

eFront Quarterly Report

Private Equity Performance Overview

Returns, risks and liquidity
of LBO Funds
in Q2 2019

Source: eFront Insight

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.

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1. Global Market Performance Overview

Summary of the analysis

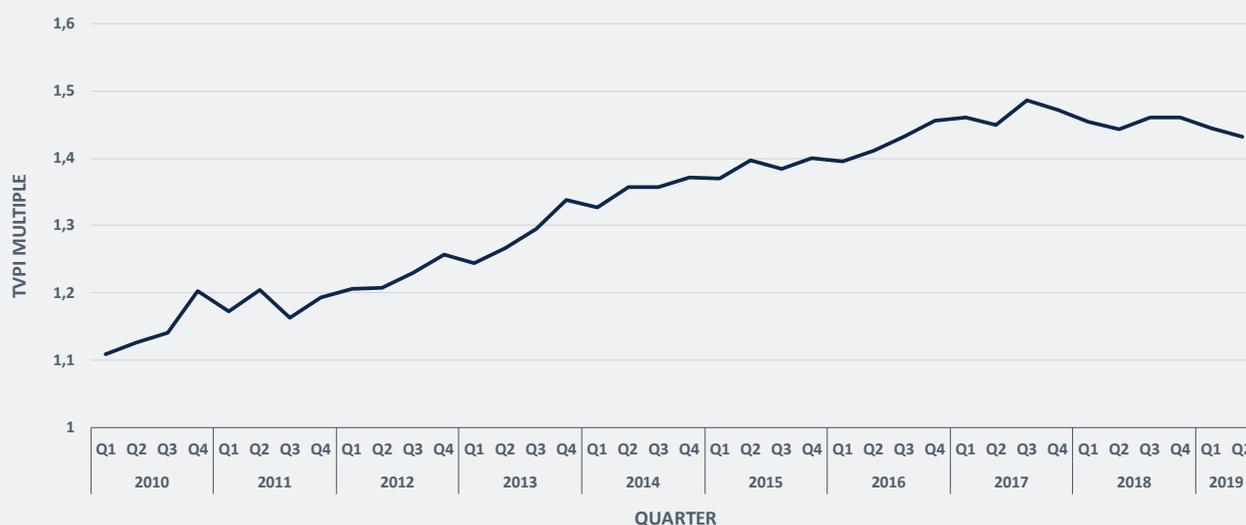
The first half of 2019 sees active LBO funds maintaining a high level of performance. Selection risk has decreased significantly, as well as time-to-liquidity, both hinting at a wave of new investments during that period. Recurring low interest rates and high levels of liquidity are also supportive of exits and dividend recapitalizations.

Return analysis (Fig. 1 and 2)

Since 2013, returns have either stabilized or decreased slightly over the first half of the calendar year. 2019 follows this pattern. Nevertheless, the performance of active LBO funds remains very slightly above (0.004x) the five-year average of 1.434x money multiple. Excess performance reaches 0.101x when compared to the ten-year average of 1.336x.

Stable, high multiples, sharply reduced selection risk and shorter duration of investments signal strong activity and a solid exit and refinancing environment

Fig. 1 – Return evolution of active LBO funds

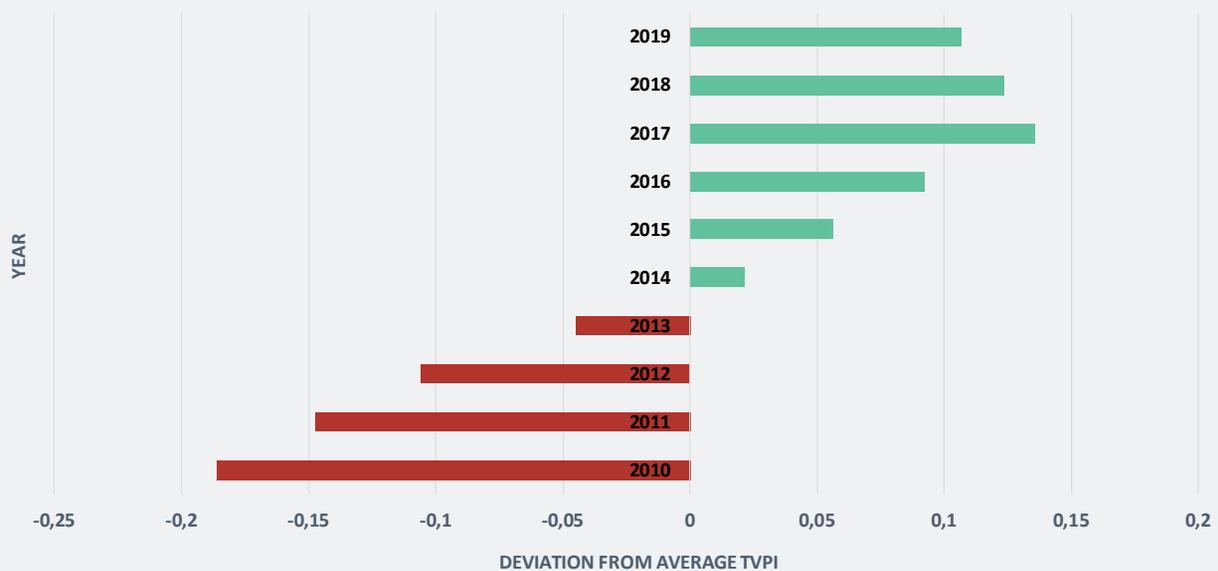


Source: eFront Insight, As of Q2, 2019

So far, 2019 continues the retreat from the peak of 2017. This is a moderate convergence towards a multiple of 1.4x. In retrospect, 2017 was an historic year, but the decline since has been subdued, with 2018 the second best and 2019 positioned to become the third-best performers this decade. However, the second half of the year might change this perspective, and 2019 could ultimately see a stabilization or even an increase in performance.

The recovery of listed stock prices during the first half of the year will clear the air for a fair market value assessment of portfolio companies in Q3 and Q4 2019.

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



Source: eFront Insight, as of Q2 2019. Basis 0 = net average of 1.331x

Risk analysis (Fig. 3 and 4)

If the performance of active LBO funds has decreased, so has the risk. Selection risk (between the top and bottom 5% funds) fell between Q4 2018 to Q1 2019, and has since stabilized. At 1.308x, the current level is close to the lowest points of Q2 2017 and Q1 2012.

A slightly lower level of performance and a sharp decrease of selection risk hint at a wave of investments in the first half of 2019. These additions to the fund portfolios are booked at purchase price minus costs and reduce the dispersion of performance between fund managers.

A longer perspective shows that the dispersion of performance of fund managers has been declining since 2010 on average. This is not a straight decline as the spike of 2016 shows. Nevertheless, after a period of stabilization in 2018, dispersion risk is on the decrease, nearly matching the historically low level of 2017.

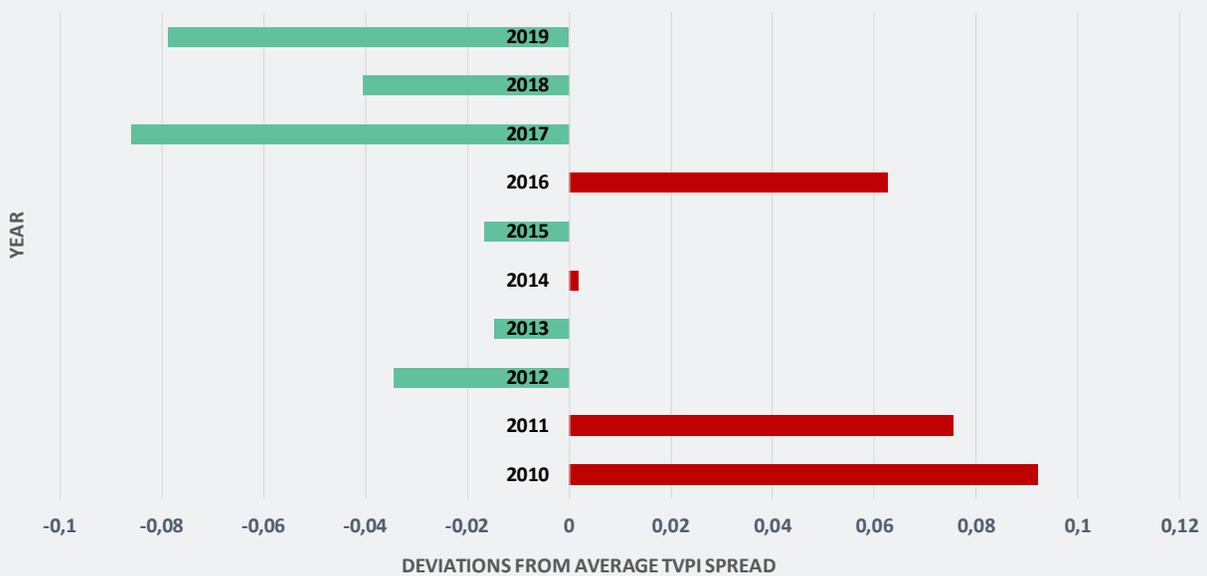
Fig. 3 – Risk evolution of active LBO funds



Source: eFront Insight, As of Q2, 2019

Should this marginally lower performance and sharply reduced risk be described as a “new normal”? It is too early to say, but there is a visible downward trend in terms of selection risk. The increasing maturity of the asset class and relatively benign macro-economic conditions can explain this risk-reduction phenomenon.

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



Source: eFront Insight, as of Q2 2019. Basis 0 = average of 1.387x.

Liquidity analysis (Fig. 5 and 6)

Since 2015, a pattern has emerged in terms of time-to-liquidity: a drop during the first quarter and an increase over the three following quarters. 2019 seems to match this pattern so far, even though the first quarter decrease is not as sharp as witnessed in the three previous years. The general downward trend initiated in 2015 seems to have reached a bottom in 2018, and since then the time-to-liquidity has stabilized at around 2.7 years.

Market conditions seem to be supportive of a higher rotation of companies in portfolios. Interest rates remain low. Industrial buyers can acquire portfolio companies thanks to abundant and fairly cheap liquidity. Moreover, the current market environment is supportive of dividend recapitalizations, which reduce significantly the time-to-liquidity. Dividend recapitalizations might explain the stabilization of time-to-liquidity just above the threshold of 2.5 years needed by fund managers to apply their skills and create value in portfolio companies.

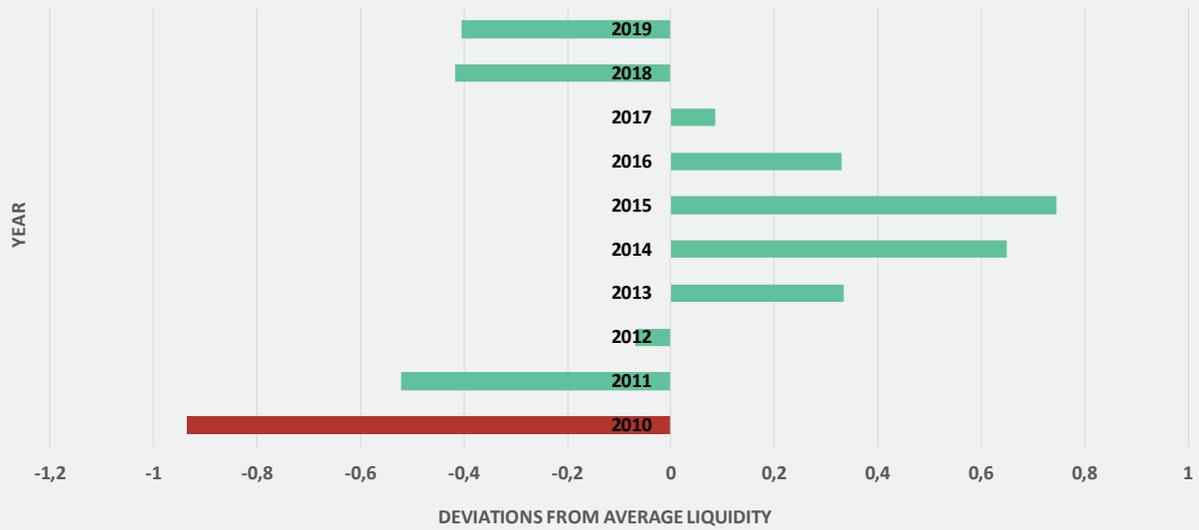
Fig. 5 – Time-to-liquidity evolution of active LBO funds



Source: eFront Insight, As of Q2, 2019

The long-term average of time-to-liquidity is now down to 3.12 years. 2019 seems on the verge of equaling or even exceeding the decrease of time-to-liquidity when compared with this long-term average. This in turn fuels more frequent and larger fund raising, as the capital distributed to fund investors can then be recycled in the next generation of funds.

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



Source: eFront Insight, as of Q1 2019. Basis 0 = average holding period of 3.12 years.

2. Vintage Year & Regional Performance Overview

Summary of the analysis

Q1 2019 provided a welcome improvement of the multiples of active funds, after a challenging Q4 2018. Q2 2019 moderated this improvement. Whether this is a pause, or the start of a deeper trend remains to be seen.

General evolution (Fig. 7)

Active LBO funds recorded a multiple increase in Q1 2019. This looks like a recovery after a decrease in Q4 2018. Q2 2019 shows a stabilisation or a slight decrease of valuations depending on the vintage year considered. Overall, the relative positioning of the vintage years is unchanged when compared to the historical average.

2010 is underperforming the historical average, and the lack of change in valuation during the first half of 2019 tends to confirm that no radical change has to be expected. 2011, 2012 and 2014 are confirming their outperformance, while 2013 flirts on and off with the historical average. 2015 is edging towards underperformance, though the funds are still young and thus subject to significant change.

The first half of 2019 is a tale of two very different quarters. The significant multiple increase of the first quarter is followed by a mild pause or decrease during the second quarter, which is not yet a cause for alarm

Fig. 7 – Evolution of multiples of active LBO funds



Source: eFront Insight, as of Q2 2019. Active funds grouped by vintage year. The current average includes only fully realized funds to 2009. Reference currency: USD.

US LBO funds (Fig. 8)

American LBO funds represent a large portion of the global pool. They notably drive the trend of an underperformance for the vintage year of 2010 and the relative outperformance of 2011 and 2014. 2012 and 2013 have crossed the line of the historical average and are now underperforming it.

Overall, active LBO funds are performing well when compared with the historical average, but the correction in valuations has moved the most recent vintage years towards the average. In particular, 2017 has recorded significant volatility of its multiple during the first half of 2019, illustrating the challenge in reaching conclusions while funds are at such an early stage of their development.

Fig. 8 – Evolution of multiples of US LBO funds



Source: eFront Insight, as of Q2 2019. Active funds grouped by vintage year. The current average includes fully realized funds to 2009. Reference currency: USD.

Western European LBO funds (Fig. 9)

Active Western European funds divide into two groups. Vintage years 2010 to 2012 are on the verge of outperformance of the historical average. The first half of 2019 confirms this progression. Vintage year 2012 strongly outperforms the historical average and is flirting with the 2.0x threshold. 2013 materialized a hiatus, as active funds are struggling to catch up with the historical trend. While 2014 was showing signs of outperformance, it eventually converged towards the average in Q2 2019.

Overall, active European LBO funds have performed well during the first quarter of 2019. Even weaker vintages such as 2013 have seen their performance improve. Q2 2019 has moderated the improvement of valuations. The second half of the year will provide further clarity on the evolution of multiples, and notably if the moderation of Q2 2019 is temporary or an indication of a deeper trend.

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



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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