CanterburyConsulting

Quarterly Asset Class Report
Private Equity

canterburyconsulting.com

March 31, 2020

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.

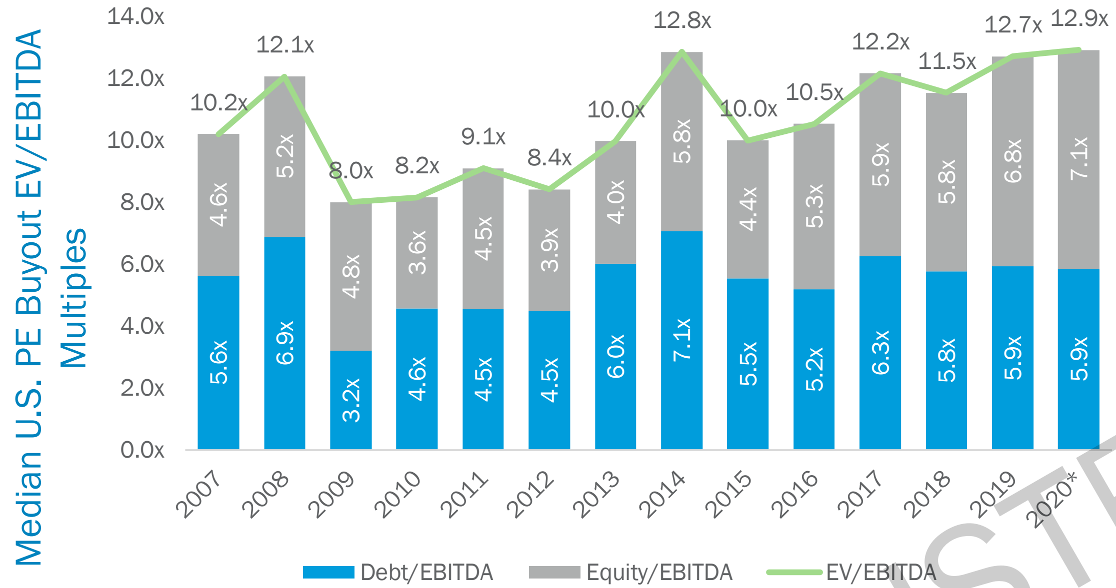
Role	Asset Categories	Risks
Growth	**Public and Private Equity**	**Market Decline**
Capital Preservation	Fixed Income, Hedge Funds	Rising Interest Rates, Highly Correlated Markets
Inflation Protection	Real Assets: Real Estate, Commodities	Deflation

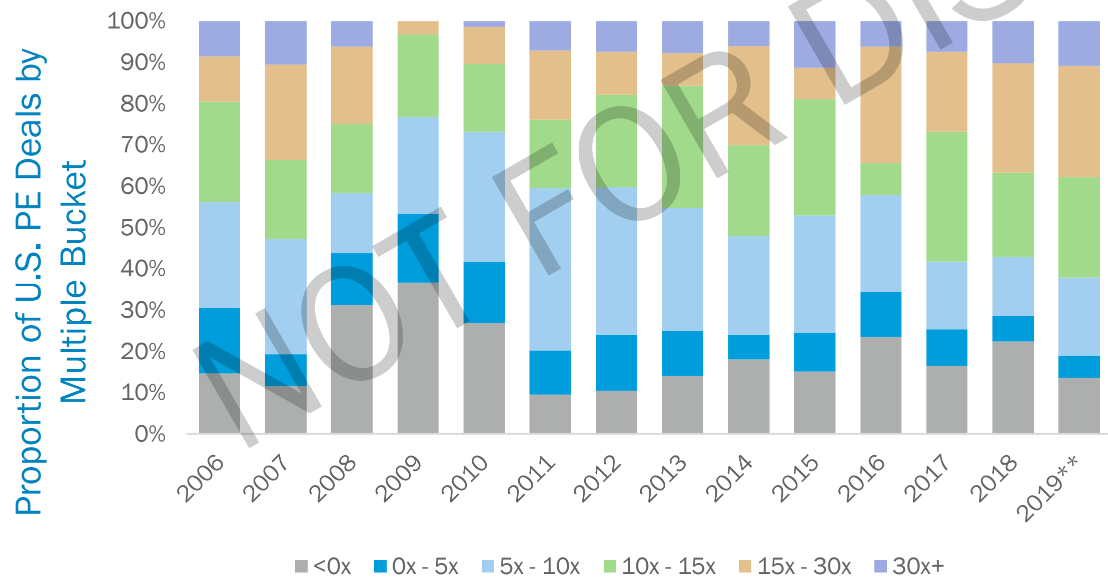
– Over a full market cycle, private equity is intentioned to generate above-market returns commensurate with risks associated with the asset class (i.e., illiquidity, time horizon, etc.).

– 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.

U.S. Private Equity Valuation Overview

Private Equity

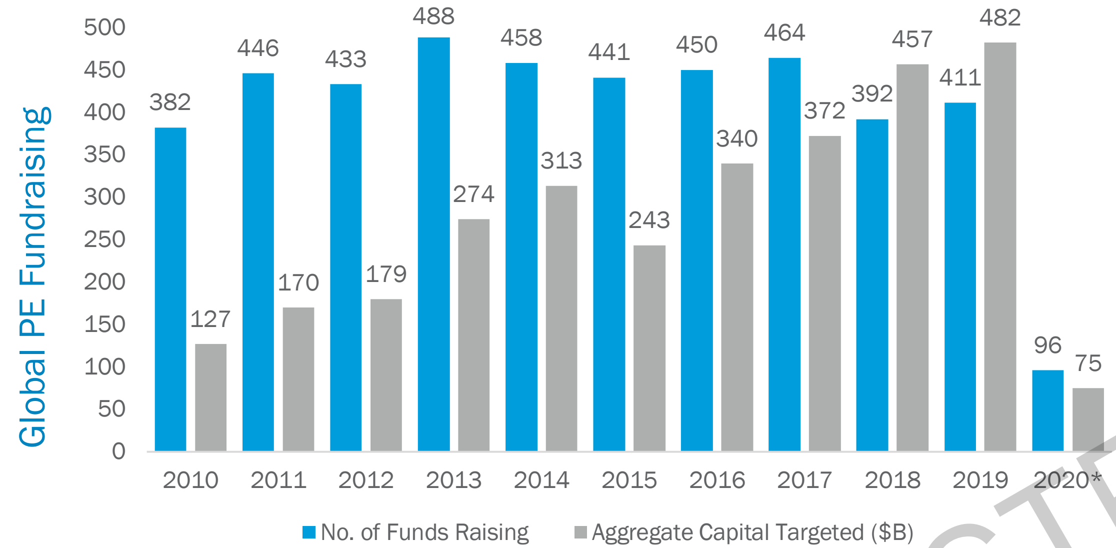


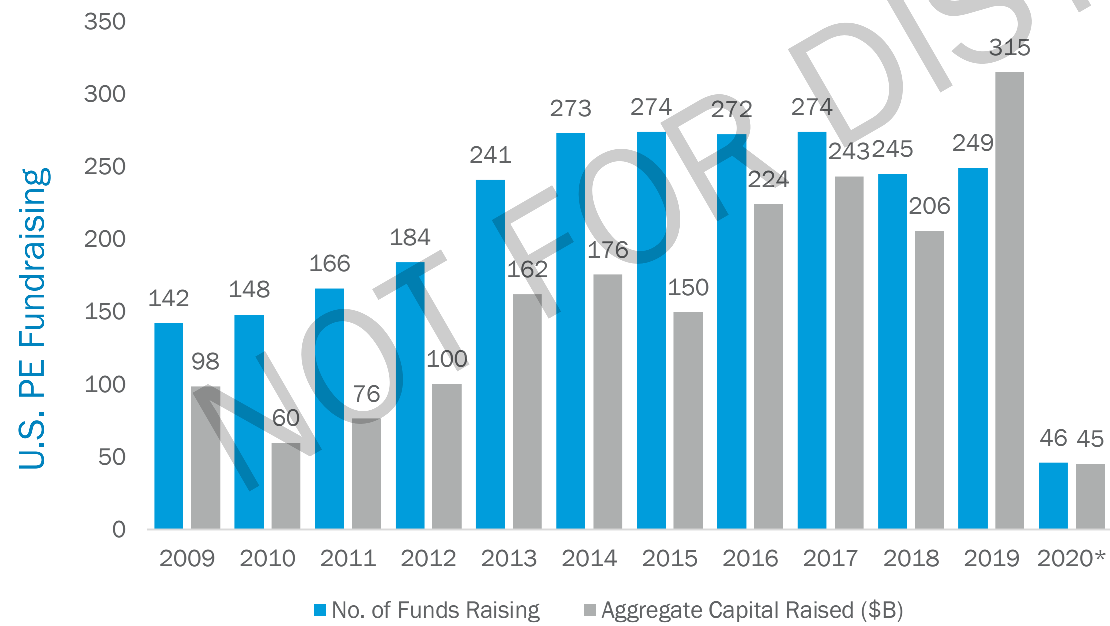


- U.S. private equity deal multiples continued their upward trend to start the year. This can be attributed to the higher number of large buyout funds that have raised capital over the last two years and have finally begun to deploy capital.
- Higher deal multiples were also impacted by buyout managers underwriting optimistic forward-looking expectations for many of its deals. According to a KPMG study of a large insurance fund's private equity portfolio, EBITDA add-backs accounted for ~30% of EBITDA forecasts compared to 15% a decade ago. The more aggressive underwriting indicates more bullish base case scenarios.
- In light of recent events centered around the COVID-19 pandemic, buyout managers will likely re-adjust underwriting to more conservative standards as many industries will experience adverse effects to top-line and bottom-line financial results. This will likely result in deal multiples decreasing in subsequent quarters.

Source: PitchBook Q1 2020 U.S. PE Breakdown
** 2020 figures are through March 31, 2020.*
*** 2019 figures are through December 31, 2019.*

Private Equity Fundraising Activity





- While 2019 was a record year for both global and U.S. PE fundraising activity, there was a considerable decline in fundraising activity to start the year relative to the same period last year. This trend is likely to continue. Increased uncertainty and the noticeable decline in economic activity throughout the U.S. and the world have led many private equity managers to pause new transactions. Managers are instead focusing on managing existing portfolio companies.
- Similar to 2019, larger funds dominated the PE fundraising landscape in the U.S, with these vehicles closing on $161.9 billion in 2019, accounting for over half of the year's total. Two large funds, Stone Point Capital and Platinum Equity, contributed ~38% of the fundraising total to start the year. While large funds with well-established LP bases will likely complete fundraising, albeit with an extended fundraising period, smaller and newer funds may have a more difficult time raising capital.

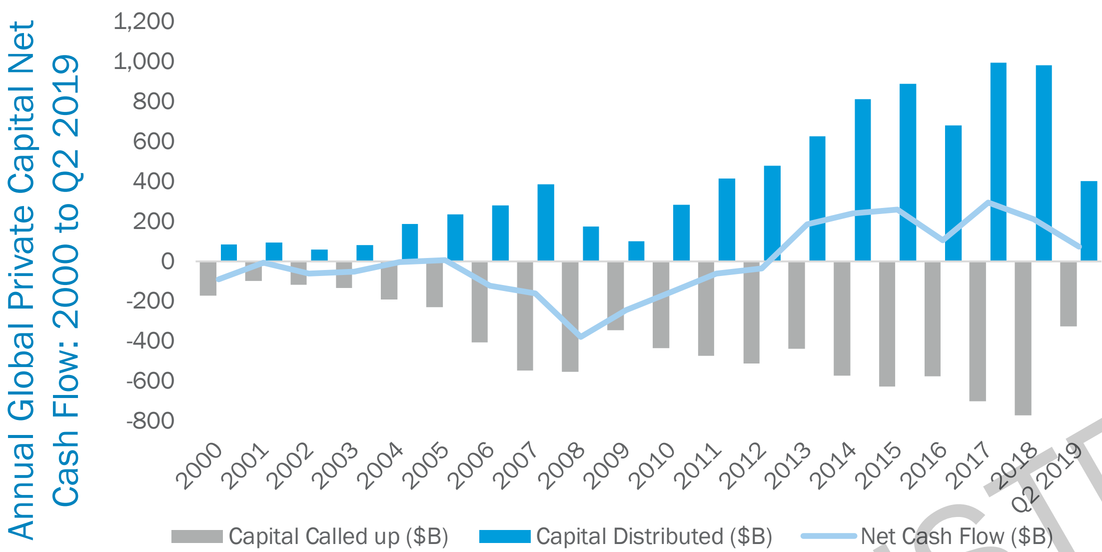
Source: PitchBook

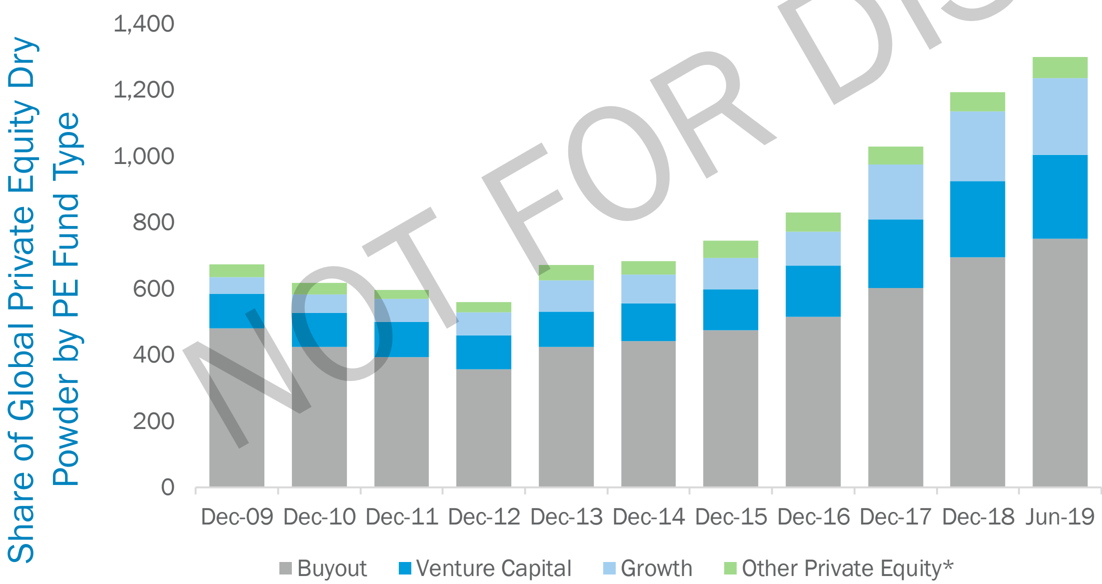
Private equity funds include: buyout, growth/expansion, diversified private equity, mezzanine, secondaries, co-investment, restructuring/turnaround, venture capital, private debt, energy, real estate, and fund of funds.

** As of March 31, 2020 unless otherwise noted.*

Global Private Capital: Performance and Dry Powder

Private Equity





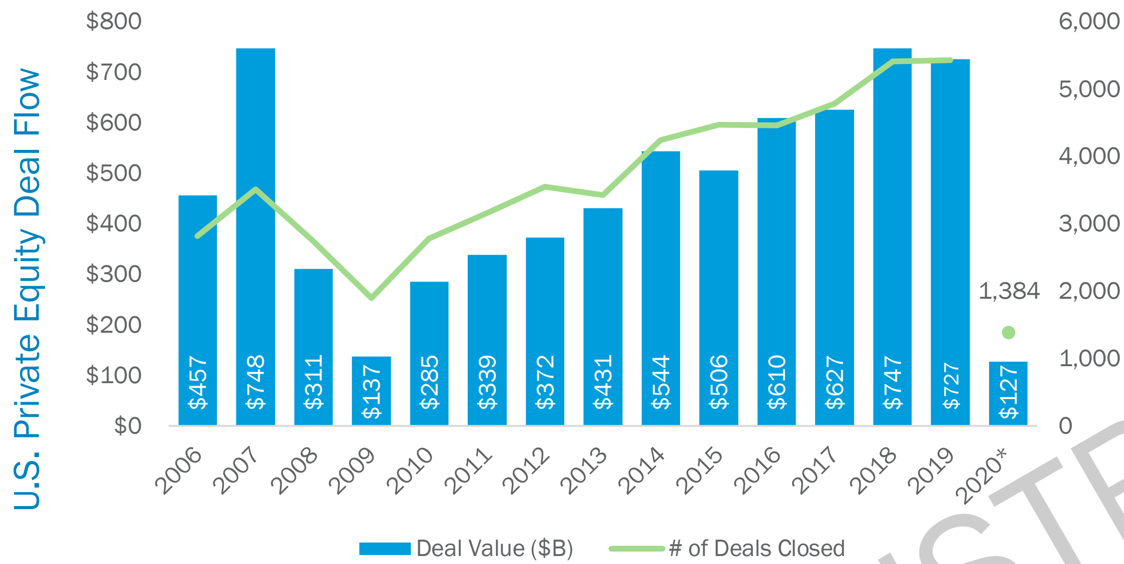
- Through Q2 2019 (the most recent data available), global LPs received approximately $400 billion in distributions. However, distributions during the quarter decreased by 67% compared to the prior quarter. Since reaching an apex in 2017, net cash flows have exhibited a downward trend.
- The COVID-19 pandemic will likely impact the timing of LP cash flows, as funds who are in the middle of their investment and harvest periods may extend hold periods for investments. However, LPs should have the option to tap the PE secondary market if immediate liquidity is needed. GPs may also seek out liquidity options for their LPs through GP-led fund restructurings.
- As of the end of Q2 2019, global private equity dry powder was at $1.3 trillion. 58% of this dry powder was allocated to buyout funds, followed by venture (20%) and growth (18%) funds.

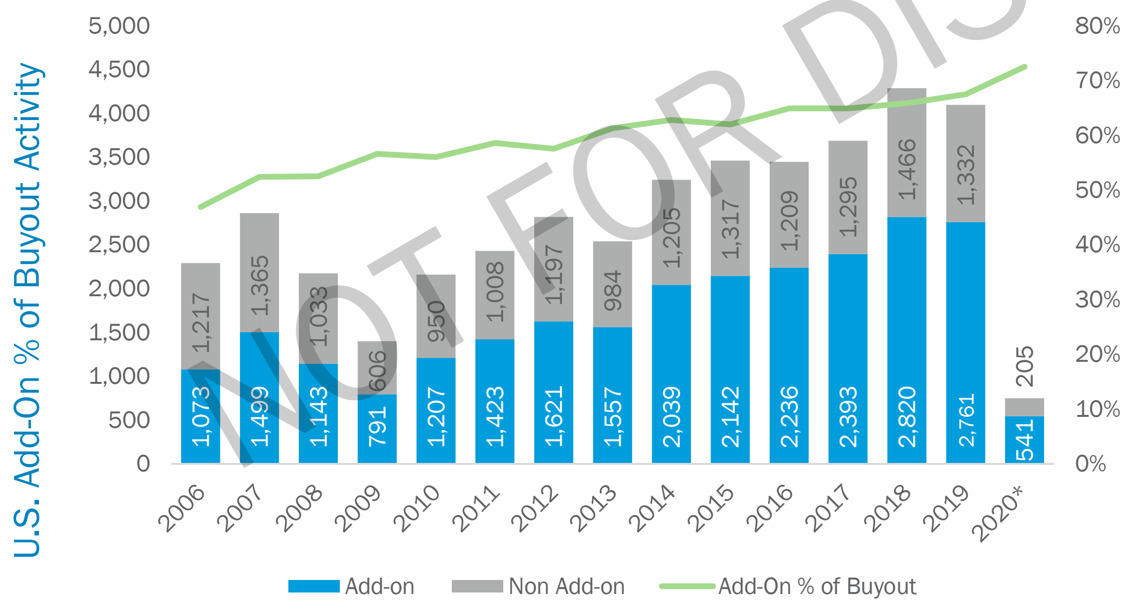
Source: PitchBook Global Fund Performance Report as of June 30, 2019

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

U.S. Private Equity Deal Activity

Private Equity



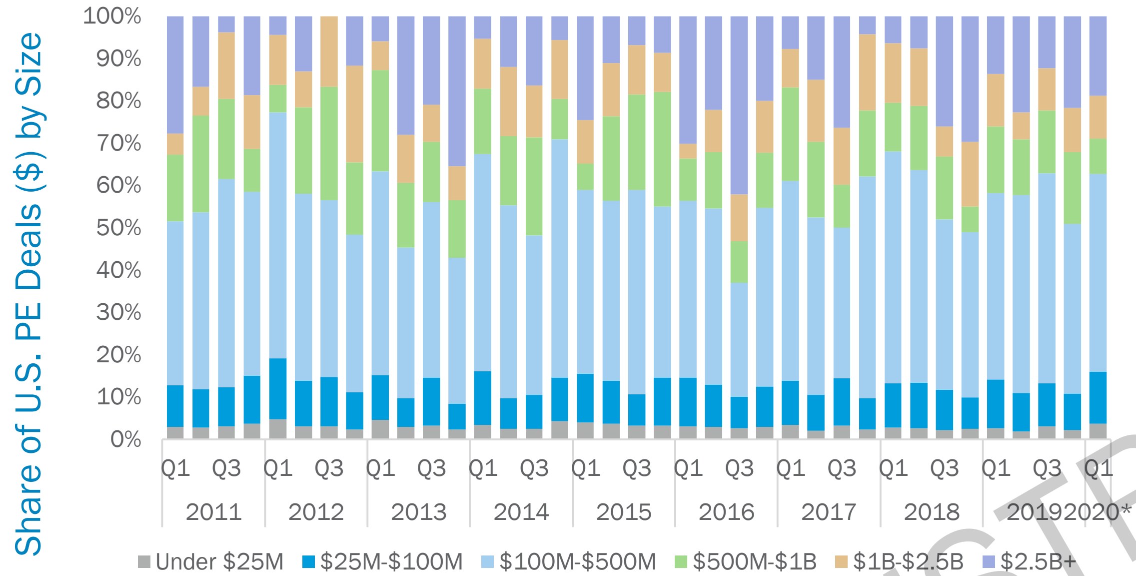


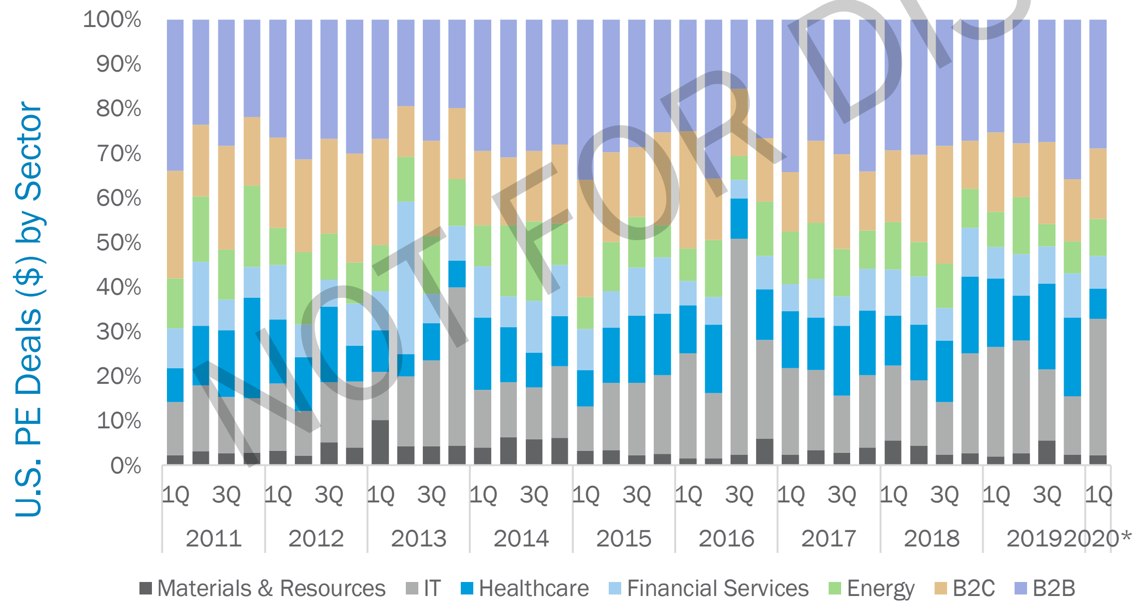
- Deal activity experienced year-over-year gains to start the year, with the number of deals closed and combined deal value increasing by 7.3% and 6.0%, respectively.
- The number of deals closed are expected to decrease considerably in subsequent quarters as government-imposed shutdowns and rising unemployment has depressed economic activity in many industries. Fund managers are holding off on new deal activity to more accurately assess the impact of depressed economic activity and re-price deals.
- Managers with high levels of dry powder are favored in this environment. These managers, who have either recently raised a fund or have been disciplined given the market environment, will likely be able to pursue deals at a discount in the coming months. These managers are also able to infuse capital into existing portfolio companies rather than having to tap into the debt markets, which are now charging higher interest rates and imposing stricter covenants.

Source: PitchBook Q1 2020 U.S. PE Breakdown

** As of March 31, 2020.*

U.S. Private Equity Deal Activity





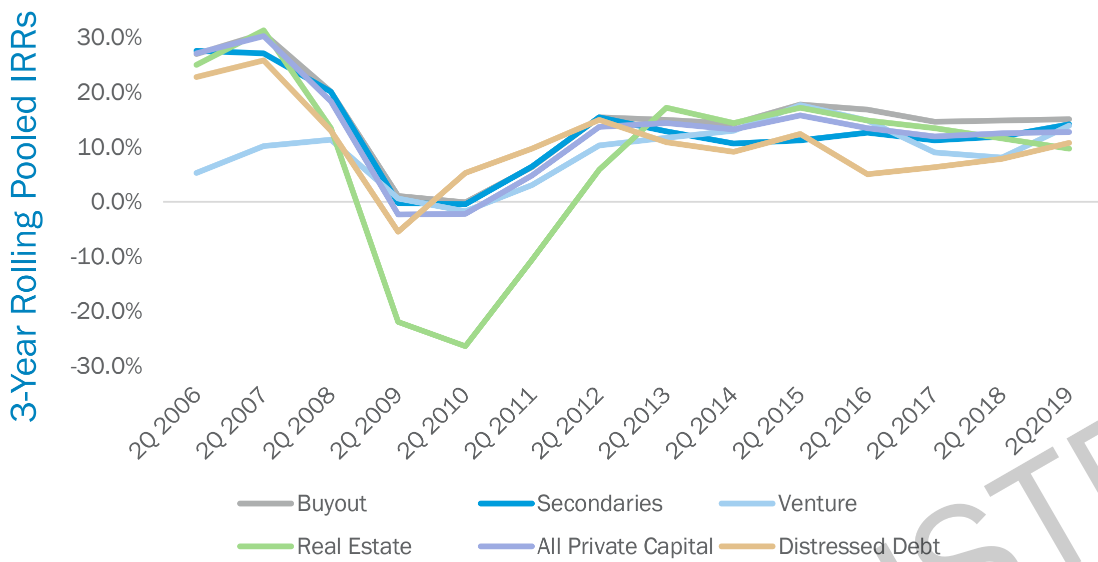
- 55% of total PE deal activity in the U.S. comprised deals valued between $100 million to $1 billion, versus 65% a year ago.
- According to PitchBook, smaller deals and add-on acquisitions should become more prevalent in this current market environment. As larger deals become more expensive to finance, smaller deals will offer an attractive way for GPs to spend down capital at depressed prices. Portfolio companies that are well-positioned in their respective sectors will seek out add-on opportunities to grab market share.
- The B2B and B2C sectors remain attractive sectors to invest in among PE firms, accounting for 45% of deal value (in dollar terms). While this is a drop from the 49% allocation from a year ago, both sectors still represent a significant part of PE deal activity in the U.S.
- Deal activity in IT was strong during this quarter, with 31% of deal activity coming from the IT sector. This is the highest proportion seen since Q3 2016. Certain investment themes in IT like cyber security, video conferencing, and cloud computing are possible areas of interest for private equity fund managers, especially in light of the current work-from-home measures instituted by many professional services firms.

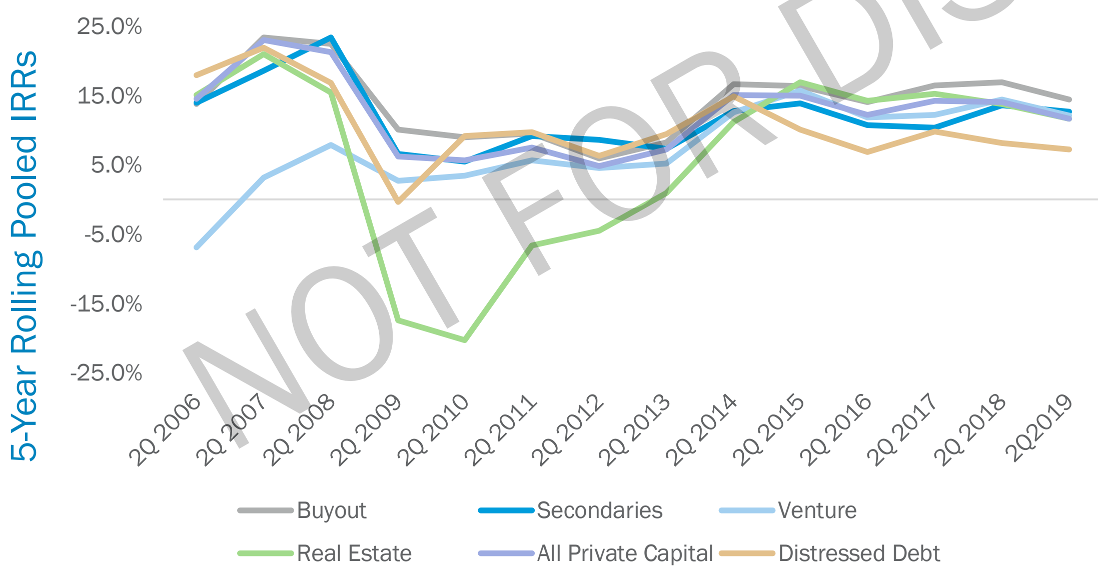
Source: PitchBook Q1 2020 U.S. PE Breakdown

** As of March 31, 2020.*

Horizon Performance

Private Equity





- Through Q2 2019, private equity markets remained stable over the last several years. Traditional buyout funds have outperformed the rest of the private equity universe, both over a three- and five-year time horizon.
- Historically, buyout strategies that were launched during or following an economic downturn have outperformed buyout strategies launched two to three years prior. This is due to the opportunity for managers to purchase assets at a discount and experience significant appreciation in these assets as the economy recovers.
- While distressed debt has continued to lag, the current market environment may favor this strategy, as companies across a wide array of industries are facing lower levels of revenue and possible bankruptcy. Distressed debt managers should be able to capitalize on the increased opportunity set afforded to them as a result of the current recession-like environment.
- Secondary strategies may also be positioned to succeed in this market. The decline in the public markets could potentially generate forced sellers, and LPs who are facing liquidity issues will look to exit out of their private equity interests via the secondary markets. These interests will be purchased by secondary firms at discounted prices.

Source: PitchBook as of June 30, 2019