KEY TRENDS IN THE PRIVATE EQUITY MARKET IN 2019

RECORD FUNDRAISING UNDERSCORING THE IMPORTANCE OF MANAGER SELECTION

With institutions increasingly allocating to private equity, 2019 was another record year for fundraising, with a total of $324bn raised for private equity in the US and Europe, a 34% increase on 2018. Despite this, the number of funds raised declined by 13%, with several large 'mega funds' in the market accounting for an increasing proportion of capital raised. Many institutions are consolidating portfolios and committing larger amounts to fewer funds, leading to more capital being concentrated on a smaller number of managers.

Within private equity, the dispersion of returns is far more pronounced than in other asset classes. Consequently, top performing managers are becoming increasingly oversubscribed and hard to access and the ability to identify and build relationships with the right managers is now more important than ever.

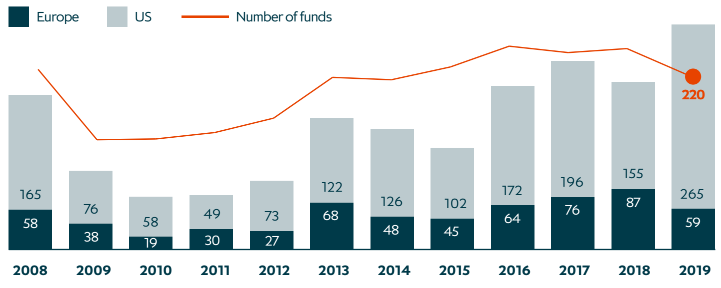
OUR RESPONSE

Strong relationships, a proactive investment process and the ability to identify opportunities overlooked by the broader market

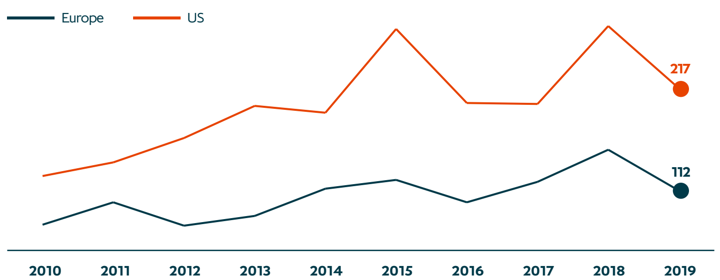
We have been investing in third party private equity funds for more than 30 years and have built up strong relationships with managers over multiple cycles. These close relationships ensure that our due diligence process is well advanced ahead of fundraising and means that we are able to secure an allocation to our preferred managers, many of which have significantly oversubscribed funds.

Examples in the year include new funds raised by Advent International, Cinven and Permira. We are also able to leverage the ICG network to access top performing managers that we have not previously invested with, in particular in the US. Strong relationships also ensure a healthy flow of co-investment opportunities.

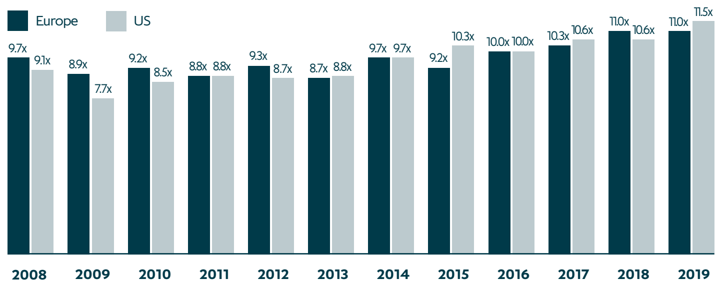
1. FUNDRAISING ($BN)



2. DEAL VALUE ($BN)



3. BUYOUT MULTIPLES



Source: S&P LCD, Preqin.

While many funds are oversubscribed in record time, the market has become increasingly bifurcated with managers not perceived to be in the top echelons struggling to gain investors' attention.

Often, we view the distinction between oversubscribed managers that close funds quickly and those who take longer to reach their target fund size to be unfounded and we are not afraid to go against the herd. There are a number of benefits to this approach: firstly, the fund may have already made a number of investments enabling us to due diligence the assets before committing (a 'late primary' investment); secondly, this dynamic often facilitates greater co-investment access; and thirdly, we are wary of the most sought after managers raising too much capital with the resultant risk of strategy drift. An example in the year of a 'late primary' investment is Gryphon V, which was 45% invested at the time of our commitment and alongside which we subsequently completed a co-investment in RegEd. With ICG as manager of the Company, we also have access to proprietary ICG deal flow, and during the year 16% of capital deployed was into ICG investments.

INCREASING COMPETITION FOR QUALITY ASSETS DRIVING SUSTAINED HIGH PRICING

Global deal activity slowed in 2019, with a 24% decrease in total buyout deal value and a fall in both deal count and average deal size. While activity was reduced, strong competition for deals from both private equity and corporate buyers has sustained high multiples paid across the two main private equity markets of Europe and the US. The average EBITDA multiples paid for new investments of 11.5x in the US and 11.0x in Europe were both high by historical standards (see chart 3).

Private debt markets were also buoyant with average debt/EBITDA ratio in the US and Europe of 5.8x. These relatively high multiples underscore the importance of managing downside risk. However, it is worth noting that leverage levels remain below those immediately prior to the financial crisis while interest rates are much lower and loan covenants are significantly less onerous, favouring the equity investors.

OUR RESPONSE

A continued focus on defensive growth and structural downside protection

The elevated multiples being paid for acquisitions in 2019 highlight the importance of having a clear approach underpinned by investment discipline. With a cautious and selective approach to deploying capital, focusing on resilient businesses, our mandate allows us to be nimble and adjust the mix of investments where we best see relative value. The managers that we invest with have long track records of value creation across multiple cycles. In addition, as part of ICG, we benefit from proprietary deal flow and our investments alongside ICG (22% of the portfolio) have the added benefits of either structural downside protection or a relative value approach:

- Structural downside protection: results from investing in a mixture of subordinated debt and equity instruments. By combining the downside protection of subordinated debt with the upside potential of the equity, these investments are targeting a blended return similar to that of a typical equity deal but with lower downside risk.
- Relative value: is the approach of ICG's Strategic Equity funds. This strategy focuses on complex recapitalisations of mature private equity funds where transaction dynamics facilitate investment at multiples materially below market.

COVID-19 IMPACT

IMPACT ON THE CORPORATE SECTOR

Since the year end, the rapid global spread of a new strain of coronavirus ('COVID-19') has dramatically altered the investment landscape. What was before the outbreak a relatively benign low growth, low interest rate environment, has morphed into what is likely to be a sharp negative growth shock.

The initial hit has been on global supply chains and China's demand for non-essential goods, commodities and services. The secondary, but likely largest and less recoverable, impact is being driven by reductions in global private consumption of services, including travel, tourism, shipping and footfall reliant businesses.

It is too early to assess the depth and duration of the shock. Early economic data indicates that in 1H 2020 most major developed economies will experience significant economic contraction. The extent of the disruption in 2H 2020 and 2021 is largely dependent on how quickly and sustainably the spread of COVID-19 can be contained and the success of fiscal and monetary policies in supporting economies sufficiently to keep them in 'suspended animation' during containment periods.

LONG-TERM RESILIENCE OF OUR FOCUS ON DEFENSIVE GROWTH

- Our strategy is focused on companies that have defensive growth characteristics; companies that performed well through previous economic cycles.
- As a result, the Portfolio is weighted towards more resilient sectors, such as healthcare, consumer staples, business services and technology.
- The Portfolio is well diversified, and invested in larger companies, which we believe are more resilient.
- There is also bias to managers who have a strong operational focus and demonstrable experience of successfully managing investments through periods of economic stress.

IMPACT OF COVID-19 ON THE PORTFOLIO

- Given the rapid escalation of the crisis, we currently have limited visibility on the short and longer-term impact of COVID-19 on the global economy.
- Performance will vary between geographies, sectors and companies and be dependent on business models and end markets.
- Our managers have moved decisively to address immediate risks and are implementing plans to protect and preserve long-term value.
- While it is difficult to accurately gauge the impact of COVID-19 on the Portfolio, as a whole, at this stage, our approach means that we have increased visibility on the performance of our high conviction investments.
- Specifically, our Top 30 Companies, which make up 46% of the Portfolio, are weighted towards high conviction investments.
- Within these companies we believe that the majority are well placed to weather the current uncertainty and take advantage of any recovery.

BENEFITS OF THE PRIVATE EQUITY MODEL IN PERIODS OF UNCERTAINTY

- Private equity's active ownership model and close lines of communication with businesses mean they can move quickly to address issues.
- Leading private equity firms have significant operating teams in place that can provide expert guidance and resource in periods of economic uncertainty, addressing issues in the early stages.
- Long-term investment horizons and access to capital, both from funds and relationships with banks, allows private equity firms to support portfolio companies during times of economic and financial market distress.