FrontLine Research Paper

EXIT ENVIRONMENT IN 2020 AND EVOLUTION OF HOLDING PERIODS

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INTRODUCTION

Investing in private equity funds involves a long-term commitment, ranging between two to seven years before the portfolio companies are sold and the value is distributed back to investors. However, the average holding period is not constant. It evolves with macroeconomic conditions affecting the exit environment over the years and with structural trends such as the introduction of the long-term fund offering to the industry that brings in the investment horizon of up to twenty years.

A detailed eFront Insight portfolio look-through dataset allowed us to look back into the 10-year long history of exits to analyse the evolution of holding periods and the disruptions the year of pandemic brought onto the private equity deal market. This dataset allows us to directly measure the holding period as a difference between the exit and the investment date, which is a measure superior to approximations calculated using the history of capital calls and distributions.

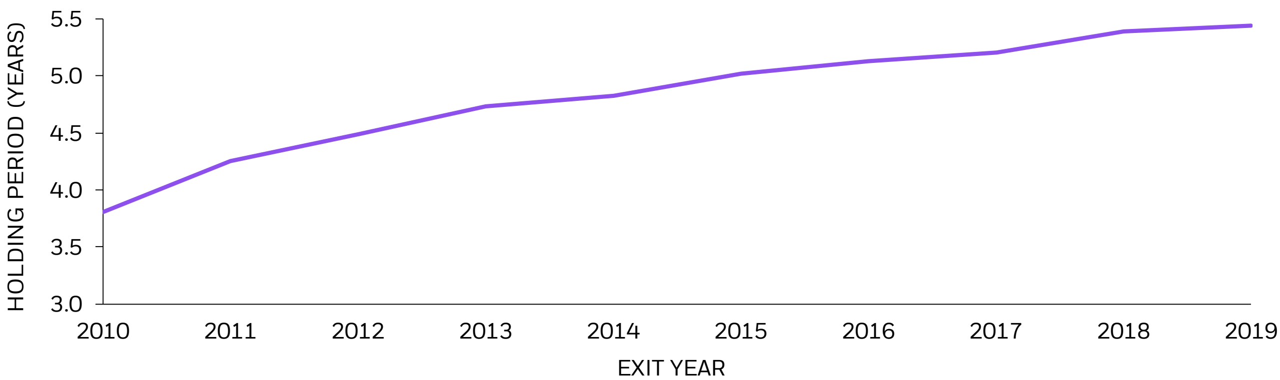
The data shows a steady increase in the average holding period ranging from less than 4 years at the start of the previous decade to almost 5.5 years in the most recent period. With only a few exceptions, the holding period for the deals exited during 2020 was longer than the historical average across all industry sectors. Simultaneously, the past year also meant the lower performance for those deals relative to the historical benchmark, except in the Information Technology and Telecommunication Services industries that were rewarded with astonishing market valuations.

The relationship between the performance and the holding period is not direct, though some exciting findings emerge. If there was a time when the speed with which fund managers were able to increase the value of the portfolio companies and sell them back to the market was the distinguishing manager selection criterion, the investor focus is now turning more in the direction of managers' ability to source the high quality deals with high profit margins and predictable cash-flows that will ultimately deliver exceptional returns.

HOLDING PERIOD AND PERFORMANCE

Historical analysis of the holding periods in private equity clearly shows a steady increase over the past 10 years. The three-year moving average holding period in 2010 was measured at 3.8 years. Since then, private equity funds have held their portfolio assets over a longer time, reaching the maximum in 2019 with a three-year average holding close to 5.5 years (Figure 1).

Figure 1 – Holding period across deal exit years (three-year moving average) for deals with exit years (2010 – 2020)



Source: eFront Insight, As of Q4 2020. The chart displays the three-year moving average of the portfolio company holding period. The deals are pooled by their year of exit and the value-weighted three-year average holding period is calculated as a difference between the exit and the investment date.

Table 1 – Distribution of deals per holding period

Holding Period	Fraction of Deals
1	6.3%
2	9.9%
3	13.7%
4	16.7%
5	15.2%
6	11.5%
7	9.0%
8	6.2%
9	5.0%
10	3.1%
11	1.6%
12	1.9%

Source: eFront Insight, As of Q4 2020.

Table 1 shows that most deals had their exits after 3 to 6 years of being kept in a portfolio. Historically, only 3.5% of assets have been managed beyond 10 years.

The increasing holding period does not necessarily reflect the worsening exit climate for the PE-backed companies.

Relatively new long-term fund strategies with holding periods of 10, 15 or even 20 years have yet to effectuate the exits for their portfolio companies, but the historical evidence of performance must have provided a proof of concept supporting this PE sub-strategy.

Another competing explanation is that those fund managers who hold high-quality companies in their portfolios choose to resort to dividend recapitalizations and hold on to these companies with further potential to grow.

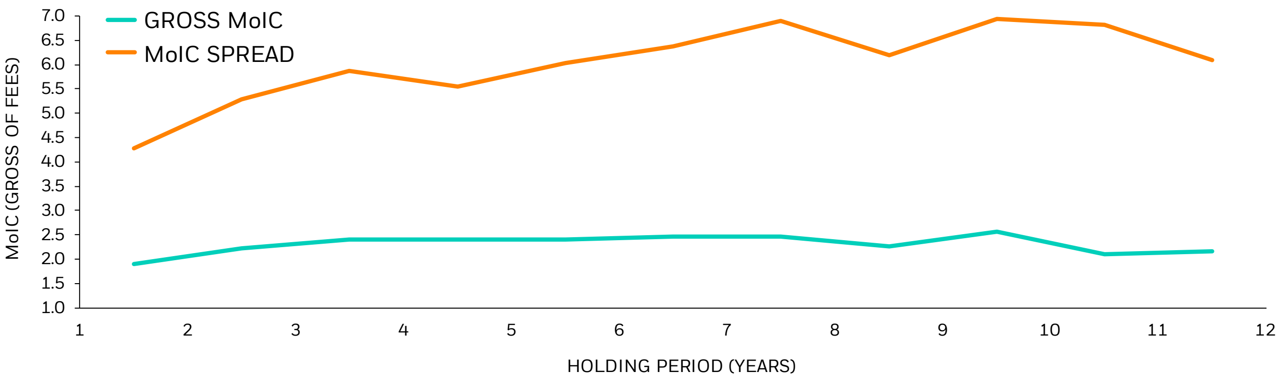
Deciding to sell a portfolio company undoubtedly includes the market timing considerations. Besides the evolving exit market conditions, the question remains if a long holding period plays a role in a deal's performance.

The average multiple of invested capital is showing an interesting pattern (Figure 2). Holding a company for less than two years will on average deliver less than 2x of multiple on invested capital (MoIC), gross of fees. The average MoIC increases with a holding period of up to 5 years and then it stabilizes around 2.5x.

It starts increasing again after 8 years of holding period and reaches its maximum value of 2.6x gross of fees for the deals held between 9 and 10 years in portfolios. It is important to note that there is no causal relationship between the holding period and the subsequent performance for this subset of deals (making only 4% of the total number of deals in the eFront Insight deal data).

The spread in performance is measured as a difference between the top 5% performing and the bottom 5% performing assets. This measure of selection risk is also increasing with the holding period, going from 4.3x for a 2-year holding period up to 8.2x for holding an asset for 11 years (Figure 2).

Figure 2 – Average MoIC and the spread in MoIC between the top and bottom 5% performing assets per deal holding period range for deals with exit years (2005 – 2020)



Source: eFront Insight, As of Q4 2020. The chart displays the absolute measure of multiple of invested capital, gross of fees. It is calculated as total realized value divided with total invested capital. The deals from the sample are pooled by their holding period between exit and investment date and the average MoIC is calculated. The spread in MoIC for each holding period range is calculated as a difference between the top 5% performing asset and the bottom 5% performing one.

ABOUT EFRONT INSIGHT PORTFOLIO DEAL ANALYTICS

eFront Insight Data Services (IDS) streamlines the exchange of data between limited and general partners through its SaaS-based information portal supported by data collection services. Sourced directly from GPs and subjected to rigorous validation protocols, IDS data has become the standard for data granularity and integrity.

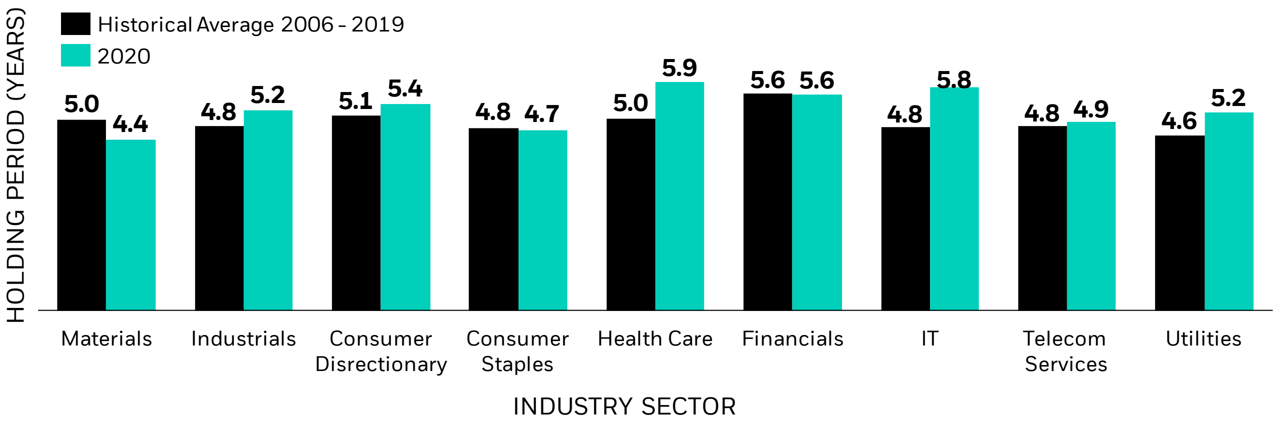
2,000+
Fund managers contributing data

75,000+
Portfolio companies and assets tracked

INDUSTRY ANALYSIS

PE companies that were sold from managers' portfolios during 2020 were held longer in portfolio relative to the historical average across industry sectors. The only exceptions are Materials and Consumer Staples industry sectors (Figure 3).

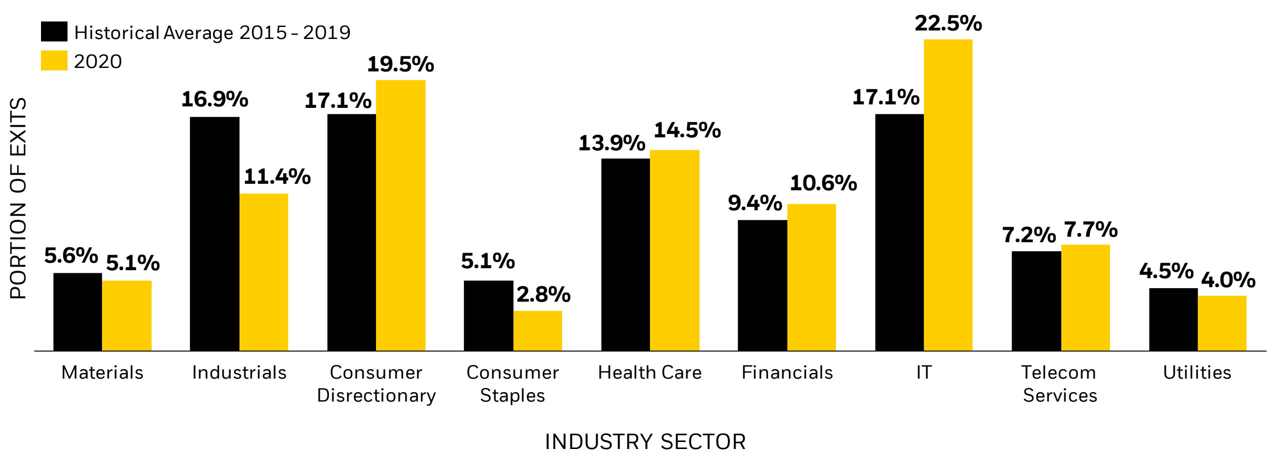
Figure 3 – Industry sector breakdown of holding periods for deals sold during 2020 benchmarked against the historical average (exit years 2006 – 2019)



Source: eFront Insight, As of Q4 2020. The chart displays average holding period for the deals with exit years from the period 2006 – 2019 and for the deals with exits in 2020, pooled by the industry sector.

Interestingly, the industry sectors that experienced the most significant positive deviations in the holding period relative to the historical average, such as IT, Health Care and Consumer Discretionary, were also overrepresented in the total number of exits that were realized during 2020 (Figure 4).

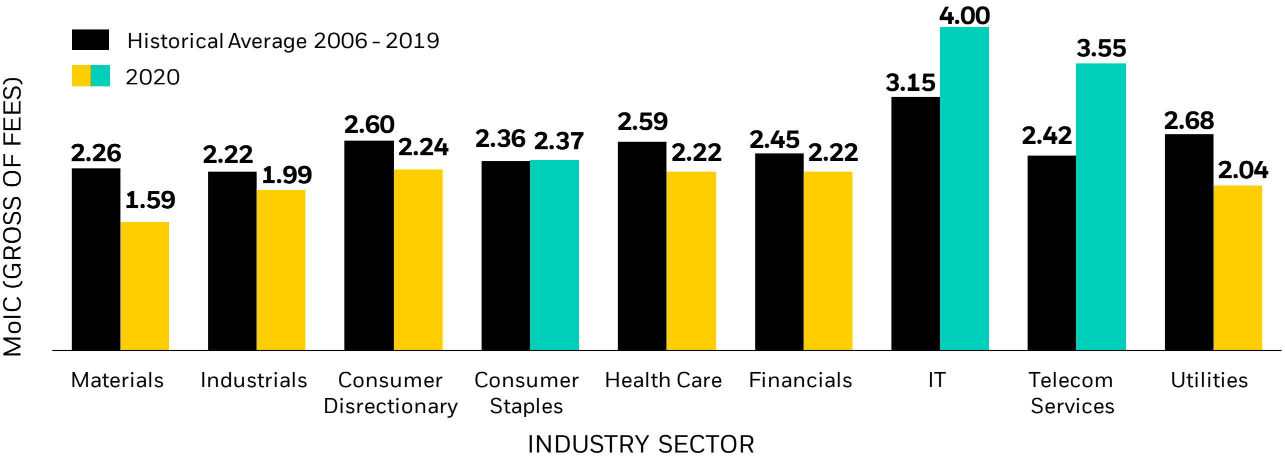
Figure 4 – Industry sector representation in total exit activity in 2020 relative to the historical average



Source: eFront Insight, As of Q4 2020. The chart displays the portion of deals sold during 2020 from each industry sector in the total number of exits realized in 2020.

Remote nature of 2020 everyday life gave rise to high levels of IT and Telecommunication Services industry deal valuations (Figure 5). An average IT deal achieved an average MoIC of 4x, closely followed by Telecom deals with average MoIC of 3.5x. The sharpest drop in realized performance has been recorded with PE-backed companies operating in Materials and Utilities industries.

Figure 5 – Industry sector breakdown of MoIC for deals sold during 2020 benchmarked against the historical average (exit years 2006 – 2019)

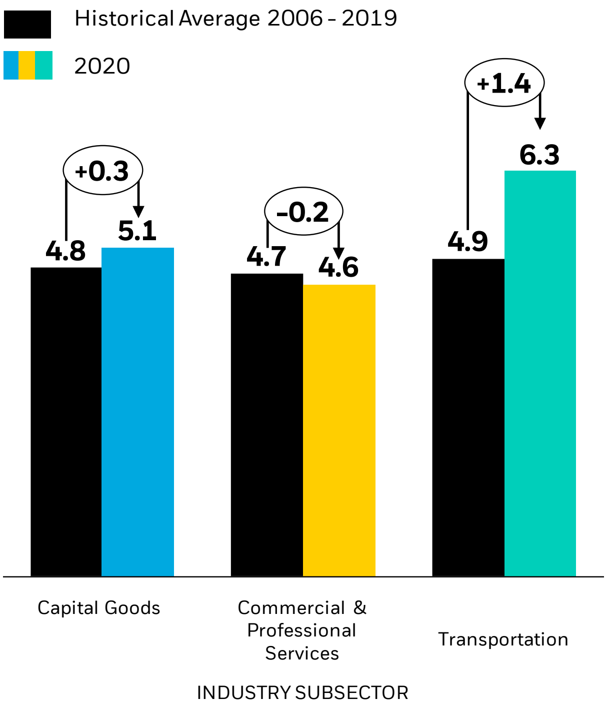


Source: eFront Insight, As of Q4 2020. The chart displays multiple on invested capital, gross of fees, for the deals with exit years from the period 2006 – 2019 and for the deals with exits in 2020, pooled by the industry sector.

The Industrials sector suffered the largest reduction in its overall representation among the total deals realized during 2020 (Figure 4).

Further breakdown across the Industrials sub-sectors reveals that companies operating in the Transportation business that were sold during 2020 were held for 1.4 years longer than the historical deals from the same sub-sector (Figure 6).

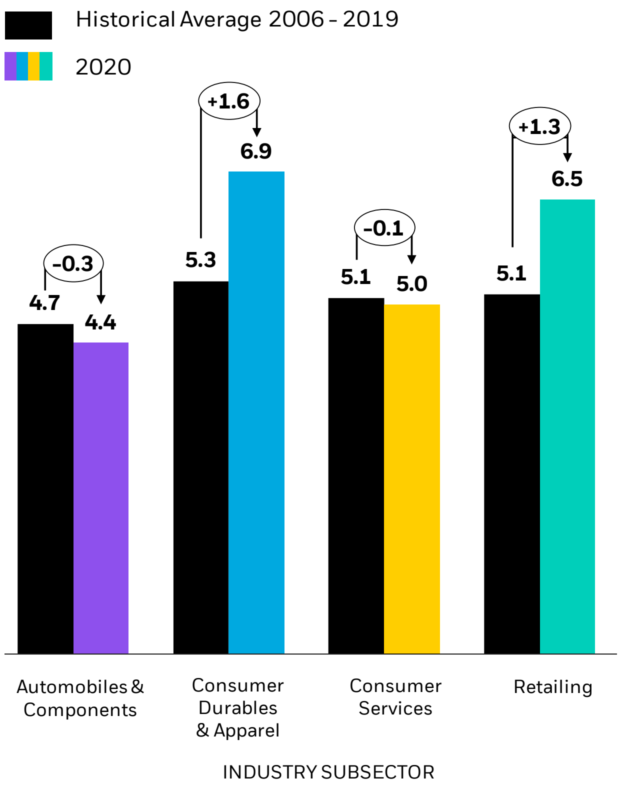
Figure 6 – Industrials sub-sector breakdown of holding period for deals sold during 2020 benchmarked against the historical average (exit years 2006 – 2019)



Source: eFront Insight, As of Q4 2020. The chart displays average holding periods for the deals with exit years from the period 2006 – 2019 and for the deals with exits in 2020, pooled by the Industrials sub-sector.

Within the Consumer Discretionary industry sector, the sub-sectors diverge in the holding period dynamics in 2020 (Figure 7). Automobiles and Consumer Services deals were sold somewhat earlier than expected, while Consumer Durables and Retailing deals were held significantly longer in portfolios prior to their exits last year.

Fig. 7 – Consumer Discretionary sub-sector breakdown of holding periods for deals sold during 2020 bench-marked against the historical average (exit years 2006 – 2019)



Source: eFront Insight, As of Q4 2020. The chart displays average holding periods for the deals with exit years from the period 2006 – 2019 and for the deals with exits in 2020, pooled by the Consumer Discretionary sub-sector.

ABOUT EFRONT INSIGHT

eFront Insight's portfolio look-through data allowed us to look back into the 10-year long history of exits to analyze the evolution of holding periods and the disruptions the year of pandemic brought to the PE market. Our data offers portfolio asset characteristics, including the investment start and exit dates, the granular industry sub-sector classification, information on assets' market values and costs of investment to support this unique analysis of holding periods and asset level performance.

EFRONT INSIGHT DATA SERVICE

Granular, high-quality, verified data and KPIs about:

- fund managers
- funds
- underlying assets

across all asset classes: Private Equity, Real Estate, Infrastructure and Private Debt

2,000+
managers providing data every quarter

75,000+
portfolio companies & properties already tracked

125+
data analysts to collect and verify data

>7,000
funds collected on quarterly basis

Insight allows for the creation of custom portfolios to analyze performance across multiple investments at both the fund and underlying asset level. Portfolios can be sliced and diced using filtering and re-weighted to perform what-if analysis and understand the effects on portfolio performance.

- Track and monitor performance and exposure of investment or analysis portfolios by asset characteristics such as geography, strategy, vintage, manager, currency, sector, etc.);
- Benchmark the performance of their investments and portfolio against industry benchmarks using quartiles and a named peer fund universe, PME, PME+, Alpha, TWR, IRR and multiple;
- Track value and performance drivers through value bridges and distribution of returns across different metrics;
- Track and monitor cash activity through various views such as J-Curve;
- Ability to configure the views for portfolios, investments, funds, companies, properties and managers choosing from a library of pre-built widgets;
- Export into PDF any area or the all the dashboards for given portfolio, investment or underlying asset.

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