Quarterly Asset Class Report
Private Equity

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canterburyconsulting.com

December 31, 2019

Role in the Portfolio

Canterbury Consulting recommends a diversified portfolio of private capital strategies. Consistently committing to private capital drives long-term asset growth, net of inflation, by taking advantage of the illiquidity premium derived from inefficient markets and superior manager selection.

– Canterbury blends strategic and opportunistic approaches to construct private capital portfolios that are diversified by sector, geography, and vintage year.

- Strategic: Using various market inputs to form a baseline, we create a recommended portfolio allocation.
- Opportunistic: We combine top-down and bottom-up analysis to achieve excess risk-adjusted returns through market intelligence and superior manager selection.

Role	Asset Categories	Risks
Growth	**Public and Private Equity**	**Market Decline**
Capital Preservation	Fixed Income, Hedge Funds	Rising Interest Rates, Highly Correlated Markets
Inflation Protection	Real Assets: Real Estate, Commodities	Deflation

– Over a full market cycle, private equity is intentioned to generate above-market returns commensurate with risks associated with the asset class (i.e., illiquidity, time horizon, etc.).

– Given the length of the time required to deploy capital and constant evolution of the opportunity set, investors in private equity must commit consistently across cycles and avoid "market timing" in order to generate returns.

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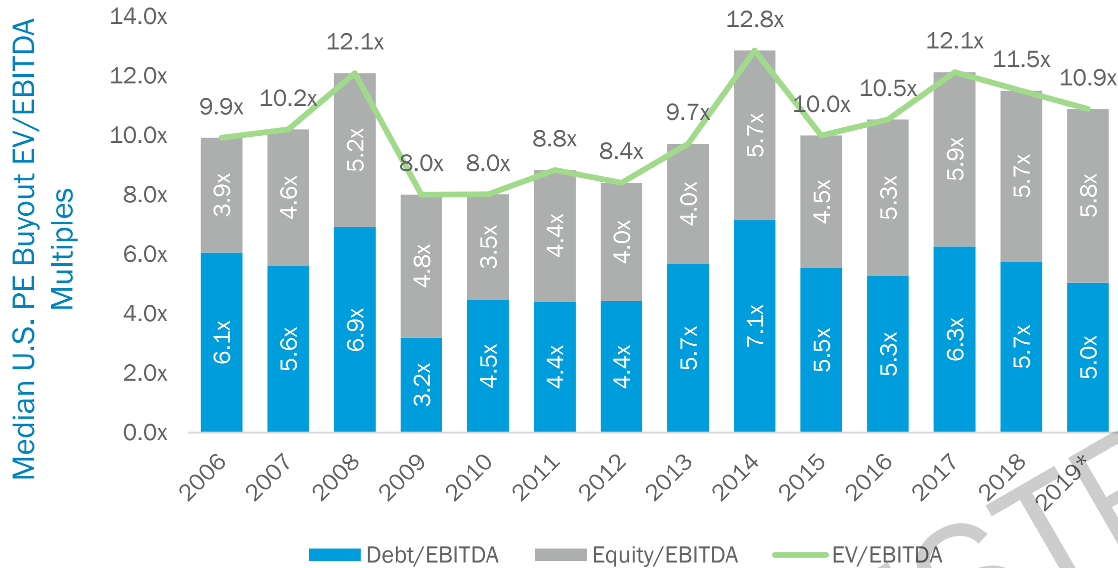
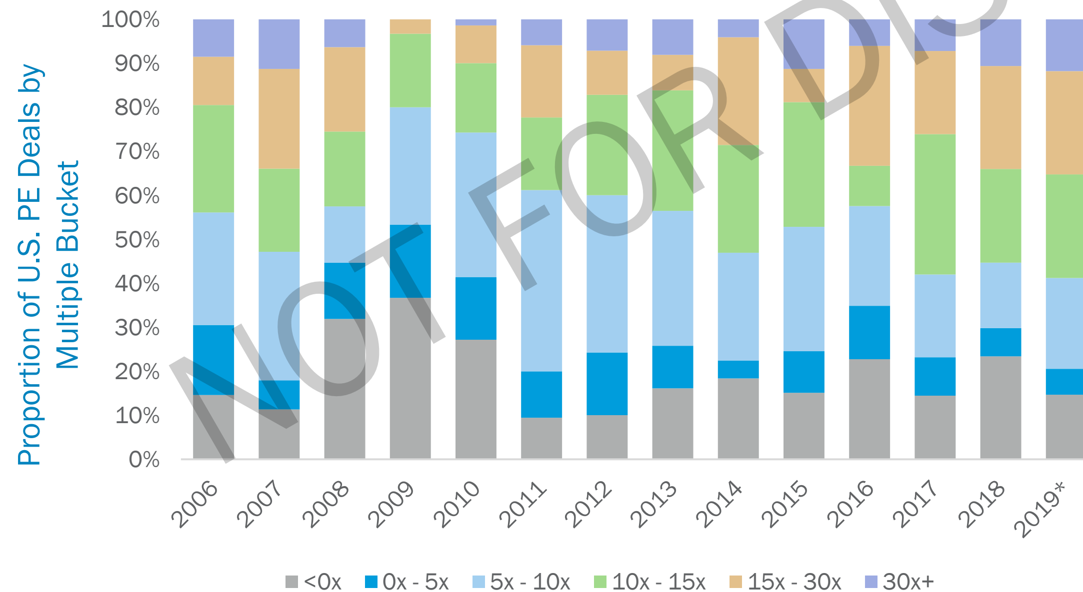
U.S. Private Equity Valuation Overview





- U.S. private equity deal multiples have remained relatively steady since 2015 and have declined the past two years to 10.9x, which is almost two turns lower than when deal multiples peaked in 2014.
- The lower proportion of debt employed in 2019 has driven down deal multiples, an indication that GPs have become more judicious with tapping into debt markets to fund their transactions.
- Deal multiples still remain substantially higher than historical averages due to factors including the following:
  - **High levels of low-priced debt in the private equity market:** The accommodative Fed monetary policy has resulted in low lending rates, which have been an instrumental part of private equity transactions. However, lenders to private equity sponsors have developed stricter lending standards and are attaching more loan covenants as a prerequisite to lending capital to help fund these transactions.
  - **Increased fundraising activity:** The increased dollars raised and current levels of dry powder have increased the competition for assets throughout the private equity markets, sustaining deal multiples at elevated levels. In Q4 alone, Leonard Green & Partners, TPG Capital, Brookfield Capital Partners, and Dyal Capital Partners raised $41.5 billion in combined commitments.
  - **Pursuit of higher growth sectors:** PE firms have invested more capital in higher growth sectors, such as IT and healthcare, which trade at higher multiples.

Source: PitchBook 2019 Annual U.S. PE Breakdown
**2019 figures are through December 31, 2019*

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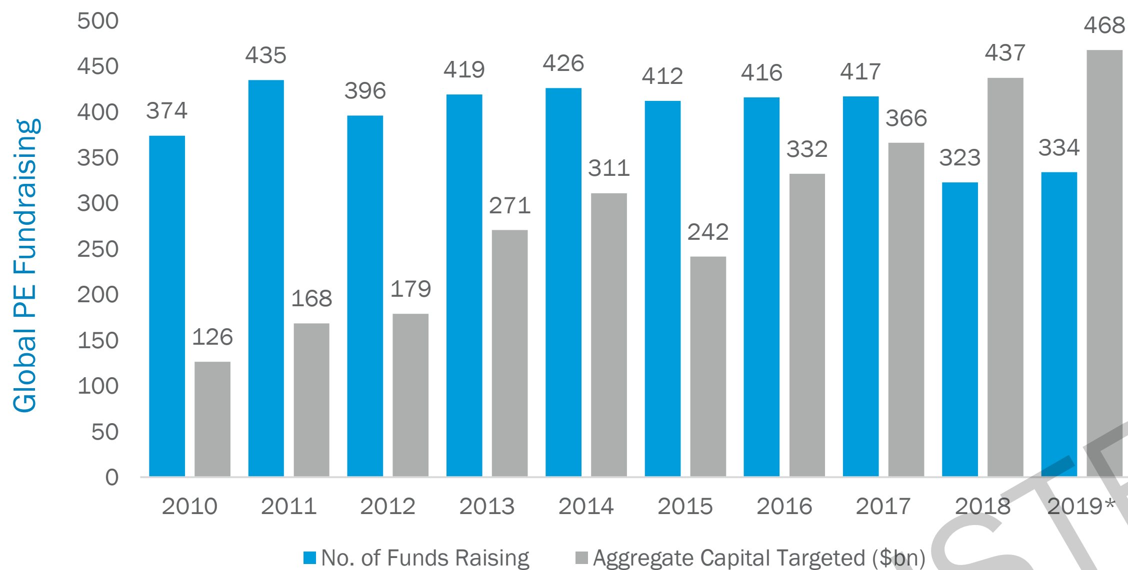
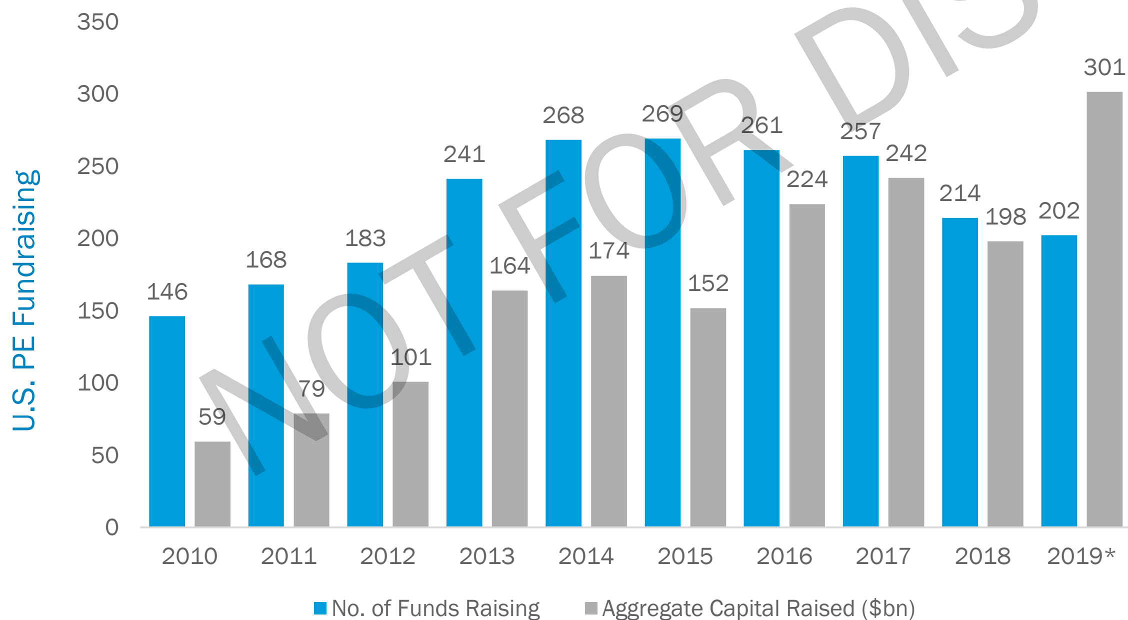
Private Equity Fundraising Activity





- 2019 was a record year for both global and U.S. PE fundraising. The uptick in capital committed, despite fewer funds raising capital, is indicative of a larger average fund size. These larger fund offerings are a function of the growing level of demand for private equity allocations as more institutional investors (i.e., pensions, sovereign wealth funds, insurance companies, etc.) seek outsized returns and broader diversification.
- The increased exposure to private equity by institutional investors has come at the expense of the hedge fund industry, which has experiencing net outflows. Traditional hedge funds have been seeking to retain capital by raising their own closed-end private equity funds. Elliot Management has completed buyouts with their subsidiary Evergreen Coast Capital, including a deal with Veritas, a buyout firm, in the $5.7 billion take-private deal of Athenahealth. Two Sigma, a quant hedge fund, raised $1.2 billion for its inaugural PE fund, Sightway Capital.

*Source: PitchBook * as of December 31, 2019*

Private equity funds include: buyout, growth/expansion, diversified private equity, mezzanine, secondaries, co-investment, restructuring/turnaround, venture capital, private debt, energy, real estate, and fund of funds.

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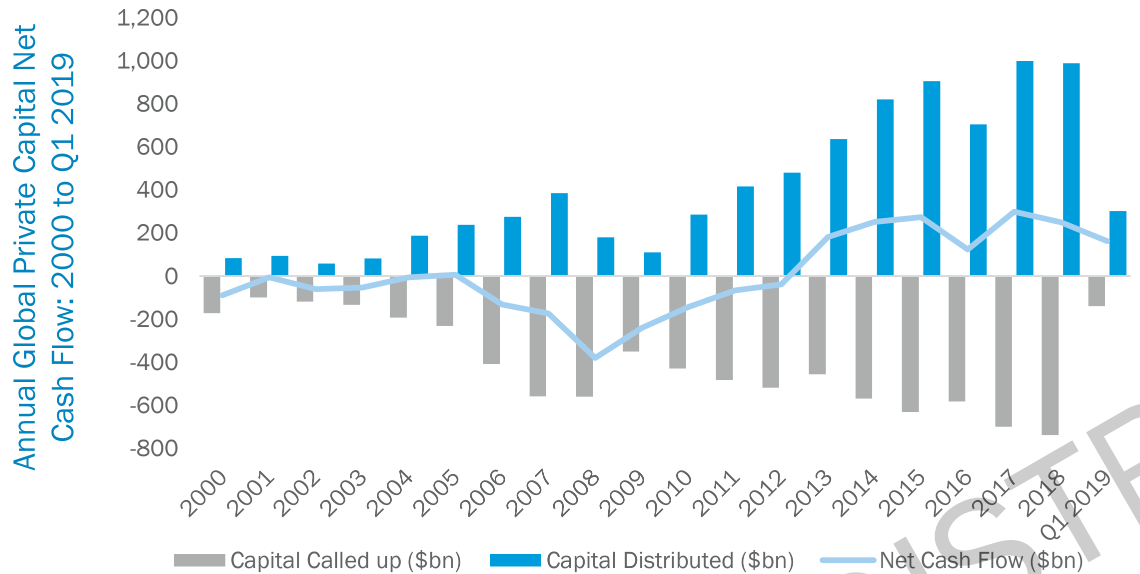
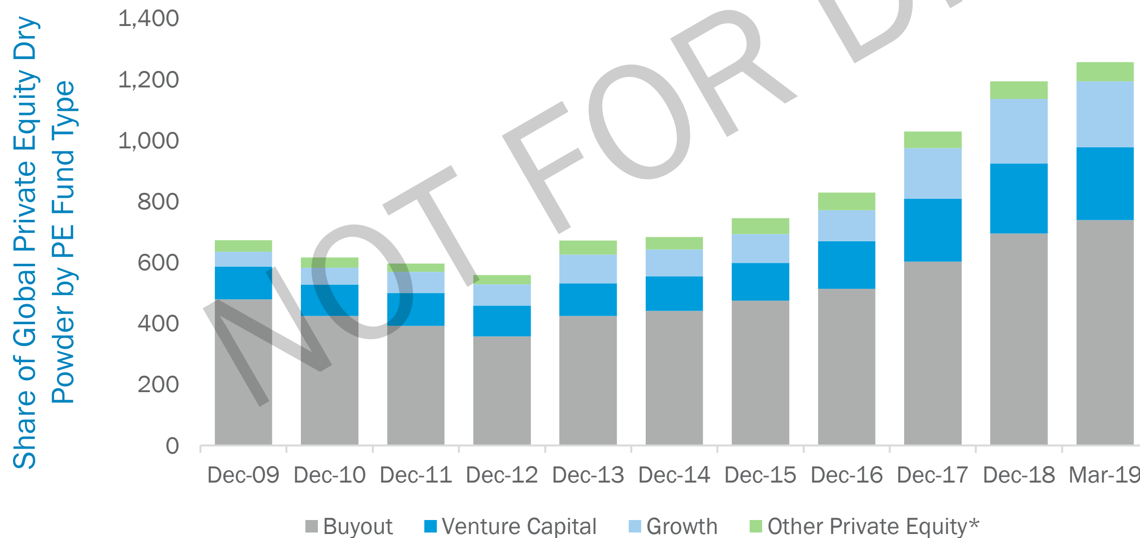
Global Private Capital: Performance and Dry Powder





- During the first quarter of 2019 (the most recent data available), global LPs received distributions in excess of $300 billion and were on pace to receive over $1 trillion in annual distributions for the first time in history.
- Despite the continued trend of positive net cash flow to LPs, capital contributions will likely increase commensurate with the levels of dry powder and the increasing number of mega funds either closing or coming to market.
- As of the end of Q1 2019, private equity dry powder approached the $1.3 trillion mark.
  - 59% of total dry powder was allocated to buyout funds, followed by venture (19%) funds, and growth (17%) funds.

Source: PitchBook 2020 Global Fund Performance Report as of March 31, 2019

**Other Private Equity includes balanced, co-investment, co-investment multi-manager, direct secondaries, and turnaround funds.*

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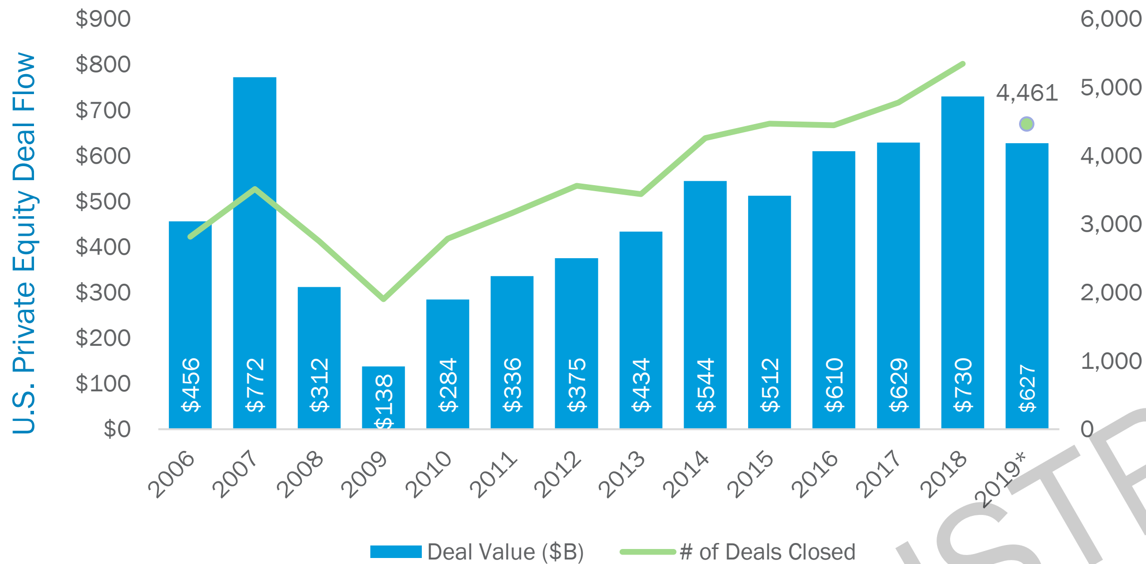
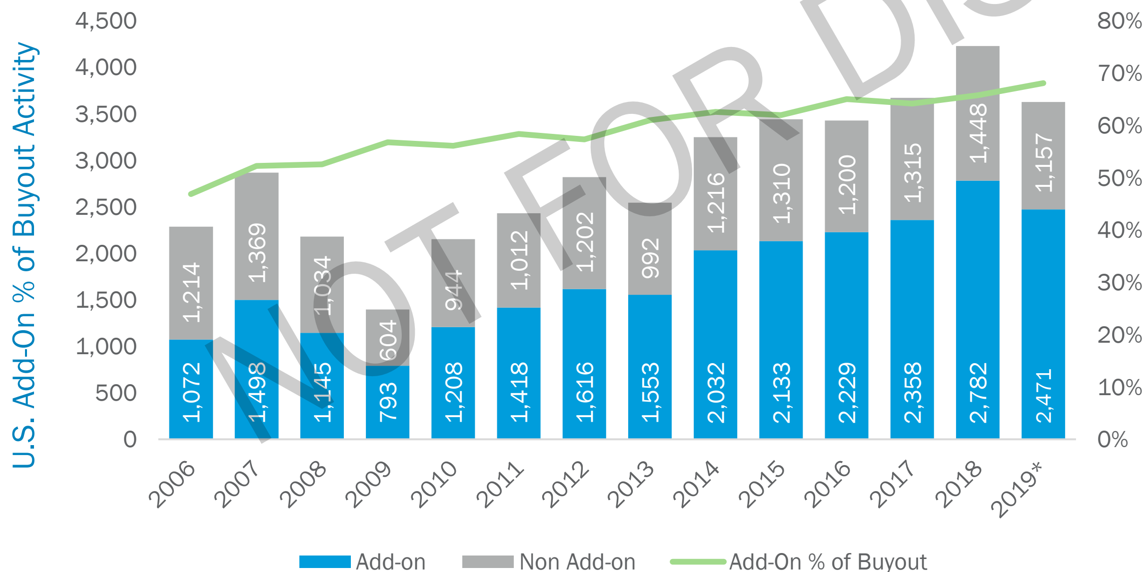
U.S. Private Equity Deal Activity





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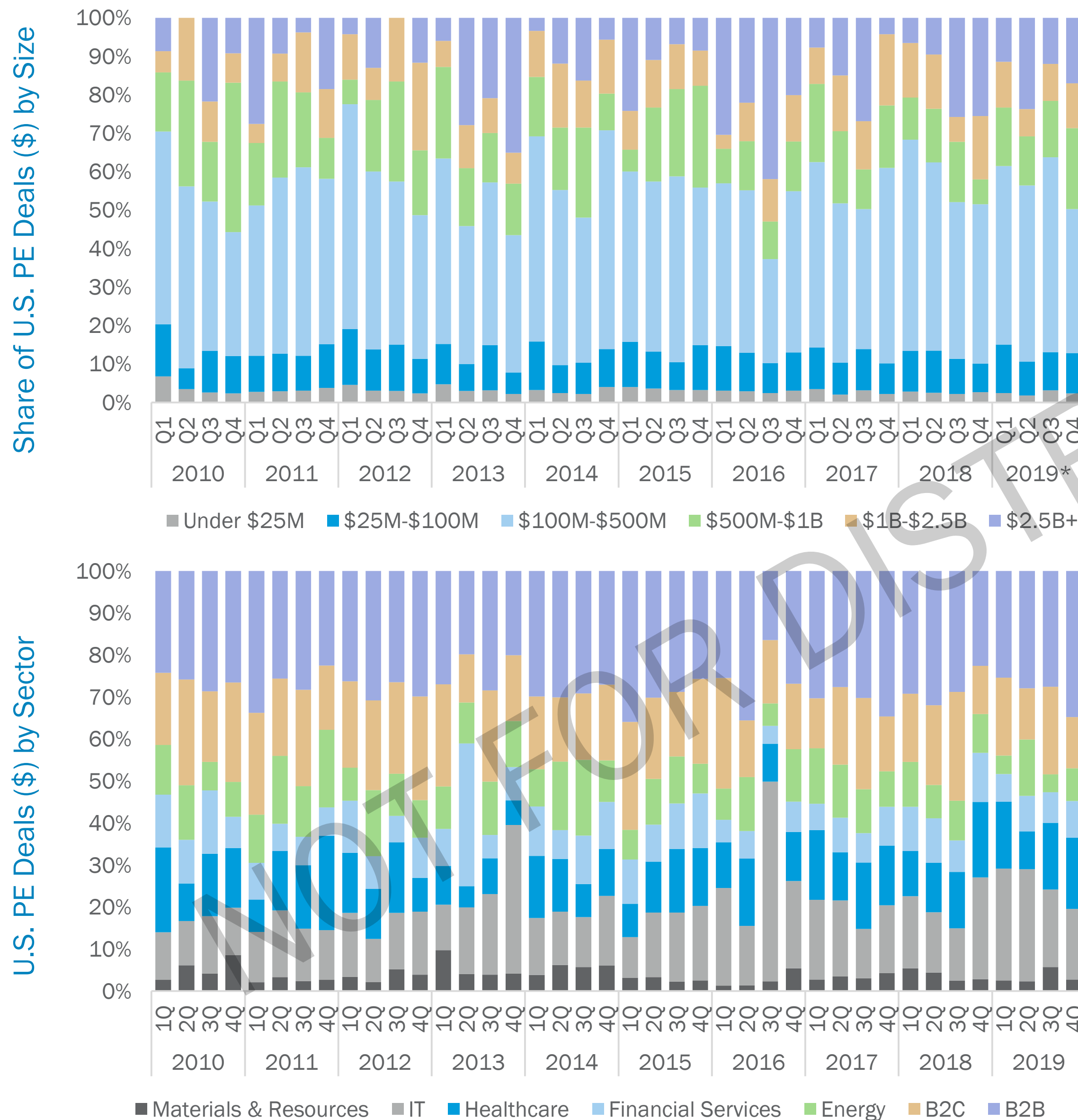
- While deal activity and aggregate deal value fell short of 2018 levels, the year-over-year dip is not indicative of a pullback in private equity. The decrease, in part, represents discipline in capital deployment from fund managers as a result of the continued elevated deal multiples.
- Increased levels of dry powder coupled with elevated multiples have prompted GPs to focus on downside protection and distinct value-add capabilities when sourcing prospective deals. A potential market downturn sometime in the coming years may also explain a slowdown in deal activity, as managers have communicated that they are currently underwriting multiple contraction into deals.
- Add-ons continue to account for over two-thirds of all buyout activity in 2019, with PE firms focusing on the lower middle market as a source of add-on opportunities.
- Another tactic that PE firms are employing to offset the elevated entry multiples is the continued emphasis on operational improvements, which include but are not limited to the following: improving IT, marketing, supply chain, and strategic hires.

Source: PitchBook 2019 Annual U.S. PE Breakdown
**2019 figures are through December 31, 2019*

U.S. Private Equity Deal Activity



- 58% of total PE deal activity in the U.S. comprised deals valued between $100 million to $1 billion, relative to 47% a year ago. This reflects the growing number of mega funds that are pursuing opportunities up market and writing larger equity checks for companies.
- The proportion of deals valued at between $500 million and $1 billion are the highest they have been since Q4 2015, likely due to the participation of sovereign wealth funds and public pensions pursuing direct deals and co-investments on their own. In the U.S., there were 121 deals totaling $67.6 billion where a sovereign wealth fund or public pension participated in the deal, an example being the $8.4 billion take-private of railroad operator Genesee & Wyoming, in which Singapore's GIC participated.
- The B2B and B2C sectors continue to be attractive sectors to invest in among PE firms, accounting for 47% of deal value (in dollar terms). This is well above the 35% share seen a year ago.
- The healthcare and IT sectors continue to remain desired points of entry for many PE firms, and comprise over one-third of overall deal flow in 2019.

Source: PitchBook 2019 Annual U.S. PE Breakdown
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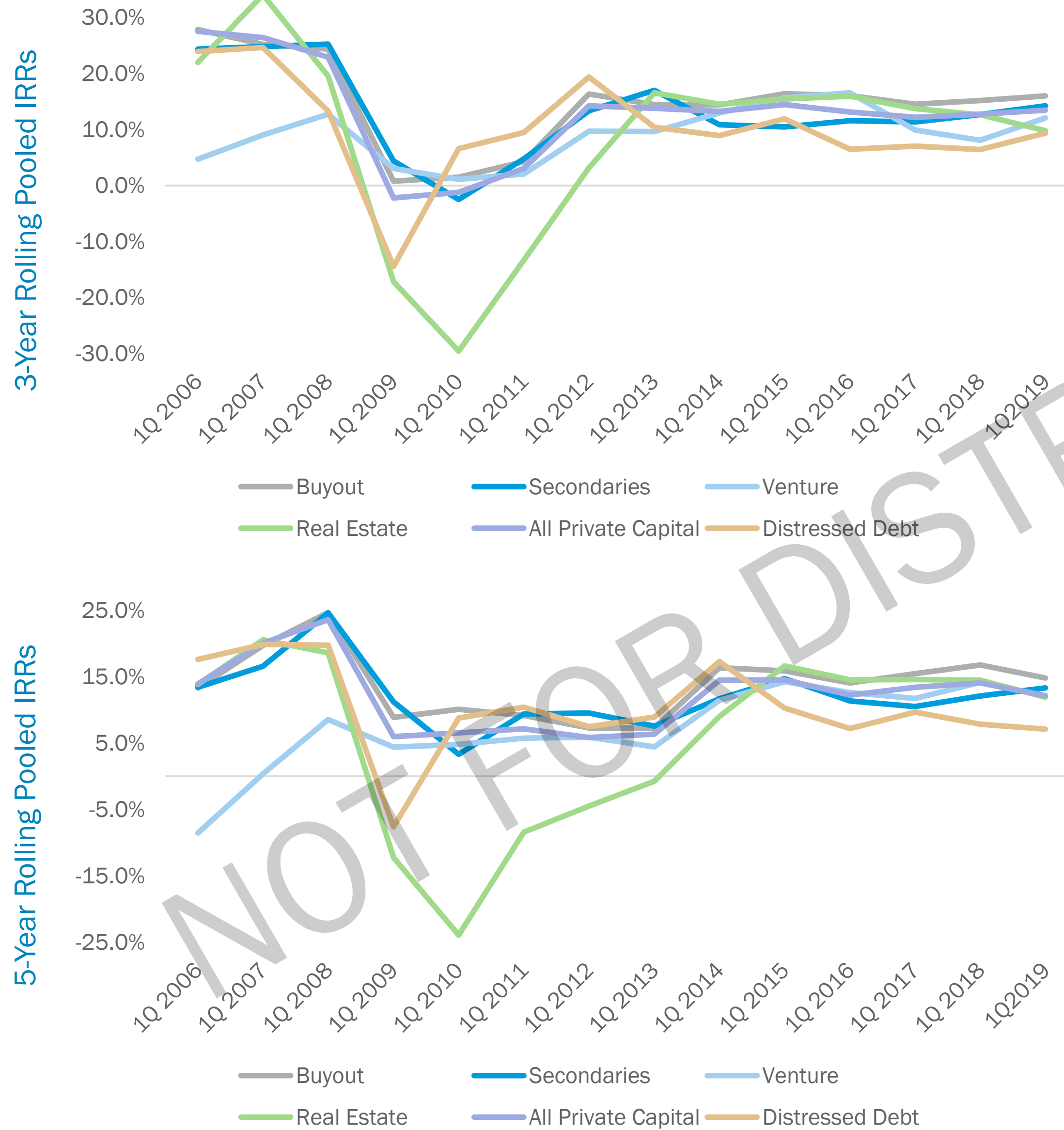
Horizon Performance



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- The private equity markets have remained stable over the last several years. Traditional buyout funds continue to outperform the rest of the private equity universe, over both a three- and five-year time horizon. The current private equity market favors buyout funds whose portfolio investments have benefited from value-add operational improvements and a run-up in deal multiples.
- Private real estate fund performance struggled as a result of the Global Financial Crisis (GFC) and remained a significant underperformer until the latter part of 2013 on a trailing basis. Since then, performance has improved in large part due to a continued low rate environment and low levels of defaults.
- Distressed debt strategies, a relative outperformer during and shortly after the GFC, have continued to lag the rest of the private market since 2014. The low rate environment and lack of distressed opportunities have driven down returns. Traditional distressed funds have been incorporating a “deep value” buyout strategy to offset the lack of any compelling distressed deals.

Source: PitchBook as of March 31, 2019