out to be zero return. Other investments may, however, generate four times, five times or even eight times invested capital. We are at the tip of the risk pyramid for the Landon family's overall investments and are part of an integrated spectrum that starts with low-risk/low-return investments.

# PRIVATE EQUITY BLOG

A round-up of current trends and issues for general partners and limited partners

### PE assets to hit $9 trillion this year

Driven by record fundraising, rarely-before-seen appreciation (estimates on p. 2) and average debt amounting to some 40 percent of deals, PE broadly defined (encompassing activist strategies in buyout, venture capital, growth, real assets, turnaround, secondaries, credit and funds-of-funds) should see assets under management increase to some $9 trillion this year, up from $7.3 trillion at year-end 2020. This estimate assumes global stock indexes hold on to Q4 gains through November 26 and that PE appreciation over the same period matches those gains. The latter isn't a particularly ambitious stretch after four quarters of PE outperformance. While we expect PE AUM to rise 23 percent this year, PE's share of global financial assets should increase just 700 basis points to 7.8 percent. Despite breakneck growth, PE has room for years of rapid expansion.

### A fifth of fundraising is digital

Some 20 percent of commitments were raised digitally in 2021 through end-November. We expect that percentage to remain steady through year-end, crushing 2020's full year record of 9 percent. Marketing remotely and committing without any physical meetings are secular trends in the wake of March 2020 lockdowns. We predict that within five years over 50 percent of fundraising will be digital. This favors big brands, one-stop-shopping and industry consolidation. But it also - finally - leaves hard-pressed investors with time to vet harder-to-size-up smaller funds and emerging managers (ironically, travelling to meet them!). Given evidence that these are the PE subsectors where the most potential alpha is, it's also where meeting within handshake range really pays off. We began 2021 thinking a 30 percent share for digital fundraising was an outrageous prediction, now we think it's a reasonable target in 2022.

### Now is the time to use GP currency

Listed PE has more than doubled gains for major indexes since the pre-pandemic stock market high in February 2020. LP stake firms are going public with abandon and Blackstone, the world's largest PE manager, has a higher market capitalization than Blackrock, the world's biggest money manager (the latter's AUM are 15 times larger than the former's!). Now is a propitious time to realize the value of GP currency - shorthand for the fungibility of GP stakes - especially given the prospect of higher U.S. taxes and rising global interest rates. GP financing, in the form of equity and non-dilutive debt, is being tapped in unprecedented quantity to finance new fund strategies, recruitment, M&A, and GP commitments. Who knows, Blackstone may use its currency to correct what founder Steve Schwarzman has called the "heroic" mistake of selling BlackRock…buying it back.

### Single-assets take majority of GP-led secondaries

While we estimate that GP-led deals will account for an unprecedented 64 percent of a record $113 billion in overall secondary market volume in 2021 (further detail on p. 2), the biggest surprise may well be single-asset transactions. Year-to-date through end-November, single-asset deals account for 53 percent of GP-leds and we expect the former to end 2021 with a relatively unchanged share (exceeding multi-asset deals for the first-time). While some 47 percent of sector value is accounted for by multi-asset deals, even here the typical portfolio is focusing on fewer assets than pre-Covid-19. Ascribe that to investors' growing partiality for highly targeted investment (more on volume for primary co-investment and direct investment on p. 1 & 2) at a time of heightened economic uncertainty tied to Covid-19.

### The model for PE retail is The Sequoia Fund

The news that venture capital firm Sequoia Capital will restructure around a new permanent capital vehicle, The Sequoia Fund, is praised as a means to stay invested in all stages of a company's growth. But this vision of a hybrid, open-ended fund straddling public and private markets equally fits the bill for how to bring PE to retail investors. It's largely in accord with recent pronouncements from the U.S. Securities and Exchange Commission and the U.S. Department of Labor. For example, the Sequoia Fund permits regular redemptions and its setup - a fund investing directly in listed stocks that allocates capital to a series of closed-end sub funds for private investments - offers an easy way to create the indirect, chaperoned investment called for by both the SEC and DoL. Sequoia is also becoming an SEC-registered investment advisor – a fiduciary status permitting them to advise individuals. The creation of hybrid funds is something we predicted - but for 2029 not 2022 (oh well).

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