eFront Quarterly Report

Private Equity Performance Overview

Returns, risks and liquidity of VC Funds in Q3 2019

Source: eFront Insight

eFront
a part of BlackRock

Introduction

eFront is the leading provider of alternative investment technology, focused on enabling industry professionals to achieve superior performance. This report leverages high quality data and powerful analytics coming from eFront Insight. eFront Insight combines multiple data sources into one analytical platform. It includes a proprietary benchmark for alternative investment performance, counting over 4,000 funds across geographies, strategies, sizes and vintage years. This is the main data source of this report. On a quarterly basis, eFront publishes an updated report showing the performance of LBO and VC funds in terms of returns, risks and liquidity. The performance of LBO and VC funds are analyzed in a sequence one quarter after the other.

The aim of this report is to provide readers with elements of analysis and understanding of the private finance universe, based only on data collected by eFront Insight. It does not intend to draw any definitive conclusion, nor judge the performance of fund managers. By providing a guided reasoning, this report hopes to contribute to the overall progress of understanding of the asset class in a short quarterly format, with all the limits that this entails.

Contents:

1. Global Market Performance Overview 4
   - Return analysis 5
   - Risk analysis 6
   - Liquidity analysis 8

2. Vintage Year & Regional Performance Overview ..10
   - General evolution 11
   - US VC funds 12
   - Western European VC funds 13

3. Methodology 14

1. Global Market Performance Overview

Summary of the analysis

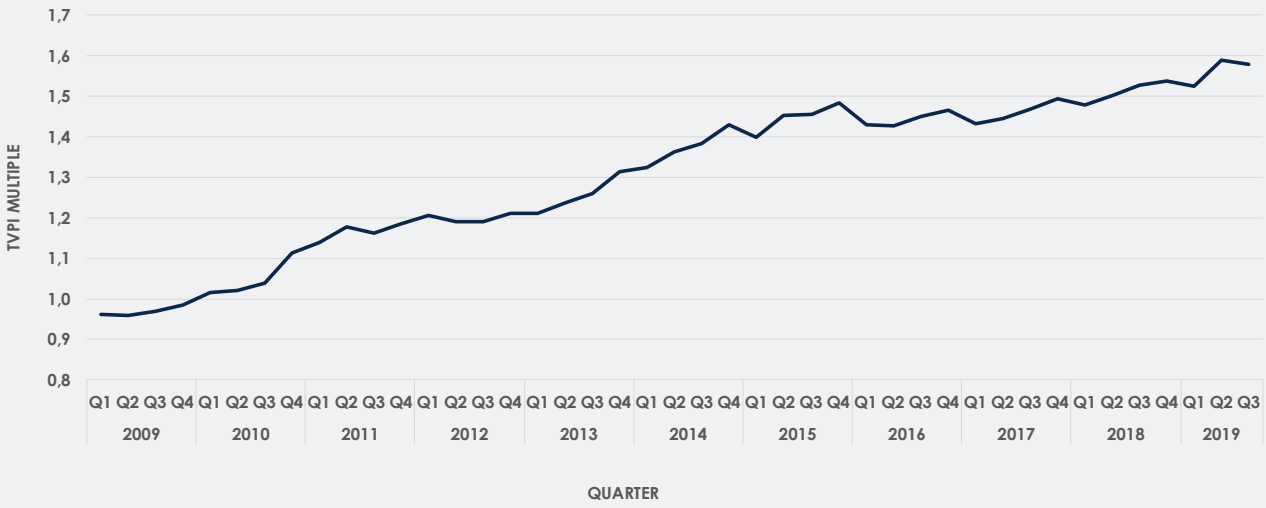
Q2 2019 has recorded the highest average of the performance of active VC funds over the last ten years. Selection risk increased and is back to the 2015-2016 level. On a risk-adjusted basis, the performance is thus impressive, but mostly unrealized as investors are holding the assets for more extended periods.

Return analysis (Fig.1 and 2)

Over the course of the last two quarters, multiples on invested capital (TVPI) of active VC funds are approaching 1.6x. After a rather stable period of four years during which TVPIs fluctuated between 1.40x and 1.55x, 2019 has recorded an apparent increase from 1.53x in Q1 2019 up to 1.58x in Q3 2019. This expansion happened in the broader context of a very favorable environment during which listed stocks rallied after a correction in Q4 2018.

So far, 2019 has been an historical year for VC funds. Returns are at an all-time high, and although risks increased, they remained within known territory.

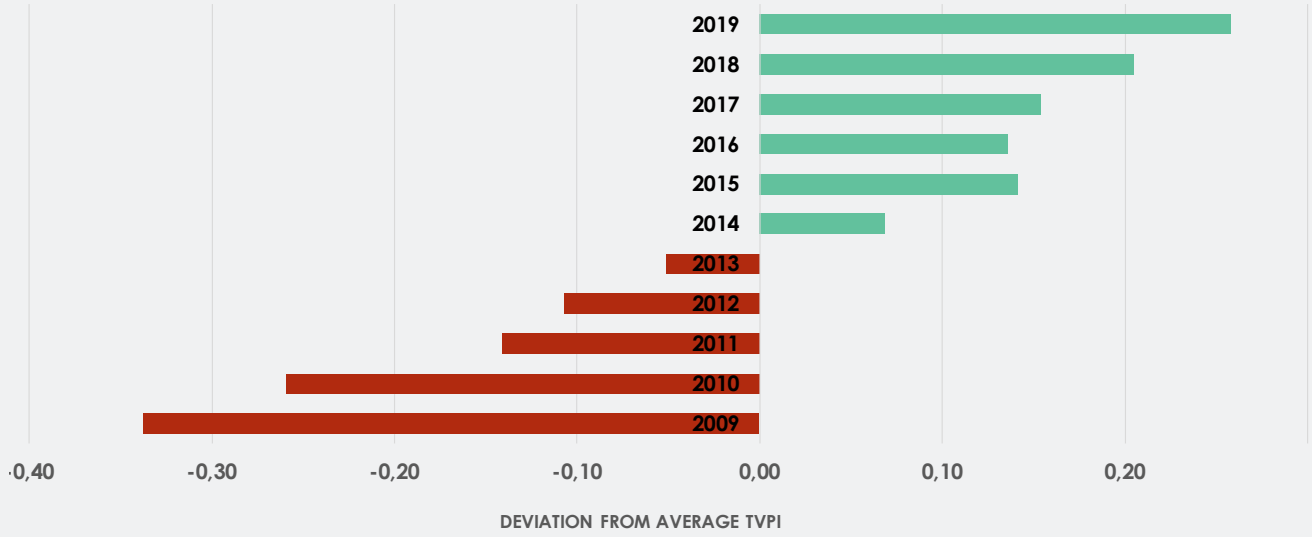
Fig. 1 – Return evolution of active VC funds



Source: eFront Insight, As of Q3, 2019

2019 marks a new all-time high and, so far, ranks first in terms of positive return deviation. Moreover, the gap between 2019 and the second highest year has sharply increased (+34.7%). In that respect, 2019 is the inversed mirror of the very negative year 2009.

Fig. 2 – Return deviation from the average of active VC funds



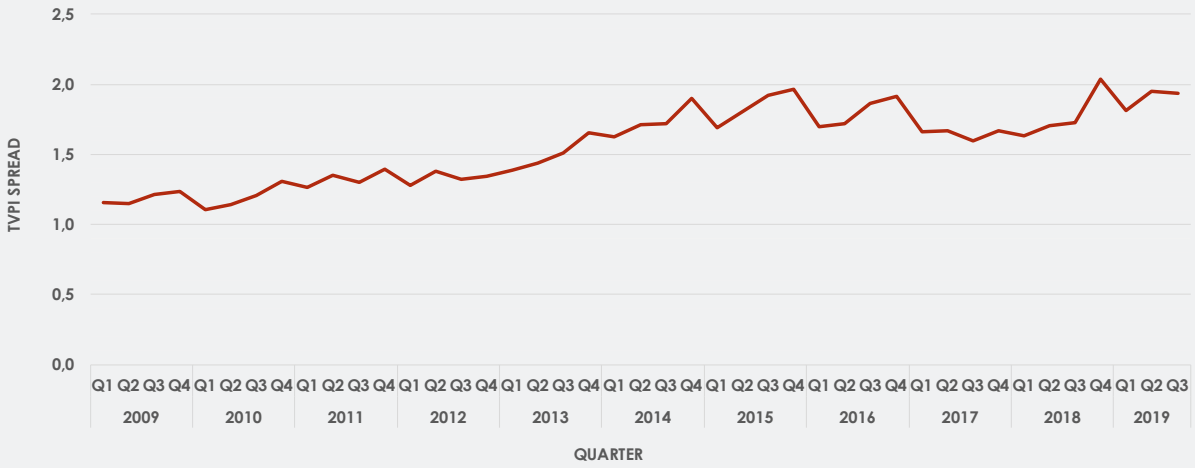
Source: eFront Insight, as of Q3 2019. Basis 0 = net average of 1.31x

Risk analysis (Fig. 3 and 4)

The increase in pooled performance is associated with an increase in selection risk, as measured by the TVPI spread. However, if the performance of active funds has reached an all-time high, the selection risk did not increase in the same proportions. The selection risk increased by 12% from 1.73x in Q3 2018 up to 1.93x in Q3 2019. The level of selection risk remains relatively close to those of Q4 2015 (1.964x) and Q4 2016 (1.911x). The long-term average anchors itself solidly beyond the 1.5x threshold.

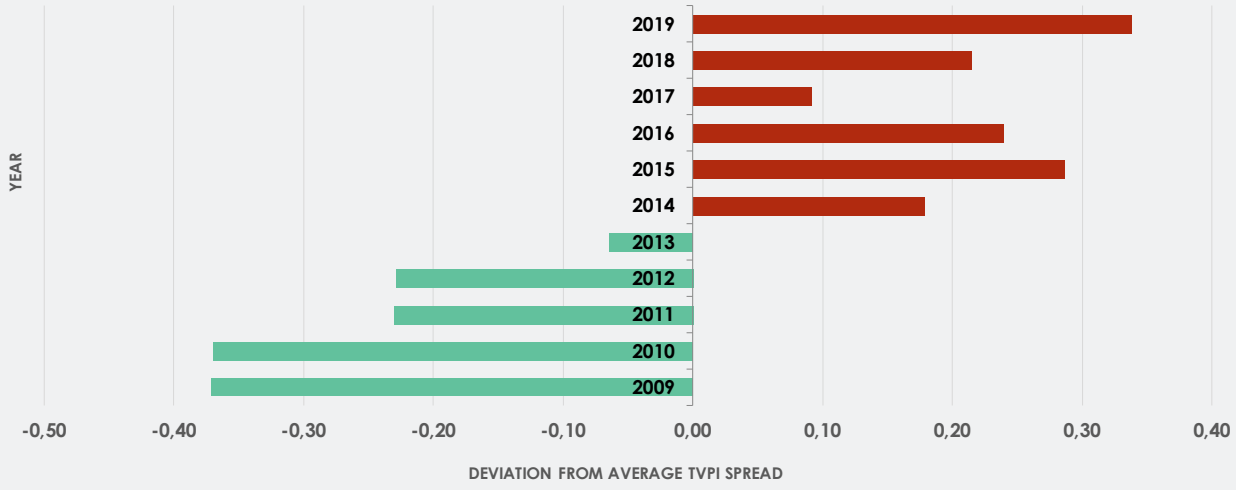
Not only had the best funds driven the performance, but the less performing ones also managed to improve. Thus, all the active funds have benefited from an upward movement, bringing the question of how much of this performance improvement is related to the contagion to start-up valuations of the progression of listed stocks.

Fig. 3 – Risk evolution of active VC funds



Source: eFront Insight, As of Q3, 2019

Fig. 4 – Risk deviation from the average of active VC funds

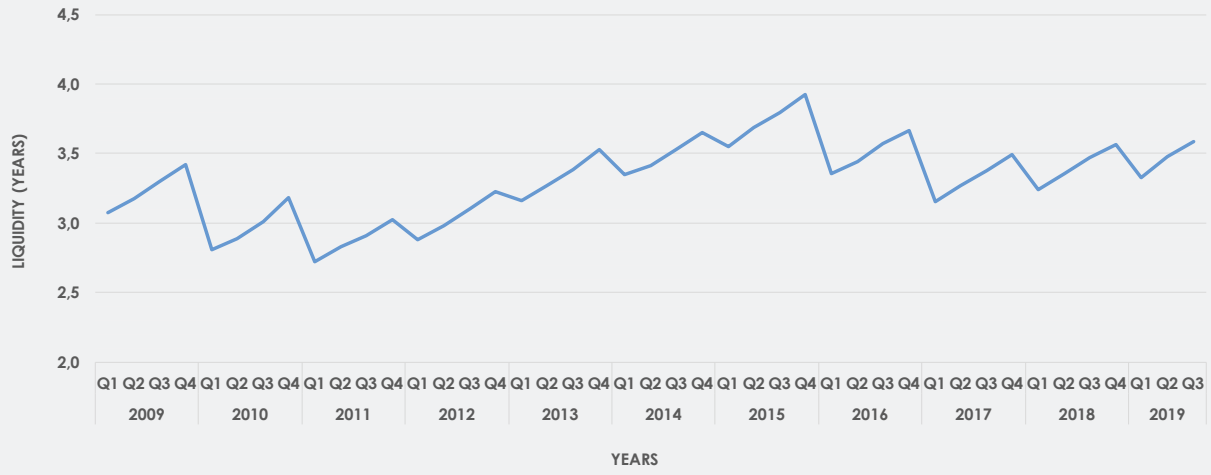


Source: eFront Insight, as of Q3 2019. Basis 0 = average of 1.56x.

Liquidity analysis (Fig. 5 and 6)

Over the last three years (2016, 2017, and 2018), a pattern has emerged with a sharp drop in time-to liquidity during the first quarter with successive recovery. Nevertheless, the recovery never managed to compensate for the initial descent until 2018. The result was a global downward trend of the time-to-liquidity indicator.

Fig. 5 – Liquidity evolution of active VC funds

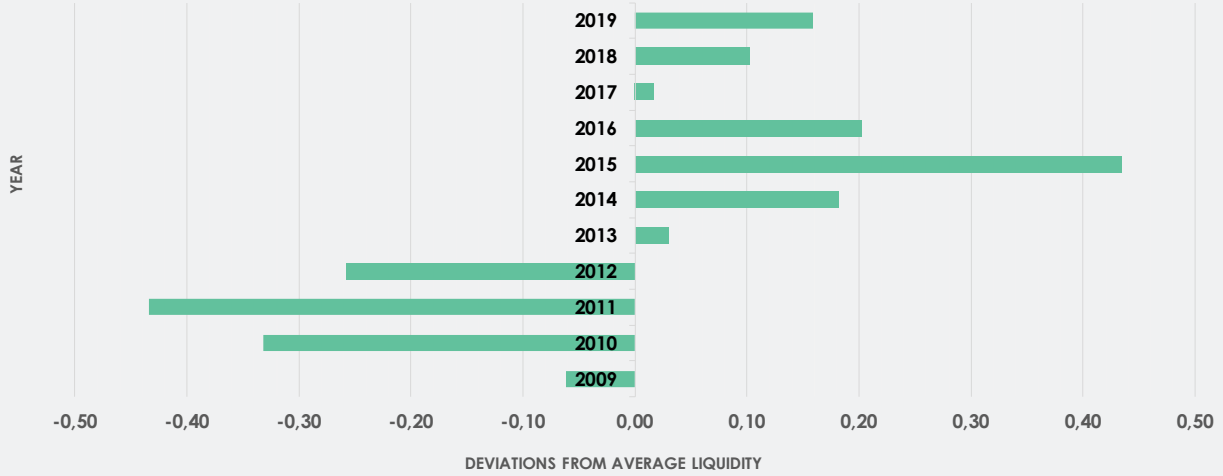


Source: eFront Insight, As of Q3, 2019

So far, 2019 goes against the downward trend. Although the first quarter has recorded a decrease in time-to-liquidity, this decrease was far smaller than the one recorded during the three previous years and much closer to the one recorded in 2012, 2013 and 2014. Moreover, the subsequent recovery more than compensated the initial drop. As a result, the average time-to-liquidity increased from 3.41 in 2018 to 3.47 in 2019.

2019 and 2018 also mark the return of VC funds into positive territory in terms of deviation from the average time-to-liquidity, as 2017 promised the reversal towards shorter time-to-liquidity. Both could also signal an overall stabilization of time necessary to generate liquidity at a level of around 3.4 years.

Fig. 6 – Liquidity deviation from the average of active VC funds



Source: eFront Insight, as of Q3 2019. Basis 0 = average holding period of 3.31 years.

2. Vintage Year & Regional Performance Overview

Summary of the analysis

2019 saw a significant increase of performance so far. US VC funds registered a spectacular progression during Q2. Western European VC funds continue to significantly outperform the long-term average, setting a new course away from the historical pattern.

General evolution (Fig. 7)

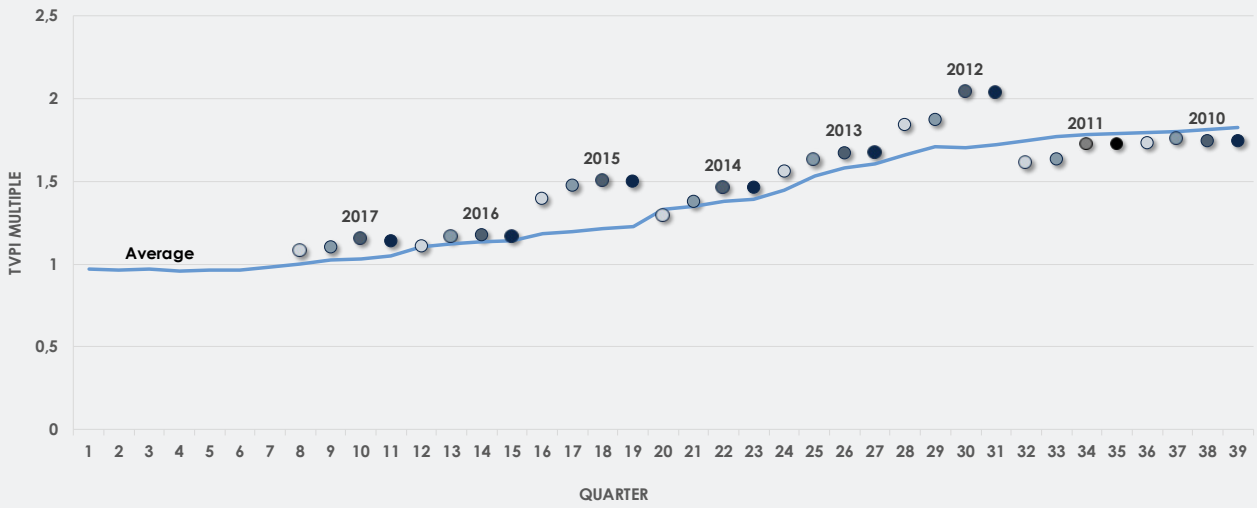
The second quarter of 2019 was pivotal as it marked a significant increase in valuation. Q3 2019 marked a relative stabilization. The progression of listed equity valuations might explain such an increase in valuation. The performance of the vintage year (VY) 2010 remains slightly below the historical average. VY 2011 managed to edge closer to the average thanks to its profound appreciation in Q2 2019. It is now following the track of VY 2010.

Q2 2019 marked a strong progression, followed by a relative stabilization in Q3. US VC funds have recorded more contrasted performance increases, while Western European ones were more regular and incremental.

As for other vintage years:

- 2012 remains on track to significantly outperform the historical average. This outperformance even increased in Q2
- 2013 continues to outperform moderately the historical average
- 2014 diverged from the average and is now on track to follow 2013 towards a moderate outperformance
- 2015 seems to follow 2012 towards a significant outperformance, although its progression during Q2 was a bit milder than for the latter
- 2016 is closely following the historical averages

Fig. 7 – Evolution of multiples of active VC funds

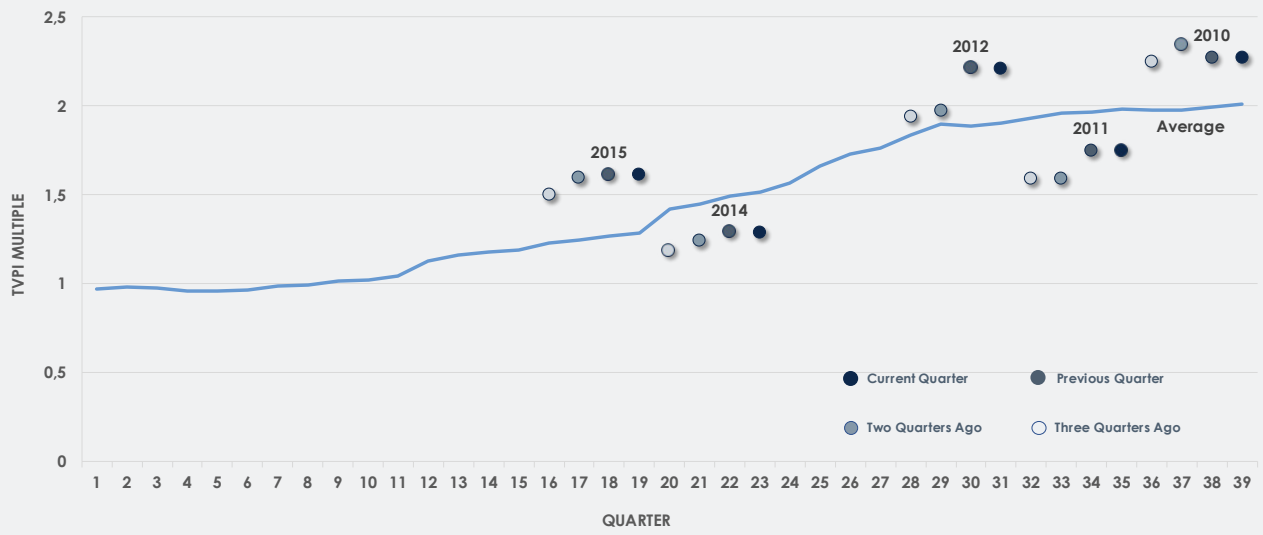


Source: eFront Insight, as of Q3 2019. Active funds grouped by vintage year. The current average includes only fully realized funds to 2009. Reference currency: USD.

US VC funds (Fig. 8)

US VC funds have recorded a surge in valuation on Q2 across the board. This increase in valuations allowed VY 2014 to catch up with the historical average. VY 2011 also got closer to the long-term average but still remains below it. VY 2012 increased its outperformance and is expected to follow the VY 2010 in a strong finish. VY 2015 has stabilized since Q1 2019 but still outperform its historical peers.

Fig. 8 – Evolution of multiples of US VC funds

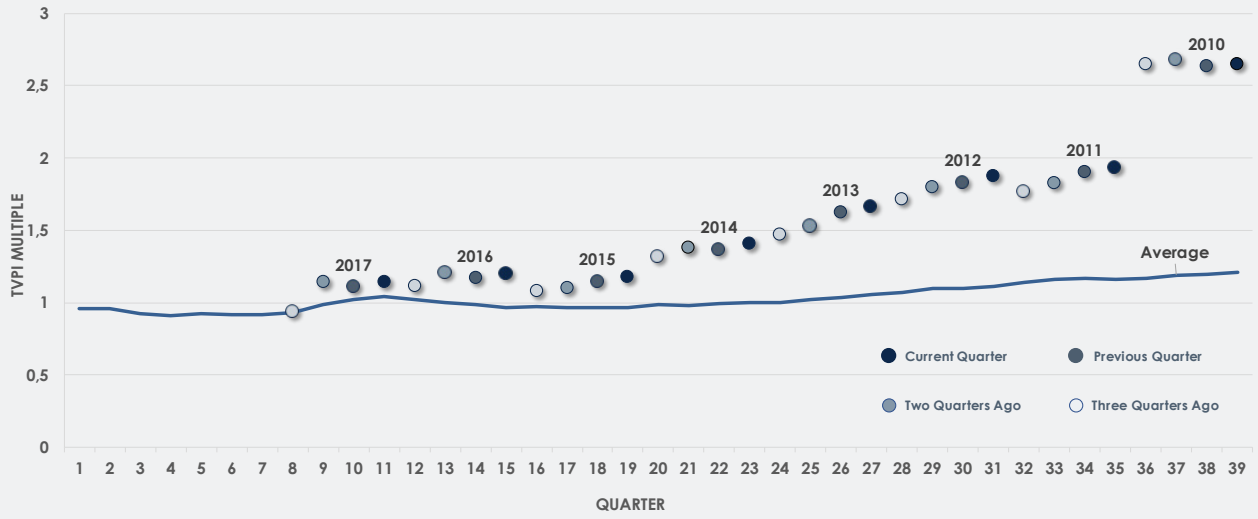


Source: eFront Insight, as of Q3 2019. Active funds grouped by vintage year.
The current average includes fully realized funds to 2009. No data for 2013. Reference currency: USD

Western European VC funds (Fig. 9)

WE VC funds still outperform the historical average. The valuation evolution can be split into two groups for the past four quarters: an incremental increase (for VY 2015, VY 2013, VY 2012 and VY 2011) and a more volatile profile with a drop recorded in Q2 2019 followed by an increase in Q3 (for VY 2016, VY 2014 and VY 2010). Overall, the evolution of WE VC funds is more regular and incremental than that of US VC funds.

Fig.9 - Evolution of multiples of W. European VC funds



Source: eFront Insight, as of Q3 2019. Active funds grouped by vintage year.
The current average includes only fully realized funds to 2009. Reference currency: EUR.

3. Methodology

Global Overview

Fig. 1 is based on multiples of invested capital (total value to paid-in, TVPI), the sum of capital distributed (distributed to paid-in, DPI) and net asset values (residual value to paid-in, RVPI). The purpose is to exhibit the evolution over time of valuations of active funds only, to get a perspective on performance in the making. Each quarter, a snapshot of the pooled average TVPI of active funds is taken. These funds are active (thus not older than 10 years old) with meaningful performance (thus not younger than two years old). In 2010, active vintage years are from 2001 to 2008. The purpose is to track the evolution of active portfolios and their maturity to compare them over time.

Fig. 2 compares quarterly deviations of TVPIs of active funds from the historical average of TVPIs of active funds (as a base 0). The purpose is to exhibit evolutions over time when compared to a long-term reference point. Except for the quarter considered (or full year when considering Q4), historical deviations are grouped per year (thus the snapshots taken in Q1, Q2, Q3, Q4 2010 are grouped as an average under "2010"). If TVPIs are above average, they exhibit a relative excess of performance during the period considered. If TVPIs are below average, they exhibit a relative lack of performance during the period considered.

Fig. 3 is based on the difference between top 5% and bottom 5% TVPI (TVPI spread), which is used as a measure of LBO fund selection risk. The resulting graph shows a quarterly evolution. The purpose is to exhibit the evolution over time of the dispersion of performance of the best and worst fund managers. Each quarter, a snapshot of the TVPI spread of active funds is taken. These funds are active (thus not older than 10 years old) with meaningful performance (thus not younger than two years old). In 2010, active vintage years are from 2001 to 2008. The purpose is to track the evolution of active portfolios and their maturity to compare them over time.

Fig. 4 compares quarterly deviations of TVPI spreads of active funds from the historical average of TVPI spreads of active funds (as a base 0). The purpose is to see evolutions over time when compared to a long-term reference point. Except for the quarter considered (or full year when considering Q4), historical deviations are grouped per year (thus the snapshots taken in Q1, Q2, Q3, Q4 2010 are grouped as an average under "2010"). If TVPI spreads are above average, they exhibit a relative excess of risk during the period considered. If TVPIs are below average, they exhibit a relative lack of risk during the period considered.

Fig. 5 is based on the calculated time-to-liquidity (measured as a function of TVPI and IRR, to extract the time necessary to achieve the second from the first). The purpose is to exhibit the evolution over time of the time necessary to generate liquidity, whether through exits, dividend recaps, but also write-offs. This measure is theoretical and sensitive to the assumption that portfolios are considered as liquid during the quarter in which the snapshot is taken. Each quarter, a snapshot of the pooled average TVPI and IRR of active funds is taken. These funds are active (thus not older than 10 years old) with meaningful performance (thus not younger than two years old. In 2010, active vintage years are from 2001 to 2008. The purpose is to track the evolution of active portfolios and their maturity to compare them over time.

Fig. 6 compares quarterly deviations of time-to-liquidity (measured in years) of active funds from the historical time-to-liquidity of active funds. The purpose is to exhibit evolutions over time when compared to a long-term reference point. Except for the quarter considered (or full year when considering Q4), historical deviations are grouped per year (thus the snapshots taken in Q1, Q2, Q3, Q4 2010 are grouped as an average under "2010"). If the time-to-liquidity falls below 2.5 years or exceeds 4 years, it is considered sub-optimal. In the case of a time-to-liquidity shorter than 2.5 years, fund managers do not have the time to maximize their performance. In the case of a time-to-liquidity above 4 years, fund managers struggle to exit or refinance their assets and might have difficulties to maximize performance.

Vintage Year and Regional Overview

This analysis is based on the fact that private equity funds follow a certain course from inception to their liquidation. To shed a light on the funds currently active, we plot their pooled average TVPI during the current and past three quarters. These funds are aggregated by vintage year. TVPIs provide a perspective on realized and unrealized returns. TVPIs of active funds at a certain stage of their development can usefully be compared with the TVPIs of fully realized funds at the same stage of their development. The latter ones are materialized by the continuous blue line on the graphs and aggregated funds fully realized funds of vintage year up to 2009.

About eFront

eFront is the leading pioneer of alternative investment technology, focused on enabling alternative investment professionals to achieve superior performance. With more than 850 Limited Partner, General Partner, and Asset Servicer clients in 48 countries, eFront services clients worldwide across all major alternative asset classes. The eFront solution suite is truly unique in that it completely covers the needs of all alternative investment professionals end-to-end, from fundraising and portfolio construction to investment management and reporting.

In 2019, eFront was acquired by BlackRock and since then operates as a specialized business unit within BlackRock Solutions, alongside Aladdin Institutional and Aladdin Wealth. For more information, please visit www.efront.com

About eFront Insight

eFront Insight is a sophisticated web-based analytical platform dedicated to alternative investments and combining granular, high quality investment data reported by General Partners, leading market benchmarks and other relevant sources in order to generate unique insights and facilitate investment decision making. eFront Insight is available to both General Partners to digitize data exchanges with investors and to Limited Partners to enhance decision making.

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