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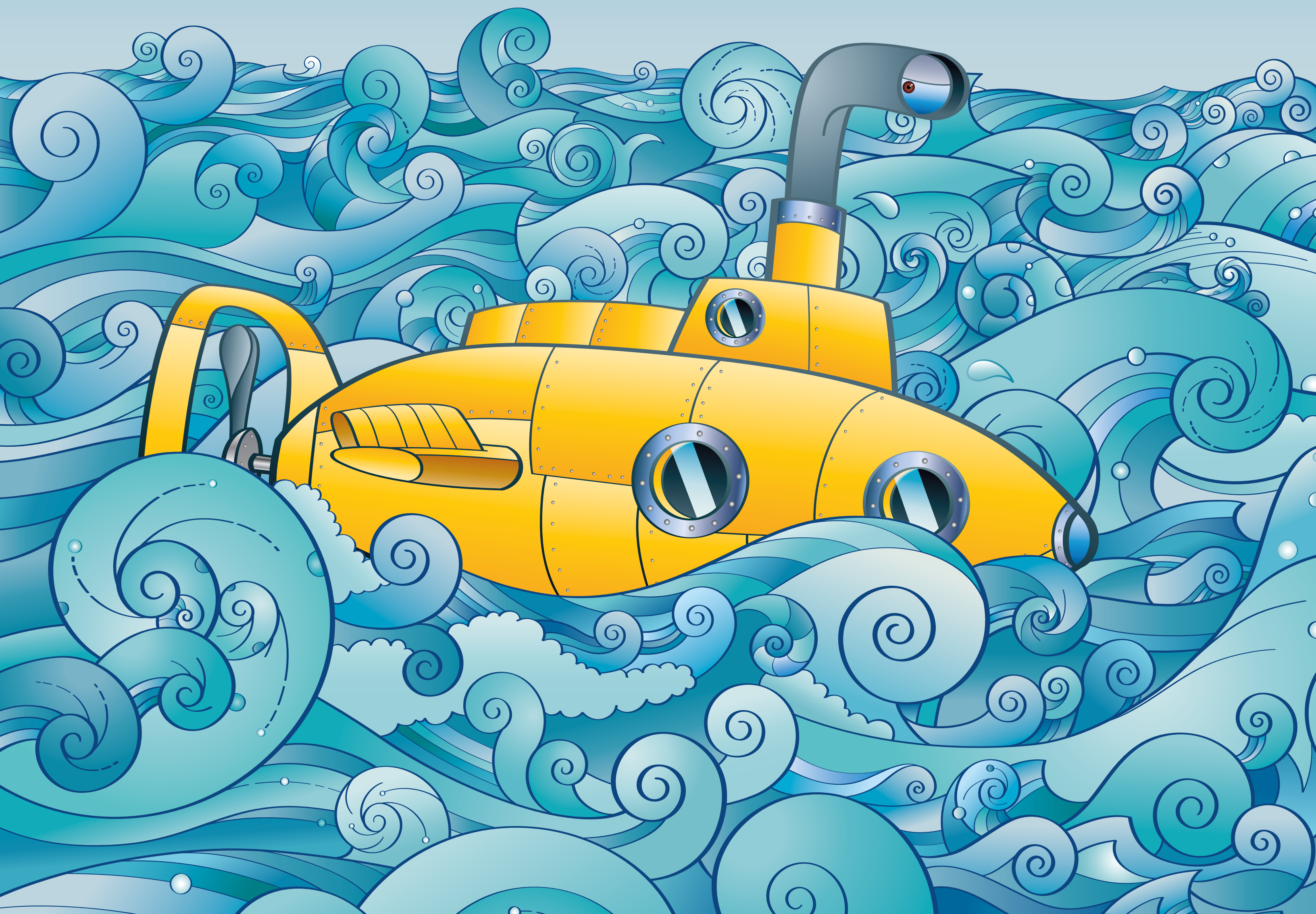

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A sense of history **Hamilton Lane's Mario Giannini has a calm take on our current troubles**

Hamilton Lane chief executive Mario Giannini said in mid-July that LPs learned from the 2001 and 2008 financial crises the importance of maintaining a consistent investment pace, ***writes Justin Mitchell.***

"The single biggest mistake we see investors make, and it's why so many underperform, is consistency," Giannini told the board of California Public Employees' Retirement System during a fireside chat with private equity director Greg Ruiz. "They fall in love with the market when it's high and then they get scared when it goes down and so they want to get out."

The reason some LPs do so well in private equity is simple: "They just kind of keep a steady pace. They don't go crazy one way or the other."

Giannini, who has been with Hamilton Lane since shortly after it was formed in 1991, shared his memories of both the 2008-09 global financial crisis and the 2001 dot-com bust.

"I can remember phone calls and discussions in front of boards where people simply wanted to get out of anything illiquid," he said, according to a rush transcript of the talk. "And it proved to be the wrong decision in both market cycles."

But this time, LPs remained resolute. "All LPs globally have kind of figured out that consistency does matter," Giannini said.

Giannini also talked Q1 portfolio values, which he said were probably down about 8-10 percent, depending on whether portfolios were focused on growth or buyouts. If a portfolio has more growth investments, it will go down less. If it has more buyouts investments, it will go down more, he said – but be poised to go up in the second quarter.

"It's really too soon to know, but given the public markets were up and operating performance we hear was surprisingly okay at many portfolio companies, I'd be surprised if it wasn't up somehow," Giannini said.

Values in PE investing

One recurring topic was environmental, social and governance,

> "I can remember phone calls and discussions in front of boards where people simply wanted to get out of anything illiquid. And it proved to be the wrong decision"
>
> Mario Giannini
> Hamilton Lane

criteria, or ESG. Giannini pointed out that while in the Scandinavian countries, Australia or New Zealand, ESG is "almost the number one criteria for investing in anything," it has yet to take hold to the same level in the US.

Board member David Miller asked Giannini about how CalPERS can work to ensure general partners are not taking actions, such as cutting jobs, which are counter to its values.

Giannini said GPs are extremely cognizant of what their investors want from them – and that one option to change behavior in the industry is for LPs to band together through organization such as the Institutional Limited Partners Association to make their preferences clear.

"It's always easy to focus on the general partners… I think limited partners need to coalesce a little bit around 'What does matter to us?'" he said. "You just can't raise capital in Nordic countries if you're not particularly environmentally sensitive. You just can't. So I think part of your effort needs to be around other limited partners."

The conversation also touched on private equity's often negative public profile. Giannini said that while that reputation has not changed, the actual nature of the industry has. Hamilton Lane's "value attribution models" show that private equity now profits much more from growing companies and making operational improvements than from cutting expenses. And he credited LPs with helping bring that about.

"In the 80s there were a lot of hostile takeovers that private equity was involved in," he said. "You just don't see that anymore because I think limited partners are saying, 'No, we know how this should work and it should work with growth. It should work with operational improvements, and not be involved in hostile acts and doing things that the industry had done many years ago.' So that has been a real evolution." ■

Ups & downs

↑

"Post-Labor Day, it's going to be a busy M&A market" ***Richard Harding***, *managing director and co-head of PE solutions at Moelis, on high-quality, covid-resilient businesses soon to be entering the market*

"We are asking everyone to put together scenarios for us: how it will look if nobody goes back to work after Labor Day" ***Greg Belinfanti***, *senior managing director at One Equity Partners, on upcoming business patterns*

↓

Big numbers

Facts and figures from across the private equity universe

$162bn

How much private equity firms fundraised in the first half of the year

20%

Texas County & District's new private equity target allocation. The system increased it from 18 percent

$425m

How much McCarthy Capital is targeting for its seventh fund

$86.7bn

How much North America-focused funds raised in the first half of 2020

€22bn

The amount buyout giant CVC Capital Partners collected for its eighth flagship fund in mid-July

1.3m

Number of Americans who filed for unemployment benefits the week ending July 11, according to the Bureau of Labor Statistics

$5bn

How much Public Sector Pension Investment Board, Canada's fourth-largest pension system, invested in the global private equity market last year

17%

Percentage of private equity deals that counted for M&A activity in H1 2020

9-10%

Percentage that Florida State Board of Administration's private equity portfolio value was expected to fall in Q1 2020

Litigation **Advent and Forescout avoid the first covid-era MAE/MAC trial**

On the eve of what would have marked the first material adverse event case litigated in the covid-19 era, Advent International and Forescout Technologies shook hands on a revised agreement that cuts the cybersecurity company's valuation by nearly $500 million, ***writes Sarah Pringle***.

The settlement, just days before a trial that was slated to begin on July 20, underscores the fact that proving a material adverse event clause, or an MAE/MAC, remains a huge undertaking. "One, MACs are incredibly difficult to prove. As the buyer, you always know that you have an uphill battle and that there's risk going in. It's really hard to win," according to Matthew DiRisio, a partner at Winston & Strawn. "Two, it's incredibly expensive to litigate these."

"MACs are incredibly difficult to prove. As the buyer, you always know that you have an uphill battle"

Matthew DiRisio
Winston & Strawn

A good weapon

"All this did was reinforce the [issues] we already knew," says another litigator, requesting anonymity. "[An MAE is] a good weapon to renegotiate down price. There are vulnerabilities on both sides of [such cases] and this is the most common result."

A MAC win would have opened the floodgates for more disputes, but this outcome was beneficial to the buyer, adds DiRisio, a member of Winston's securities litigation practice.

"[PE] buyers may not actually be disappointed that this is settled," DiRisio says. "The reason is, just looking objectively at MACs, you have to assume the odds are you're not going to win a MAC … On balance, a deal that's at a pretty good discount to the sale price is better than having the Court of Chancery say the deal doesn't constitute a MAC. That would be more damaging to buyers than a settlement on the eve of [the trial]."

At the core of Advent's argument was the disproportionate financial impact that the company suffered in relation to its peers, while also arguing the cybersecurity company failed to operate in the ordinary course. But Forescout argued that its deteriorating performance was caused by covid-19.

Under the amended terms of the transaction, Advent is set to acquire all outstanding shares of Forescout common stock for $29 per share, down from $33. The revised agreement brings the deal's value to $1.43 billion, from $1.9 billion. Advent, partnering with Crosspoint Capital Partners on the transaction, struck its initial all-cash deal for Forescout on February 3. ■

Covid-19 fallout **Blackford Capital's Mopec reaps lurid rewards**

As covid-19 cases overwhelm healthcare systems around the country, morgue equipment provider Mopec is experiencing unanticipated gains.

Mopec, a portfolio company of Blackford Capital, generated higher sales during the second quarter than all of last year, the firm says.

In response to covid-19-fueled demand, Mopec has introduced new products, repositioned its sales and marketing efforts and registered as a supplier in every state. All of this while the pandemic ravaged PE-backed companies in other sectors.

One change in the playbook: Mopec began working with state governments, something it hadn't done before. The company traditionally sold medical equipment and laboratory products to funeral homes, morgues, university medical schools and hospitals. "Government entities weren't concerned with what happened with dead bodies earlier," explains Martin Stein, founder and managing director of Blackford Capital. "So the shift that occurred was that we had to sell to a whole new group of customers."

Government entities are purchasing products to be used in coordination with hospitals. One such item used to protect healthcare workers and funeral home directors is Mopec's CDC-compliant body bags. The company, following its acquisition by Blackford, partnered with manufacturers to distribute body bags. "People don't really know how covid is transmitted," says Jeff Johnson, a managing director at the PE firm. Putting bodies in body bags made of special fabric helps to eliminate the spread of virus. ■

Lights, camera, LPs! **Sweden's EQT takes virtual meetings to a new level with an old medium**

Creating a fully-formed, network-quality TV show is probably not the most common way to present an annual investor meeting to clients from around the world, but Scandinavian giant EQT did just that. In early June the investment firm teamed up with a media production company to hold its yearly LP meeting in the style of a TV show, ***writes Adam Le*** of sister publication *Private Equity International*.

Streamed online to LPs via a portal custom-built by the firm's internal tech team, EQT condensed two days' worth of content into a two-hour program that included updates on portfolio companies, performance and crosses to investment staff in London, Zurich and Hong Kong.

"We received really positive feedback from investors on the content and on the format in general," says Jussi Saarinen, the firm's head of client relations and capital raising.

The program was "live-on-tape," meaning it was pre-recorded in real time, and the virtual format resulted in around 520 LPs tuning in, which is almost double the 290 who attended the firm's investor meeting in person in Stockholm last year. EQT's AIM-by-TV show comes as the private equity industry faces the challenge of how to stay connected with LPs and raise capital from existing or new investors remotely, due to the coronavirus-induced lockdown in many parts of Europe and North America.

There is evidence that launching and closing a fund is possible during a global pandemic. In late June London-headquartered Tenzing Private Equity said it had raised £400 million ($493 million; €439 million) for its second vehicle, and that this was the first-ever buyout fund raised entirely virtually.

"GPs and LPs have embraced technology – it's almost jolted us into 2050," says Alexander Rayden, a senior managing director in Evercore's private funds group who advised on the fundraise. Technology brings greater efficiency and effectiveness to capital raising, he adds.

> "GPs and LPs have embraced technology – it's almost jolted us into 2050"
>
> Alexander Rayden
> Evercore

In Tenzing's case, 40 percent of the capital raised came from investors who had no prior relationship with the firm. Some of these institutions were required to change their investment protocols and seek approval from trustees to sign off on commitments for a firm they had not been able to conduct due diligence on or meet in person. "I'm proud of the industry's ability to be dynamic and adapt," Rayden adds.

According to Saarinen, EQT has raised capital from investors who joined the firm's platform after the coronavirus crisis began.

Not all investors can get comfortable with virtual fundraises. Speaking at a virtual industry event in June, Delaney Brown, head of private equity funds at Canada Pension Plan Investment Board, said committing to a first-time fund during lockdown would be tricky for the pension.

"We very selectively invest into emerging managers and first-time funds anyway, but right now I think it would just be more challenging to give them a fair crack of the whip," Brown said. "If they're a new group to us and the people are new to us, you can get so far in a virtual interaction but it's quite difficult to commit capital to somebody that you've not spent time physically with."

The future of investor relations and capital raising is most likely a hybrid model comprising virtual and in-person meetings, posits Saarinen. Still, nothing can replace in-person meetings, he warns.

"You can maintain relationships over the phone, and even video, but you can't build them over the phone," Saarinen says. "These virtual events, they will not replace physical meetings. We're social animals, and this is a people business. People want to meet and spend time together." ■

Gender inequality **AXA takes aim at male-only boards of directors**

AXA Investment Managers is stepping up its fight against gender inequality in the companies in which it invests, setting new targets in both developed and emerging markets, ***writes Kalliope Gourntis*** of sister publication *Infrastructure Investor*.

The Paris-based asset manager, which ranked 31st in sister publication *Private Equity International*'s Global Investor 100 list of the biggest private equity investors around the world, will introduce a 33 percent diversity target from next year. This will aim to push listed companies in developed markets to have female members account for at least one third of their boards of directors.

"AXA IM will specifically oppose the election or re-election of the nomination committee chair where these minimum requirements are not met," the firm said in a statement. "If the election/re-election is not on the agenda, AXA IM will vote against the approval of accounts."

The firm is also targeting listed companies in emerging markets and Japan, as of this year, where the board of directors does not include at least one female director. In the case of larger boards, the minimum for female representation is set at 10 percent.

"Studies show that a well-balanced and gender-diverse board of directors leads to higher profitability and value creation, overcomes issues of group think, triggers debates and innovation, and leads to stronger diversity of representation across the organization," AXA IM's head of ESG research and active ownership, Yo Takatsuki, said in the statement.

AXA IM had $9.9 billion, or around 1.1 percent of its assets under management, exposed to private equity as of 31 December, according

to the GI 100. The asset manager will use its voting power at companies' general meetings if there are concerns that a company is failing to disclose and implement measures aimed at addressing gender inequality at the executive committee-level.

Last year, AXA IM focused on pressuring companies to seek gender equality at every level of the corporate hierarchy. Those efforts resulted in the asset manager targeting 272 companies due to diversity concerns – a 369 percent jump compared with the 58 companies it had targeted in 2018.

Examples of its voting activity include not approving a company's report and accounts, or a relevant director, at companies in developed markets that had all-male boards; voting against the chairman of the nomination committee of companies

> "Studies show that a well-balanced and gender-diverse board of directors leads to higher profitability and value creation"
>
> Yo Takatsuki
> AXA IM

in the UK FTSE All Share Index where less than a quarter of the board is female; and voting against the chairman of the nomination committee or relevant director at US companies with women comprising less than 20 percent of the board.

This year, between January and May, AXA IM has targeted 186 companies.

Greater diversity

Asked why AXA IM was focusing on gender diversity and not more broadly on ethnic and socioeconomic diversity, a spokeswoman said the asset manager "will consider how to address other types of diversity."

The firm conducts bias training for its employees, which covers racial stereotyping, the spokeswoman said. "We are also an active participant of the Investment Association's Diversity Project, and its campaign #TalkAboutBlack that aims to address the chronic under-representation of black talent in asset management by developing a sustainable pipeline of black leaders," she added.

In addition, AXA IM is also piloting internally a series of group discussions focusing on ethnicity.

"We see our approach to diversity and inclusion as being on a journey and, in order to take our next steps towards driving meaningful change, we must first have an open dialogue on ethnicity to develop a deeper understanding of individual experiences from a grassroots level," the spokeswoman explained. "We recognize that we, and the wider asset management community must do more, and we will continue to strive for greater diversity at every level."

AXA IM itself has achieved or exceeded the 33 percent target it has set for its investee companies, for its management board, remuneration committee and its audit and risk committee. It's slightly below target – 29 percent – when it comes to its board of directors, with two women on the seven-member board. ■

Quick hit **Family capital's moment**

Q+A

With **Paul Carbone**
Pritzker Private Capital

Paul Carbone is president and managing partner of Pritzker Private Capital, the private markets arm of the Pritzker Group, an investment firm run by the Illinois-based Pritzker family. Pritzker Private Capital invests in mid-market companies across a host of sectors, including healthcare, services and manufacturing. The firm focuses on family-run businesses in North America. Family offices are surveying the impacts of the coronavirus crisis and looking for ways to make their money work in this unprecedented situation. Carbone feels family capital is ideally suited to this environment.

Q What are the advantages of family capital during this crisis?

Family capital is often both permanent and proprietary, allowing for maximum flexibility in terms of its structure, terms and intent. Family investors can most readily craft capital solutions which are tailored to the specific needs of a business and its owner. In particular, family capital is not bound by the duration constraints of traditional private equity funds. We have the flexibility to invest for the long term and look past shorter-term crises to pursue an attractive path to sustainable growth.

Q How would you compare it with private equity?

Family capital is most advantaged when business sellers or seekers of capital care about their companies post-close. For businesses that care about legacy, their company culture and how long the company operates as an independent entity, family capital often can most adeptly address these needs versus traditionally structured capital. In addition, for a family business seller, family investors bring an understanding and an appreciation of how family businesses operate and what they need to be most successful. Shared vision, philosophies and values are often the common foundation of successful partnerships.

Q What investment strategies do you recommend families employ? Would you recommend minority or majority investments?

With the inherent flexibility and longer-term perspective I've mentioned, family investors are able to customize solutions to the specific challenges facing founder-led and family-owned businesses. As one example, today we are seeing discrepancies between how businesses might view their prospects and how potential investors might underwrite those same forecasts. In a market where sellers and buyers may not agree on valuation, having the flexibility to provide structured minority capital allows family investors to bridge value discrepancies. Also, the new transaction debt market is anything but robust today as lenders focus on their existing credits and they too take a conservative cut at business projections. As a result, much of the traditionally structured majority ownership capital is on the sidelines with few new control deals getting done, leaving potentially attractive investment opportunities to family investors using minority capital structures. Family investors can look beyond the turmoil of today's market and not worry about having to generate the immediate/consistent growth traditionally structured funds might need to satisfy their requirement for a nearer-term exit from their investment.

Q How has Pritzker Private Capital approached this moment?

Throughout this crisis, our sizable investing and operating teams have worked seamlessly and tirelessly in support of our company employees and our companies. In addition, we have invested only where we have deep expertise and understanding, and have tried to avoid companies with significant uncontrollable or unfamiliar risk. Our efforts have been further reinforced with the formation of Pritzker Advisory Board, which includes eight senior executives with deep, relevant operating expertise to bolster our internal bench of talented operating executives. As a result, we are fortunate that our employees, management teams and companies are performing well during this crisis. In turn, we are very interested in investing in and working with new businesses who value our differentiated family capital and seek a partner who can bring a flexible structure, shared values and a longer-term perspective. ■

On the move Recent personnel changes within private equity, its portfolio companies and service providers

Service providers

Prostar Capital
The company promoted Stuart Blackadder to managing director and head of its US office in Greenwich, Connecticut. Also, Prostar has upped Kevin Johnson to chief financial officer. Blackadder first joined Prostar in 2012 while Johnson came on board in 2018.

SierraConstellation Partners
The advisor to mid-market companies in transition named Bill Partridge as a managing director. Partridge will be based in the San Francisco Bay Area. Also, SCP hired Merv Merzoug as a director in New York City and Elizabeth Knapp as executive assistant to Boston office leader Tom Lynch.

The Raine Group
The global merchant bank named David Levy as a senior advisor. Levy previously served as president of Turner, where he oversaw the company's domestic broadcast portfolio, as well as its domestic ad sales and distribution businesses.

WilliamsMarston
The accounting advisory and management consulting firm promoted Ryan Ganley to director and Nolan Kiernan to manager. Ganley joined the accounting advisory and management consulting firm in 2017 from PwC. Kiernan joined WilliamsMarston in 2018 from PwC.

Private equity firms

OpenGate Capital

The Los Angeles private equity firm named Pradeep Ramamurthy as co-head of investor relations. Ramamurthy will work with OpenGate founder and CEO Andrew Nikou as well as Alanna Chaffin, the firm's co-head of investor relations and communications.

Ramamurthy previously worked as managing director at the consulting firm Cauvery and as a managing director at the private equity firm The Abraaj Group. He also has served in senior operational and management positions at the White House, US Agency for International Development and the US Intelligence Community.

Millpond Equity Partners
The Boca Raton, Florida firm named Jeremy Menkhaus as vice-president. Previously, Menkhaus was a vice-president at an unnamed private equity firm in San Francisco.

Oak Hill Capital Partners
The firm has named Micah Meisel as a partner. Previously, he was managing director at InTandem Capital Partners.

Roxborough Group
The real estate focused firm named Nicholas Bryer as senior vice-president. Recently, Bryer was vice-president of investments at CIM Group.

Portfolio companies

Advarra
Advarra, which is backed by Genstar Capital, has named Gadi Saarony as CEO. Recently, Saarony was executive vice-president and chief clinical research services officer at Parexel International. Advarra is a provider of global research compliance services.

Syniti
The company named Suzanne Barth as executive vice-president and chief people officer. Recently, she served as EVP and chief HR officer at GTY. Headquartered in Needham, Massachusetts, Syniti is a portfolio company of BridgeGrowth Partners.

The Atlas Group
The company named Jim McMullen as CEO. Atlas Group is backed by private equity firm AE Industrial Partners LP. He previously served as Atlas's COO.

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Silver Lake gets the gold

Silver Lake raised nearly $15 billion for its sixth flagship fund that it launched into the teeth of the pandemic downturn, a source told *Buyouts*. The downturn appears to have had no effect on Silver Lake's fundraising process, which kicked off in the first quarter. Fund VI is expected to reach $18 billion as a final tally, which could come as soon as August, the person said. Park Hill Group is working as placement agent on the fundraising.

Fast clip

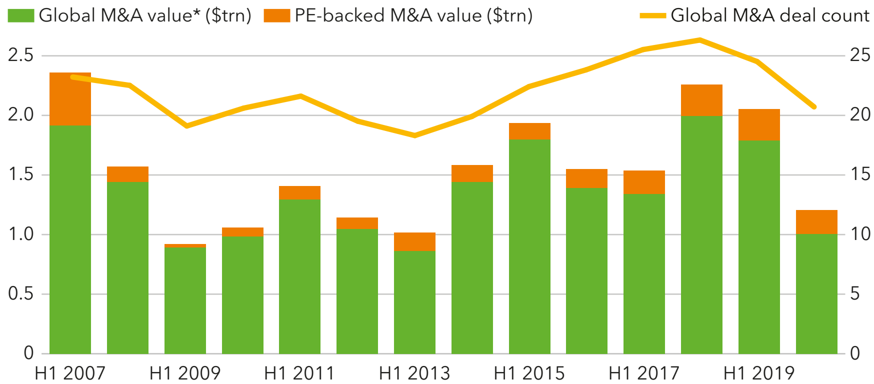
Cove Hill Partners wrapped up fundraising for a second long-term consumer- and tech-focused offering, securing about $1.5 billion, a person with knowledge of the matter told *Buyouts*. Surprisingly, the Boston private equity firm raised Cove Hill Partners Fund II and a parallel vehicle at a fast clip during the health crisis. Marketing officially began in the late spring, the person said, well after the outbreak of the covid-19 pandemic. Fund II is roughly 50 percent larger than its predecessor.

Fertile ground

Harvest Partners launched a third non-control, structured capital fund as market dislocation and liquidity constraints spawn opportunities for alternative equity strategies. The New York private equity firm filed Form D fundraising documents for Harvest Partners Structured Capital Fund III and a parallel pool. The vehicles are together seeking $1 billion. Credit Suisse is the placement agent. If Harvest meets the target, Fund III will be 27 percent larger than its predecessor.

First-half results **PE-backed buyouts outperform relative to the M&A market**

Overall M&A vs PE buyout deal values



Source: Global Mergers & Acquisitions Review, Refinitiv; * excluding private equity-backed deals

As a percentage of the broader overall M&A pie, PE-backed buyouts had their best first-half performance in 13 years, while total deal activity sank the first six months of the year, according to data from Refinitiv, ***writes Karishma Vanjani***.

Globally, the number of deals fell by 16 percent through the first half of 2020. But private equity deals accounted for 17 percent of overall M&A activity over the period – the highest percentage since H1 2007.

"PE is outperforming the broader market," says Matt Toole, director of deals intelligence at Refinitiv. Although the overall value of private equity transactions dropped by 24 percent, alongside an 8 percent decrease in deal count, the alternative investment class shows promise. "These [PE] companies have a tremendous level of capital," adds Toole.

Bond issuance hit record highs in the first half of 2020, according to the financial market data provider. The global debt capital markets issued $5.5 trillion-worth of bonds in the first two quarters, a 35 percent jump from a year ago and the strongest opening over a six-month period since 1980.

Still, the M&A markets generated only $1.2 trillion in combined deal value over the corresponding period, a 41 percent drop year-on-year.

The market volatility can be partly attributed to moves made by the Federal Reserve. Besides the rollback of interest rates in March, the Fed also started buying back corporate bonds. On May 12, the bond-buying facility bought $305 million-worth of corporate bonds, according to publicly available data. "It created a perfect storm," says Toole. "Conditions were extremely attractive for issuers who wanted to be in the market and even the opportunistic issuers."

Outlook

Toole expects the airline, media and travel industries to reimagine their structures. But the state of the deal pipeline depends on how quickly industries open. "We haven't seen a huge spike in transactions; most businesses are assessing what their landscape looks like."

Still, Toole sees opportunity for investment: "PE might be able to [go] where they haven't been in the past few years," he says. "They certainly have the capacity to make a transaction now," he adds, pointing to the huge sums of dry powder sitting on the sidelines.

Allocations **PE value is down at Florida SBA, but secondaries opportunities await once Q2 valuations are in**

Florida State Board of Administration's private equity portfolio value is expected to fall 9 percent to 10 percent for the first quarter of 2020, staff has told ***Justin Mitchell***.

At the June 30 meeting of the Investment Advisory Council, senior investment officer John Bradley said this "compares very favorably" against the program's benchmark, which fell around 20 percent. He noted the final Q1 valuations were still coming in.

Contributions had decreased by about 60 percent since the coronavirus crisis took hold and froze dealflow, Bradley said. He still expected 2020 to be a positive cashflow year for the board, which manages assets for the Florida Retirement System Trust Fund.

"What's different this time is our distributions have actually increased by approximately 15 percent," Bradley said. "A majority of the increase in these distributions has been from the sale of publicly-traded shares and the selling of publicly-traded shares has been very strong over the last few weeks. And so if there are any questions as to how our private equity GPs feel about public market valuations, this is probably as strong of a signal as I can think of."

> "[The staff] has been very selective about which GPs we have re-upped with and which we have increased scale with"
>
> Ash Williams
> Florida State Board of Administration

Opportunities amid the crisis

The board seemed interested in what opportunities the crisis provided and how the fund could take advantage of them. Staff were asked multiple times about secondaries. They said the market would remain slow for now.

"There's really this sense of waiting for 6/30 valuations to come out to get a good sense of where these portfolios should be priced for an appropriate return," Bradley said. "We would think [secondaries] will pick up in the next six to nine months."

Until then, things will be uncertain. "On the sellers' side you get that normal situation where the sellers' expectations really haven't digested yet, and so there's still a pretty sizable bid-ask spread in the valuations side," he said.

But once the dust clears, Bradley seemed confident there would be action in the secondaries market. "While we might not see the depths of distress that we saw in 2008 and 2009, I think since then... LPs are much more active repositioning their portfolio, taking things to market," he said, adding that Florida would be well-positioned to take advantage of that.

No levering

Executive director and chief investment officer Ash Williams said there are no plans to increase the overall private equity presence.

Responding to council chair Vinny Olmstead, Williams said Florida would neither increase its asset allocation or pursue what Williams dubbed a "more radical idea... levering up our existing private equity exposure or other parts of our portfolio." He added: "What we don't want to do is increase risk in the portfolio in a way that we potentially increase the downside risk of short-term downdraft in the market shock to the portfolio and the related contribution shock that that could generate."

Bradley added that staff was limited to a 20 percent allocation for alternatives, which includes both private equity and another asset class called strategic investments.

Williams added that Bradley and the staff have "been very selective about which GPs we have re-upped with and which we have increased scale with and which we have chosen not to re-up with."

"I think that activity in and of itself has been very effective in improving the value proposition for our private equity investment book," Williams said. As of June 30, the fund was valued at $160.7 billion. Private equity made up 7.3 percent against a 6 percent target, according to a Florida spokesman. Strategic investments made up 8.87 percent against a 12 percent target. ■

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WellSky looks sunny
TPG is evaluating the sale of WellSky, the software company serving post-acute-care providers among other healthcare settings, according to five sources familiar with the matter. Goldman Sachs and William Blair are offering sell-side financial advice, the people said. WellSky, formerly Mediware Information Systems, posts annual EBITDA of approximately $150 million, sources said. The company could fetch a valuation of around $3 billion.

Elder-care alternative
Apax Partners agreed to buy a stake in InnovAge from Welsh, Carson, Anderson & Stowe in a deal valuing the provider of PACE (Program of All-inclusive Care for the Elderly) at $950 million, according to four sources familiar with the matter. In connection with the agreement, Apax and WCAS are set to jointly control InnovAge, with each owning 49 percent stakes, one of the people said. The deal has yet to close. For Apax, the deal is its first healthcare platform investment since 2018, when it bought Healthium MedTech, an Indian medical devices player.

A different Zoom
Amid all the bad news in the market dislocation, here's a success story: TA Associates turned its 2014, $90 million investment in ZoomInfo into a valuation of $6.12 billion in the company's public offering in June. That represents the largest paper return in the firm's history. ZoomInfo, which provides a cloud-based intelligence platform for sales and marketing teams, began trading on Nasdaq on June 4. Its stock, initially priced at $21 per share, soared 90 percent in first-day trading.

Funding diversity **Firm launches $100m program to help minority-owned and -led businesses**

Founders First Capital Partners (FFCP) launched a program in June to help minority-led and underserved businesses access capital, ***writes Teddy Grant***.

The firm's Racial and Social Economic Equality Initiative will invest $100 million into underserved companies. The money is a credit facility provided by Community Investment Management, a debt provider led by managing partner Jacob Haar.

The initiative seeks to help diverse managers "not only just by providing capital, but helping them gain relationships with large organizations to grow their business," FFCP CEO Kim Folsom tells *Buyouts*.

The program also will help businesses "transform and improve their revenue models. It's really difficult for them to get substantial capital for job creation."

The company is providing an average of $250,000 to around 500 businesses. Funding can go up to $1 million, and the $100 million will be invested over four years with a return cap rate of 1.5x and a royalty rate of 6.5 percent, according to Folsom.

FFCP mainly invests in service-based companies in areas such as IT, training and certification that usually work with larger businesses.

Formed in 2015 by Folsom, FFCP has worked with more than 300 diverse-led businesses, helping them grow revenues to more than $130 million. The firm also helped those companies increase period-over-period growth by more than 25 percent, brought in $20 million in third-party funding and supported the creation of between two to five jobs on average, Folsom says.

'Absolutely phenomenal'
One shining example of FFCP's investment is Swann School of Protocol, an etiquette training business in San Diego.

Swann School founder and CEO Elaine Swann calls the experience "absolutely phenomenal. I had more growth in my business in the last two years being involved with Founders than I had in the five to seven years before that," Swann says. The company has 20 owned and operated businesses across the country, most of which are run by black women, according to Swann.

"Every major organization has key things that they have to do to operate and generally it's done by small businesses. It's just that [most] of the businesses they work with are not businesses led by people of color"

Kim Folsom
FFCP

"Every major organization has key things that they have to do to operate and generally it's done by small businesses," Folsom says. "It's just that [most] of the businesses they work with are not businesses led by people of color. We're trying to grow that."

Healthcare corner **Signs of normalcy on the horizon?**

Comment

Expert analysis by **Sarah Pringle**

It seems deal conversations are picking back up a bit in healthcare land.

Apax came out on top in the process for Welsh, Carson's InnovAge, which offers an interesting alternative to traditional nursing home care. The two firms are set to own equal stakes in the provider of PACE (Program of All-inclusive Care for the Elderly).

In another new development, there are two processes I recently covered in which the parties were scheduling to hold some sort of in-person meeting or on-site walk through, sources told me.

Is this a sign of some return to normalcy or are people just desperate to leave their homes? As more processes move forward, such considerations are likely to be case- and geography-specific, one banker told me. It also may add another benefit to running a tightly conducted process requiring fewer engagements.

Cancer care

Many of you have probably heard of Cancer Treatment Centers of America, which operates integrated cancer care across five cancer hospitals and five outpatient care centers.

CTCA has grown increasingly well-known through its aggressive direct-to-consumer branding and advertising efforts over the years – a big differentiator from other oncology care providers, sources say. Other health organizations like Mayo Clinic, Kaiser Permanente and Cleveland Clinic have followed with expanding advertising budgets, but CTCA is well ahead.

> “In this environment, it's tough to get someone started from scratch”
>
> Source familiar with the CTCA process

Now, a little more than a year after bringing on a new CEO – Pat Basu, a former Optum/UnitedHealthcare exec, private equity investor and White House aid – the company is poised for a potential sale, I've learned.

Turns out, a quietly run process for CTCA is well underway, with two of the bidding groups comprising a private equity fund and a not-for-profit health system that have teamed up.

CTCA underscores a theme that some say they expect to see more of in today's everything-remote universe. That is, folks are realizing the benefits of running a super narrow and exclusive sale process.

"In this environment, it's tough to get someone started from scratch if you haven't met management and had in-person connectivity pre-covid," says one source familiar with the CTCA process. CTCA, for its part, fielded inbound interest pre-pandemic, sources say. ■

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Sarah Pringle is editor of sister title *PE Hub*

ON • THE • WIRE

Nuggets from our daily emails to subscribers

■ Into the breach

When you're a multi-strategy mega-platform, you can seize on opportunities created by shifting markets. In the lending breach created by the cratering of the CLO markets, Apollo Global Management formed a lending platform intended to provide about $12 billion in financings over the next three years, the firm said. Apollo formed the platform across several of its permanent capital vehicles and in partnership with Mubadala Investment Co. The platform, called Apollo Strategic Origination Partners, will target transactions of about $1 billion.

■ Silver Lake goes for gold

Silver Lake raised nearly $15 billion for its sixth flagship fund, which it launched into the teeth of the pandemic downturn, a source told *Buyouts*. The downturn appears to have had no effect on Silver Lake's fundraising process, which kicked off in the first quarter. Fund VI is expected to reach $18 billion as a final tally, which could come as soon as August, the person said.

■ Deal surge

Activity in the private equity secondaries market appears to be building under the surface, with the expectation that the lid will blow off and activity will pour out sometime after August. Multiple sources told *Buyouts* in July that they were in conversations with GPs about potential liquidity option transactions. This is all in preparation for the release of Q2 performance marks on funds, at which point the belief is buyers and sellers will be comfortable transacting off of that information. ■

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Editor's letter

Bracing ourselves for the second half

Karl Shmavonian
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Under normal circumstances, summer is a quiet time of year to take stock and anticipate what's coming in the fall. This year, keeping tabs on things is an uphill battle, but we're giving it a shot and taking a look at what to expect in the coming months.

Issue number one for all is the frightening outbreak of covid in many parts of the US that were relatively healthy early on, and the demoralizing returns to shutdowns, or partial shutdowns, in states that had opened up (California being a prime example). Nobody can make market predictions with certainty when we have no idea how people will live their lives, how they'll shop, whether they will travel and if kids will be in school. The only prediction that everybody can agree on is that best solution for everybody is a coronavirus vaccine.

"First-half Chapter 11 filings were up 26% versus the first half of last year"

While most members of the PE community are in it for the long haul and seem fairly confident, there are disturbing signs: commercial Chapter 11 filings were up 43 percent in June compared with the same period last year, with 609 filings, according to Epiq. And first-half Chapter 11 filings were up 26 percent versus the first half of last year. On a related note, there have been ominous rumblings in the CLO world, with one player saying that we're seeing "the chickens come home to roost" *(see p. 28)*.

Another sign of the times, as Chris Witkowsky wrote recently in the *PE Hub* morning Wire, is "recycling," a process that emerged at the beginning of the crisis in which GPs recycle proceeds from recent sales into older investments, often to shore up troubled entities affected by the pandemic. Rumors have it that the process is being stretched so that a couple GPs are asking LPs to return distributions they received from sales that happened years ago, which is taking things a bit far.

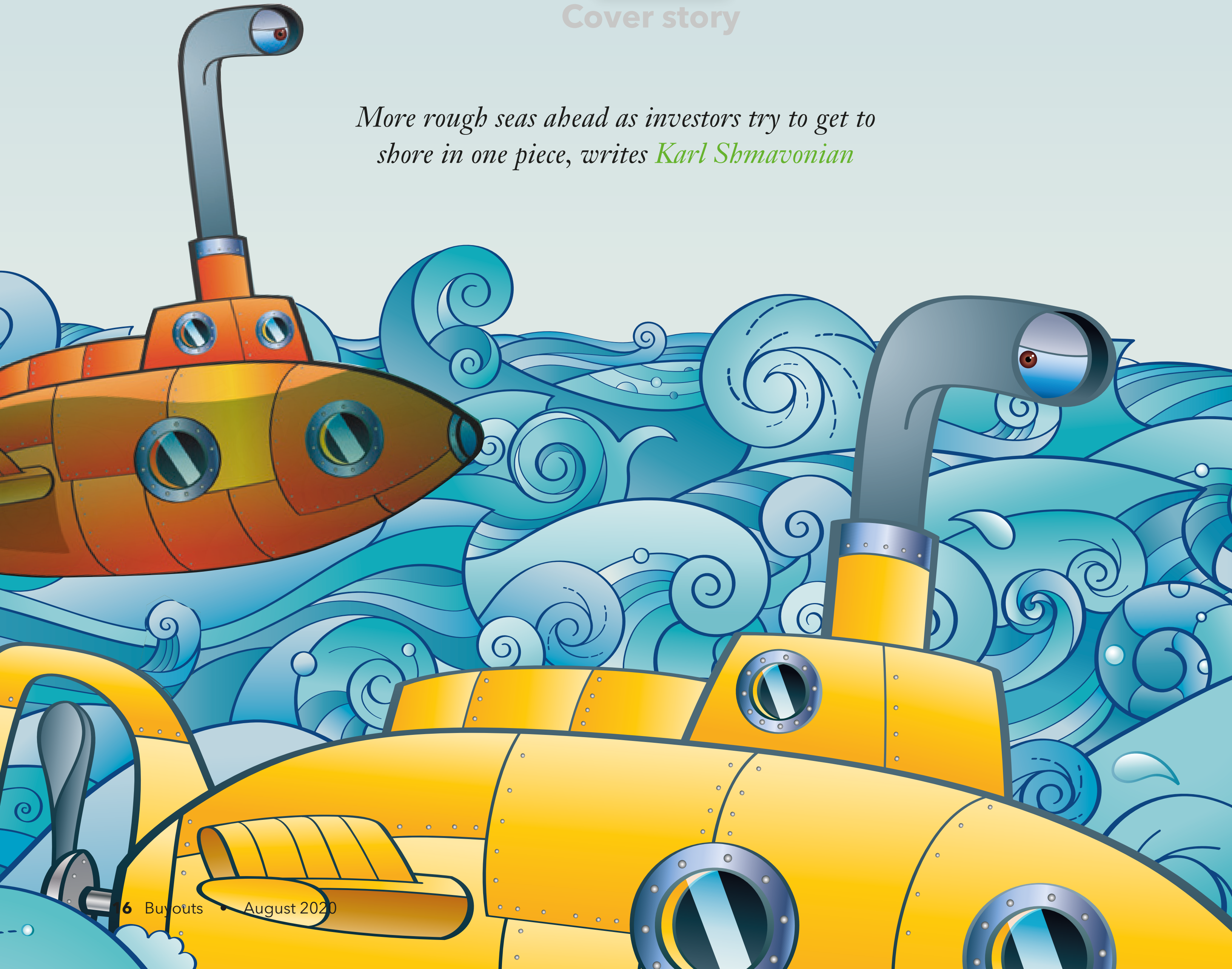
We hope you are staying healthy and enjoy the waning days of summer.

Karl Shmavonian

Coming up for air

Cover story

More rough seas ahead as investors try to get to shore in one piece, writes Karl Shmavonian



Dear reader, you are forgiven if you have "We all live in a yellow quarantine!" going through your head as you read our cover package. We thought that some color was needed to lighten your mood and ours.

We're taking a look at how things have played out in the M&A, fundraising and LP worlds during the past few months, but more importantly, we're trying to suss out how things may evolve over the remainder of the year. We've talked to a variety of the players who are in the thick of it – many of them veterans of previous shocks, such as the global financial crisis of 2008 – and asked them for their take on the markets.

In the fundraising world, there are promising signs: private equity raised $162 billion in the first half of this year, actually higher than last year's first-half total of just over $150 billion. A lot of that may have been locked in before the pandemic struck, but it offers a glimmer of hope.

Not as rosy: PE-backed M&A activity sank dramatically and quickly in the first half of 2020. The overall value of private equity transactions dropped by 24 percent, alongside an 8 percent decrease in deal count in the first half of 2020. But dealmakers are loaded with dry powder and are optimistic. Given the medical crisis and the global adaptation to remote learning, commerce and education, it's not surprising that investors are chasing companies in the health and tech sectors.

Another trend that we've seen: LPs are increasingly funneling their money to big-name GPs that they've worked with for years, leaving emerging managers out in the cold (the "flight to what you know," as one investor put it). The primary reason for this is the inability to have face-to-face meetings, which means that LPs are less likely to make a first-time investment with an emerging manager whom they have met only on Zoom calls.

Our writers are also hearing from sources about how hard it is to get accurate valuations of portfolio companies going forward – ultimately, how can you know how companies will fare when we don't know how people will work, where they will live, how they'll exercise, how they'll shop for clothing and food, if they'll travel and how far, how they'll socialize, attend sporting events, movies, theaters and museums? Seismic changes in lifestyle will lead the markets.

Finally, epidemiology is destiny: either the pandemic continues to escalate, slowly flattens or is eradicated by a miracle vaccine. Until the consequences of the virus play out, all bets are off.

M&A poised for steady recovery

After a rough first half there are signs of an upswing in deal activity, particularly in tech and healthcare, writes Karishma Vanjani

Deal activity is poised to pick up in the second half of 2020, but M&A won't be near pre-covid levels as private equity firms remain cautious buyers and sellers, industry experts tell us.

PE-backed M&A activity sank dramatically and quickly in the first half of 2020 due to covid-19. The overall value of private equity transactions dropped by 24 percent, alongside an 8 percent decrease in deal count in the first half of 2020, according to Refinitiv data.

Dealmaking is already showing signs of snapping back, fueled by the presence of resilient companies, record levels of dry powder and strong credit markets.

But this resurgence will be slow as sponsors play the long game. Private equity funds are taking their time assessing risks and future performance of companies before deploying capital, according to bankers and advisors.

Hot pockets of investment

At Bain & Co, clients' investment pipelines are primarily focused on healthcare and tech, says Brenda Rainey, a senior director within the private equity practice.

For example, one larger healthcare tech deal being shopped is TPG's WellSky, which could command a valuation of around $3 billion, or close to 20x EBITDA, sister publication *PE Hub* reported in July.

Generally, tech has been a predominant area of investment since the great financial crisis. The sector recorded an almost 600 percent increase in deal count from 106 in 2009 to 735 last year – surpassing every other sector since 2007 – according to Refinitiv's Americas data.

> *"We are asking everyone to put together scenarios for us: how it will look if nobody goes back to work after Labor Day"*
>
> **GREG BELINFANTI**
> **One Equity Partners**

"I don't think this comes as a surprise," says William Sanders, global head of financial sponsors at Morgan Stanley, referring to tech capturing a big chunk of the S&P market. "Some people think those are pretty defensible businesses."

In the first half of 2020, 409 announced PE-backed technology deals in the Americas produced $21.5 billion in combined deal value, according to Refinitiv.

In notable tech deals year-to-date, publicly traded Keysight Technologies acquired Eggplant, a UK-based automated software testing tools provider, from Carlyle Group. The deal's valuation implied a revenue multiple of nearly 8.7x.

Dealmaking also depends on which assets lenders are comfortable funding, according to Rainey.

"There is certainly a bias for quality assets," Rainey says. "Businesses that have more certainty for their products and services are much more likely to get past the scrutiny of the lenders."

That's not to say other segments of the market, like food manufacturing, aren't attractive to investors.

"The whole world can't chase [tech, healthcare, telecom]; there's better value in other sectors, too," Sanders says.

In fact, public food manufacturers are near three-year highs, and private equity backers in the sector are eager to bring assets to market, according to David Iverson of Lazard.

However, suppliers or distributors to restaurants such as Sysco that don't sell a lot to grocery stores are not doing well, cautions Iverson, managing director and head of the advisory firm's consumer, food and retail arm.

Flight to quality

Business performance has varied widely across sectors and geographies based on individual assets' exposure to covid-19, as well as how successfully they've been able to adapt to the downturn.

While attractive and defensive industries like tech are active, sponsors are focused on business models rather than sector-specific companies, according to Richard Harding, managing director and co-head of private equity solutions at Moelis.

"Businesses that are out there right now are high quality; the ones that have generally showed the ability to perform," Harding says.

And these resilient businesses have immediately become more valuable. "They are actionable in a market where there are far fewer opportunities and at least as much capital," adds Harding.

"There is a massive wave of companies that are ready to try to sell. If things continue as they are, starting September, you are going to see an uptick"

DAVID IVERSON
Lazard

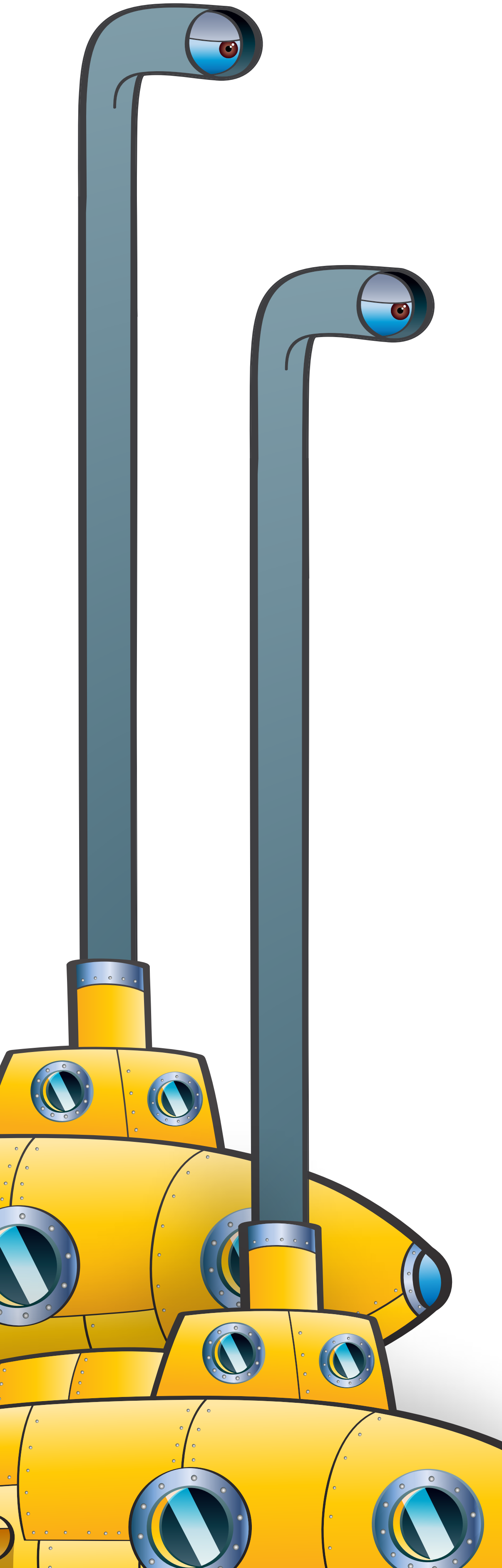
Sitting on a trillion-dollar cash pile, private equity firms are eager to invest; but a supply-and-demand imbalance makes doing so much more difficult.

The strongest businesses are expected to command great valuations, but for investors it is difficult in this environment to estimate future, post-covid performance and come up with accurate valuations. "We are asking everyone to put together scenarios for us: how it will look if nobody goes back to work after Labor Day," says Greg Belinfanti, senior managing director at One Equity Partners.

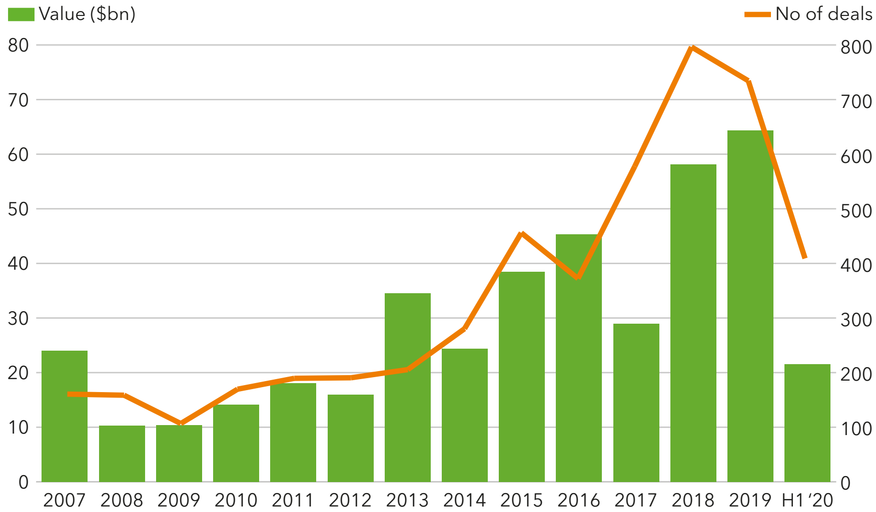
Things are looking up, but the revival in M&A activity in the back-half of 2020 is likely to be gradual rather than dramatic, simply because there aren't as many financially healthy, affordable targets in the market as there were pre-covid. "You will not buy a cheap gym if it's not going to open up," a prominent advisory firm banker says, referring to discounted assets.

"With some exceptions, like direct-to-consumer companies, we are telling our clients [that] it's not a good time to be a seller; there is enough uncertainty out there," Iverson says.

Deal volume in the consumer and



PE-backed tech M&A has seen a steady growth in deal count and value



Source for charts: Refinitiv

food space has declined significantly since the pandemic surfaced, but that could soon change. "There is a massive wave of companies that are ready to try to sell," Iverson says. "If things continue as they are, starting September, you are going to see a noticeable uptick."

Harding agrees. High-quality, covid-resilient businesses will enter the market as founders accelerate monetization efforts, he says: "Post Labor Day it's going to be a busy M&A market."

Pricing

Some sponsors are vying to pay lower multiples for businesses given today's climate, but sellers are not ready to accept a discount, a situation that will be resolved when either the buyer or the seller blinks.

"When it comes to higher quality assets, the sellers want what they could have had before [covid], and the buyer wants a discount," Sanders said.

As an alternative to traditional M&A, some PE investors in the first half of the year took advantage of distressed assets.

Others saw opportunity to deploy capital through PIPEs, with investments in more than 162 public companies as of mid-July, according to PitchBook data.

Why? The math is simple, according to Aaron Cheris, who leads Bain's Americas retail practice: Distressed businesses that suddenly lost most, if not all, of their cashflow needed instant liquidity and "GPs had enough capital to move faster than public offerings."

"Covid definitely led to a number of PIPEs in the US," Rainey agrees. "When capital needs to be raised quickly, PIPEs can be efficient."

Heading into the back half of 2020, deal dynamics look better than to be expected. Markets are so far regaining losses and experts believe there is minimal distress beyond retail.

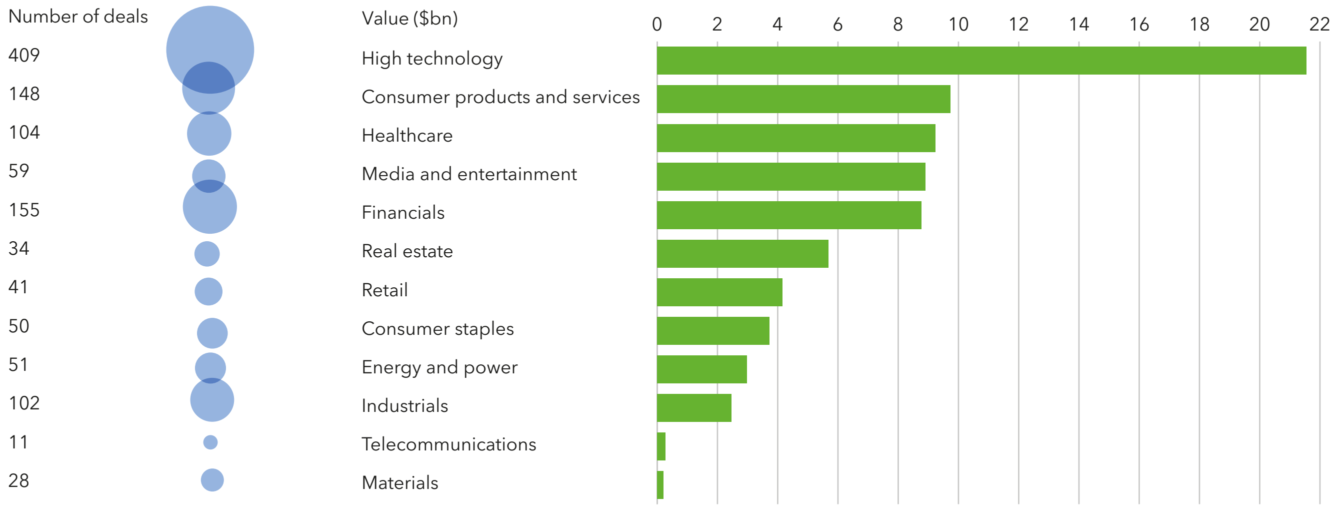
"In general, it appears businesses performed better in Q2 than expected," says Bob Baltimore, managing director and co-head of M&A at Harris Williams.

The revived lending market and the availability of businesses that have successfully managed cost structures have left less room for covid-discounted deals, some experts argue. "Because there is liquidity and financing capability, it's hard to find anything cheap right now," Sanders says.

Higher interest rates don't seem to be affecting M&A activity: "The pricing is slightly higher, but we were at a pretty inexpensive point last year," Baltimore says.

Besides, even if some companies

PE-backed M&A in the Americas, by target industry (H1 2020)



are distressed, they are not distressed enough to sell at a big discount.

"We've seen several minority investment opportunities from advisors where companies are in need of capital," says Steven Liff, senior managing director at Sun Capital. "But even though they are impaired by covid-19, they are not willing to give up control and sell at any discount."

"If you are a PE investor, you are glad the market is rallying," Sanders says. "But this snapback has been so fast that you can't get the lower price [on potential targets] you wanted."

Big picture: the 10-year bull run came to a hard stop with coronavirus. "I think buyers were looking to regain some ground in what has otherwise been a very seller-friendly market," Harding says.

Dealmaking in the remote environment

Adding complexity to the recovery, PE investors are taking time evaluating targets and assessing risk under what remains an everything-remote environment.

"The change in the mode of communication is something buyers and sellers need to get used to," One Equity's Belinfanti says.

"We are working on one deal now where everything has been virtual," Liff, of Sun Capital, says. "But at some point we will get on a plane and see the company so we can have the touch and feel before we close."

"The whole world can't chase [tech, healthcare, telecom]; there's better value in other sectors too"

WILLIAM SANDERS
Morgan Stanley

In another banker's view, PE investors are among the most likely to jet out to close deals in person, even amid coronavirus. If you can put a couple thousand people in Disney World, for instance, you can go do due-diligence, he says.

"I don't think [dealmaking] will stop due to [almost all-virtual] due-diligence," Sanders says.

Oh yeah, the election

Election years typically push PE investors to get deals done in case the deal approval structure changes.

"Anytime we are getting into an election year, if we have a feeling that there will be changes in Congress... people will really focus on getting deals done prior to year-end," says Jeremy Swan, managing principal at accounting and tax advisory firm CohnReznick LLP.

But this year is different. The pandemic has put the election conversation on the backburner. "Right now, it's more of a hypothetical discussion around the potential outcomes," Baltimore says.

If anything, the potential for a change in corporate tax laws has been one of the bigger talking points, according to sources. "From a tax perspective we are hoping that things won't change," Swan says. A higher corporate tax rate would be detrimental to funds and individuals, he adds. ■

Survival of the fittest

LPs lean toward re-ups with GPs, leaving some emerging managers out in the cold, writes Teddy Grant

As markets slowly open from the pandemic lockdown, one dynamic likely to continue through the rest of the year is the widening of the gap between well-established GPs and emerging managers.

"The fundraising market is bifurcated and, in many cases, selective," says Aksia Vice President David Fann. "Those funds that are sought-after were strong performers and were essentially re-ups for clients."

Less established managers are likely to struggle without the ability to meet limited partners in person. On the other hand, LPs appear comfortable re-upping with existing managers in their portfolio, where there is often less need for intensive due diligence given their familiarity and experience together.

"The challenges with conducting due diligence via Zoom are more pronounced for new funds, making it easier to invest with existing, quality managers," New Mexico Educational Retirement Board's chief investment officer, Bob Jacksha, says, adding that the system will likely slow down on forming new relationships in the near future.

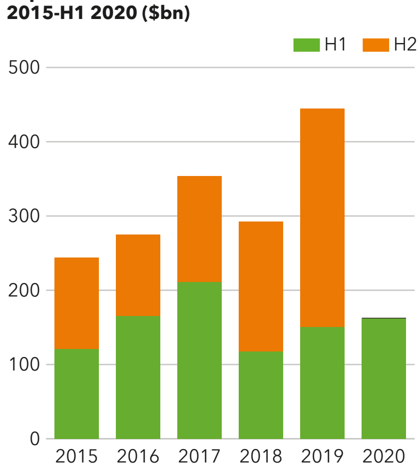
Re-upping with existing managers would not be out of the ordinary for the pension. Last year, the system pledged up to $150 million to AE Industrial Partners' Aerospace Aggregator Fund after previously investing in its first two funds, Buyouts previously reported.

New Mexico ERB's views on new managers have changed from a few years ago. In 2018, then deputy chief investment officer Steve Neel told *Buyouts* that "investing in new funds helps us build a reserve of goodwill."

Not every pension will shift its strategy, at least for now. Bob Maynard, CIO of Public Employees Retirement System of Idaho says that the system will take a "wait and see approach" regarding investments for the rest of the year. "[It's] business as usual given the circumstances. Nothing spectacularly changing," Maynard says.

"Newer managers potentially need to be very careful about lining their ducks [in a row] before they actually hit the market," according to Monument Group partner Bart Molloy. "That could be done by securing a cornerstone investor or putting together co-investment capital to get them ready to go to market. For emerging managers it's still achievable but needs to be approached very thoughtfully."

Capital raised for North America-based funds, 2015-H1 2020 ($bn)



Source: Buyouts

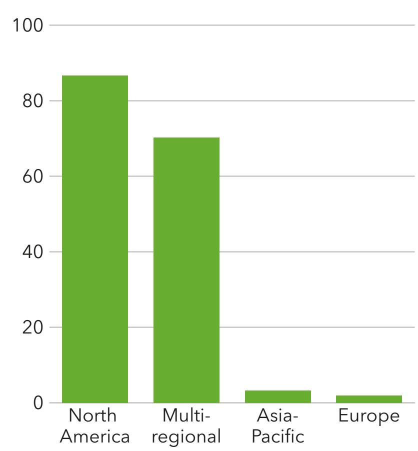
Eaton Partners' Peter Martenson says fundraising in the second half of 2020 will "perform well," particularly as LPs direct capital to funds that will take advantage of dislocation opportunities.

"I've spoken to a lot of funds that have raised capital within the last six to nine months and they are extremely optimistic in putting capital to work in today's market," Jeremy Swan, a managing principal at CohnReznick, tells *Buyouts*. "They would typically have a three-year window to put that capital to work and they're now looking to put all [of it to] work in the next nine months and have full buy-in from their LPs to go ahead and do that."

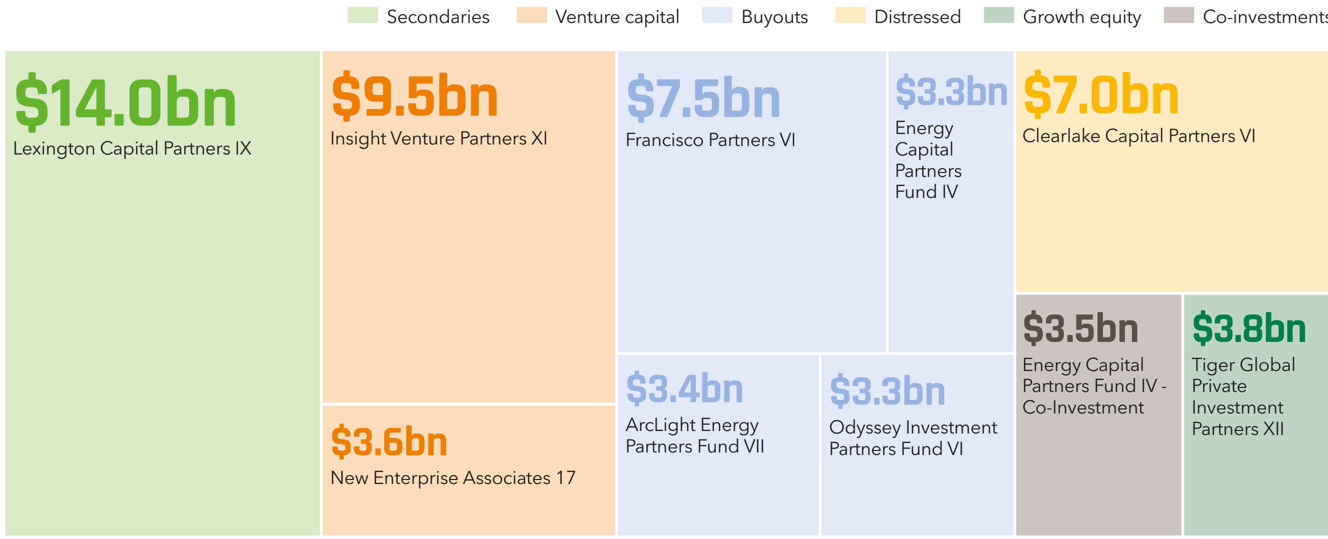
LPs will continue to put capital to work as long as the market doesn't dip again from a second widespread spike in the pandemic, says Sun Capital Partners managing director Joe Silver.

LPs may scale back their commit-

Regional focus of funds closed, H1 2020 ($bn)



Top 10 largest fund closes, H1 2020



ments to funds in the second half of year, but many learned from the global financial crisis that they should not dip in and out of the market, Molloy says. Historically, strong vintage years came during and after crises, when asset prices drop and investors find strong companies at great value.

Big firms shine

A strong fundraising market in the first half gave the market hope that the second half will remain steady.

US and Canadian private equity funds raised more than $162 billion from January to the end of June to invest globally, according to data from Buyouts, a slight increase from last year's $150.6 billion haul.

North American focused funds raised $86.7 billion in H1 2020; Asia-Pacific markets followed with $3.2 billion; and European funds raised $1.8 billion.

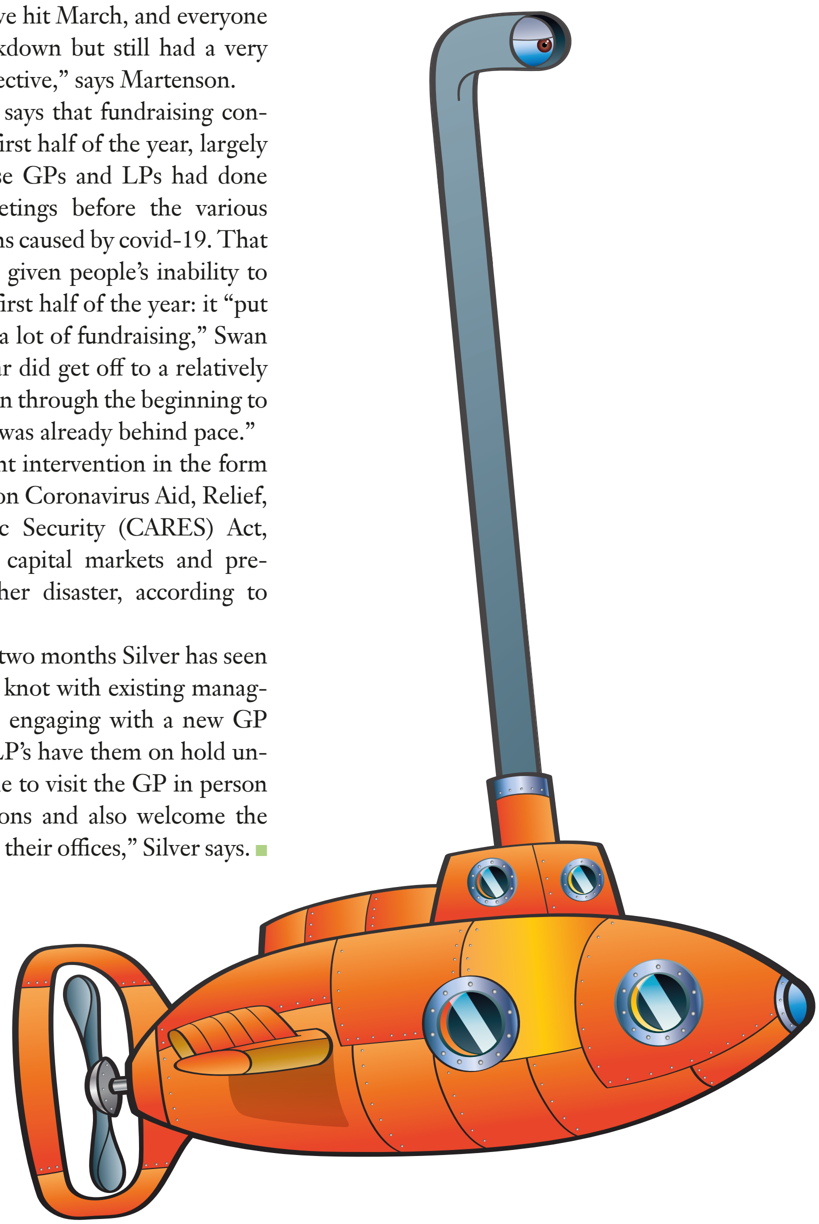
Larger funds had strong fundraising for the first half of the year, with four of the top 10 funds closed during that period in the buyouts category. Meanwhile, Thoma Bravo, Silver Lake and Clayton, Dubilier & Rice topped the list of the 10 largest funds in the market by target size, with all ten seeking more than $114 billion combined, according to *Buyouts* data.

The strong showing for the first half of 2020 stands out, especially given the shock of the pandemic. "Things were going fine through the first two months of Q1. Then we hit March, and everyone went into lockdown but still had a very positive perspective," says Martenson.

Martenson says that fundraising continued in the first half of the year, largely in part because GPs and LPs had done in-person meetings before the various state shutdowns caused by covid-19. That was fortunate, given people's inability to travel for the first half of the year: it "put the brakes on a lot of fundraising," Swan says. "The year did get off to a relatively slow start. Even through the beginning to mid-March it was already behind pace."

Government intervention in the form of the $2 trillion Coronavirus Aid, Relief, and Economic Security (CARES) Act, stabilized the capital markets and prevented a further disaster, according to Fann.

In the past two months Silver has seen LPs re-tie the knot with existing managers. "As far as engaging with a new GP relationship, LP's have them on hold until they are able to visit the GP in person at their locations and also welcome the GP's back into their offices," Silver says. ■



Keeping a firm grip on things

LPs keep emotion out of the picture as they evaluate opportunities and potential riptides in a volatile market, writes Justin Mitchell

As turbulence and uncertainty continue to roil markets, LPs balance their ability to gauge their private equity portfolio value and their desire to stay commited. How they resolve that tension could decide whether they emerge as a winner or loser from the covid crisis.

Steven Hartt, a principal at Meketa Investment Group, advises his clients not to upend their plans. "I think that making changes to a private equity portfolio for our clients is really a very challenging thing to do," he says. "What we've advocated for clients is to try to remain a consistent participant in the private equity asset class over time and not try to time the markets."

But if LPs want to do this, they will need to exercise almost constant vigilance to achieve clarity on valuations as well as find new and creative ways to evaluate opportunities – suggesting a long, tough road ahead.

"I don't think there's any kind of a magic bullet other than continued hard work and seeking to try to make the best decisions with the information that you have"

STEVEN HARTT
Meketa Investment Group

Late to the party

LPs usually receive private equity returns from managers on a quarter lag. That means that as of June 30, most LPs were just learning how the first-quarter fallout affected their portfolios.

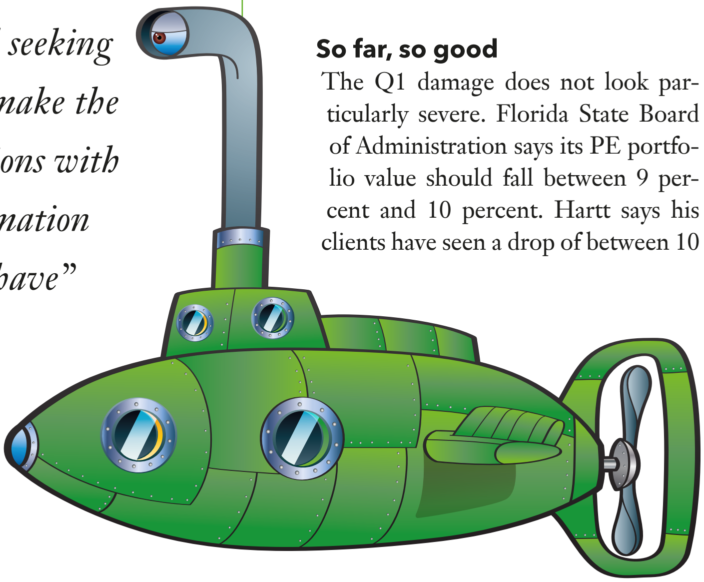
David Larsen of Duff & Phelps says that is not a big deal when the market is stable and relatively predictable. Accounting standards allow LPs to report quarter-lagged results as long as the change in value is not significant. But when there is a market disruption like this, the considerations and rules change.

"It puts more pressure on them to find out information," he says. "They need to either call their GPs and find out an estimate of where net-asset value is going to be, or they need to come up with a process internally to come up with their own estimate."

That means even routine reporting to stakeholders, let alone making investment decisions, will require more time and effort. "They need to be in good contact with the general partner, they need to be asking questions, they need to be pushing to get timely information, all so they can make their own decisions and so that they can report in their financial statements fairly," says Larsen. And some LPs have been less than happy with GP transparency, even before the lockdown reduced face-to-face interaction and research, according to a recent survey (see 'Erosion of trust' sidebar).

So far, so good

The Q1 damage does not look particularly severe. Florida State Board of Administration says its PE portfolio value should fall between 9 percent and 10 percent. Hartt says his clients have seen a drop of between 10



An erosion of trust

According to a recent survey of its members by the Institutional Limited Partners Association, LPs are concerned about what they perceive as a rising number of GPs writing limited partner agreements that limit or eliminate their fiduciary duty to the fund.

As ILPA states it, fiduciary duties are being "eroded across the industry," a summary of the survey said. ILPA found that 71 percent of LPs have seen fiduciary duties contractually modified or eliminated over the past year in at least 50 percent of the funds they backed. "Reduced fiduciary duties not only harm governance but also the quality of alignment between GPs and LPs," the summary said.

"I've also noticed a degradation in the language in legal documents surrounding a GP's level of fiduciary responsibility," a fund-of-funds LP said in a separate interview. "I'm not sure we've seen a fund document that fully eliminates a GP's fiduciary responsibility, but I wouldn't be surprised if they're out there."

Fiduciary duties are established in federal law through the Investment Advisers' Act, as well as by state and other jurisdictional rules. Fiduciary duty under the Advisers' Act can't be modified by contract, while state rules, generally stricter than federal law, can be, according to Justin Storms and Jonathan Adler, partners with Debevoise & Plimpton.

The SEC treats federal law as requiring GPs to disclose what they're going to do with a fund, including terms and conditions and potential conflicts. The disclosure is the key to fiduciary compliance and has been at the heart of much of the SEC's enforcement against PE firms in recent years.

Most LPs will not allow fiduciary duty to be completely eliminated, but it can be limited by defining a manager's standard of care as being liable only for acts of "gross" negligence (reckless disregard) as opposed to simple negligence (or fault), the report said.

ILPA recommends in its best practices principles that limited partner agreements should not dilute the GP's fiduciary duty and GPs should not make recommendations that would inhibit their fiduciary duty to LPs.

GPs in the private placement memorandum should "clearly, affirmatively and prominently disclose" the standard of care owed to the fund and the LPs, ILPA recommends.

"That language is not there to ensure the GP does the right thing when things are going well," the fund-of-funds LP said. "Rather, that language is there to protect LPs when a fund goes south, maybe even reaching zombie status. At that point, the LP/GP dynamic can often become a zero sum game, and it is at that point when an investor would take comfort in the protections of the agreement. So yes, it is a concern."

The industry is not experiencing an erosion of fiduciary duties, both Adler and Storms said. Instead, increased disclosure has made LPs more aware of the nuances of fund contracts, they said. "The provisions of fiduciary duty have not changed, but there's been more discussion, which leads to LP-friendly clarifications," Adler said.

"For LPs, there is a burden to review those disclosures and understand what it is a sponsor is permitted to do," Storms said. "The LP community has perceived some of that disclosure as itself eroding the fiduciary duties under federal law."

percent and 20 percent, depending on exposure. John Stake, a principal at Hamilton Lane, recently told sister title Private Fund CFO that private market valuations as a whole were down about 9 percent for the first quarter as of early June.

But that is only part of the story. At a recent Los Angeles City Employees' Retirement System meeting, Jeffrey Goldberger of Aksia TorreyCove said Q2 valuations, which "will incorporate almost a quarter of lost economic activity," would be what truly show the extent of the damage.

Distance learning

Meanwhile, the crisis has also upended the way GPs and LPs cultivate relationships. Before an LP invests with a new manager, it will typically have face-to-face meetings to gauge whether they are a good fit. Due to widespread lockdowns, this is clearly impossible.

So far, that has led to what some call a "flight to quality," but what Hartt dubs a "flight to what you know." Most LPs do not want to invest with a manager they have not had a chance to meet. Therefore, several major managers on the market shot past their targets on their latest funds as LPs scrambled to allocate to proven winners. That means newer, unproven managers may face obstacles. Hartt says he thinks his clients are going to try to find some ways around this so they don't miss out on quality opportunities.

All of this will take stamina and endurance, though. "I don't think there's any kind of a magic bullet other than continued hard work and seeking to try to make the best decisions with the information that you have," Hartt says. ■

A borrower's guide to an unmappable landscape

Experts weigh in with their advice on getting subscription finance in the new environment. By Graham Bippart

Lawyers representing borrowers, lenders or both all say they are busy with new loans, if not at pre-covid levels. But there's little doubt nearly all banks are being more selective, and that the pace of dealmaking has slowed, even with a decline in fundraising and dealmaking levels – as sister publication *Private Funds CFO* has learned in its deep-dive series of stories covering the subscription credit universe.

There's no rubric by which to determine whether, when or how much a given fund can get financing. But Fund Finance Partners managing partner and co-founder Zachary Barnett says that, right now, the more vanilla the fund, the better. "Any type of subscription finance trade that's not right down the middle is challenged given the general pullback. The more standard deviations you get away from the traditional product (via size, structure, certain offshore jurisdictions, foreign currency, lack of investor diversification or otherwise), the more difficult it gets," he says.

Funds with one investor, for example, are "more challenging than ever" to place, he adds. FFP has had difficulty placing some esoteric trades that Barnett says, before the crisis, banks "would have been fighting over."

Getting financing for new sponsors has been said to be particularly challenging in this environment, though it has been done. Debevoise & Plimpton partner Pierre Maugüé says: "If you have an attractive opportunity to open a relationship with a new sponsor and the banks have been courting that relationship for a while, it can be done."

"Any type of subscription finance trade that's not right down the middle is challenged given the general pullback"

ZACHARY BARNETT
Fund Finance Partners

Prepare for delays

The problem is even top borrowers with excellent fund strategies are finding themselves queueing up and waiting for lenders to respond. In normal times, getting a term sheet for a deal would take a couple of weeks, market participants say. Now, it can take a month or more.

That is partly because lenders, bumping up against allocation limits, are having to compete internally for capital. That's causing them to delay declining desirable sponsors for as long as they can in the hope they can make some room.

"There are times that I might be supportive of a deal and try to create room for it, while at the same time manage the external process," says one banker, adding the bank is open with some borrowers, declining them quickly. "For other sponsors, we've tried to play the game internally and, unfortunately, sometimes that takes two to three weeks, because doing a new sub line isn't the highest priority" for executives at the bank who have the final say, that banker adds. "Could we do the delivery better on some deals? Of course. I think everyone could say that."

Another dynamic behind the slowing pace of dealmaking in sub lines, despite lower fundraising activity, is that, with big lenders hitting product and concentration limits and focusing on priority clients, large deals require co-ordinating more banks.

"Wells has said no to almost everything," one European lawyer at a large global firm said in April, referring to the bank's European sub line lending business. "That means all sorts of banks are getting deals that Wells would have done." (Wells says it is actively lending to existing clients, and they are not the only bank market players say have slowed or stopped new lending.)

Smaller banks were, at least in the early months of the crisis, said to be aggressively lapping up deals they would not have been able to compete for, and in some cases would normally have been a participant, not a lead bank. "We are still seeing dealflow. It's primarily the result of competitors tightening their underwriting criteria," said one such lender in May.

Uncommitted extension refusal

Pre-covid, borrowers were accustomed to being readily provided with further, "uncommitted" extensions from their lenders – it's a relationship market, and lenders are incentivized to be accommodating. But that's changed, too.

Subscription credit lines are often structured with an original tenor – pre-covid that was often three to four years, now it's most often one to two years, say sources – with the bank committing to one or two one-year extensions, should the borrower need to extend the investment period of a fund, for example. Even as of late April, as the need to extend investment periods became achingly clear for many funds amid the downturn, some lenders were reluctant to extend commitment beyond the term of expired facilities, Debevoise's Maugüé said at the time.

Most market players point to banks' product or concentration limits as the cause. "There's nothing wrong with the quality of the manager or LPs or the situation the fund's in," says Matt Hansford, head of Investec's UK fund finance team. "I think it's specific banks focusing on where they see their core client base to be."

"Where a prospective new borrower does not have an existing relationship with the bank, the banks are increasingly requiring that the borrower move its bank accounts to the lending bank"

SHIRAZ ALLIDINA
Citco

Committed extension periods are still being honored, but FFP's Barnett says this is the first time since the crisis, barring specific extenuating circumstances, that he's seen relationship lenders turn down borrowers for uncommitted extensions, leaving the borrowers searching for entirely new lines elsewhere.

Switching lenders

Borrowers may have to be willing to do other business with a new lender, Barnett adds; a fact asserted by several other market participants.

"There is a heightened interest in subscription line lenders looking to do other business with their clients. Banks that are active are focusing on other opportunities within the bank to grow the relationship – they're factoring that in more than they did before when it comes to extending subscription line credit."

Shiraz Allidina, director in the capital solutions group at Citco, which offers fund finance products to its fund services and fund administration clients, says borrowers should be prepared to move their fund deposits to new lenders.

"In the case where a prospective new borrower does not have an existing relationship with the bank, the banks are increasingly requiring that the borrower move its bank accounts to the lending bank," he says. That may be because some banks need to grow deposits to support new lending.

But Michael Mascia, partner at Cadwalader, Wickersham & Taft, argues that it isn't a requirement of lenders, but rather that the ability to offer deposits can make a given transaction more attractive for "certain lenders."

Either way, that can be a problem for some sponsors, says Mary Touchstone, partner at Simpson Thacher & Bartlett.

Some borrowers, getting a line from a new lender, may wish to keep the fund account with the previous bank, putting a control agreement in place to ensure the new lender can obtain control of the account in an event of default, she says. That can help avoid the risk of confusing investors or mistakes in wire transfers and other operational risks. ■

Setting off tripwires in the credit market

An unusual occurrence in the $800bn market for collateralized loan obligations is stirring up concern, writes Robin Blumenthal

For the first time since the global financial crisis, the most senior debt tranches in a number of CLOs have tripped their overcollateralization tests, as reported in sister publication *Private Debt Investor*. This signals that the economic effects of covid-19 are hitting even the least risky parts of the CLO capital stack. CLOs are structured credits in which the underlying portfolios consist of senior secured bank loans, typically made to businesses that are rated below investment grade.

Overcollateralization tests help keep the principal value of a CLO's underlying bank loans from exceeding the total principal value of the notes issued by various CLO tranches while the CLO debt is outstanding. When breached, cash is likely to be diverted from equity and junior-rated tranches to senior debt.

Some observers maintain that the structure of CLOs, which fared reasonably well during the GFC, should protect them from the pain that similar derivative instruments, such as residential mortgage-backed securities and collateralized debt obligations, suffered in 2008. But the longer the economic carnage drags on, the greater the potential for price pressure on the CLOs as the excesses, driven by the search for yield that resulted in a lowering of credit quality, wind down.

"As others have said, we're seeing the previews; the movie is still to come"

PHILIP GALGANO
Egan-Jones

"As others have said, 'We're seeing the previews; the movie is still to come'," says Philip Galgano, senior director and head of ratings at Egan-Jones, an independent credit rating agency. "All the noise coming out of the market looks an awful lot like what happened with RMBS."

Richard Wheelahan III, founding partner of Fund Finance Partners, an advisor to asset managers, says: "What we learned from 2008 is that there are things that happen early in a credit crisis that portend the scope and magnitude of the crisis. Overcollateralization tests being tripped in the senior tranches so quickly into a down cycle is one of those signals."

Key differences

There are important distinctions between CLOs and the asset-backed vehicles that nearly brought down the financial system in 2008. Leverage in a collateralized debt obligation or a mortgage-backed security is higher than in a CLO, says Jonathan Sloan, managing director in Houlihan Lokey's portfolio valuation and fund advisory services business. And, unlike with RMBS (residential mortgage-backed securities), he says there is "true diversification" with the corporate loans that underlie the CLO debt, which is spread across different industries.

This time, says Sloan, the CLO owners are in "much better shape" than in the GFC, both due to the underlying collateral in the CLOs and the sturdiness of CLO holders.

Unlike the hedge funds that needed to raise cash to satisfy margin calls in 2008, CLOs today, even in the lowest tranches, are frequently held by large institutions or closed-end funds with dedicated strategies. Moreover, last time, debt that had been routinely and perhaps too often rated AAA and trading at par fell to 20 cents on the dollar.

In March, although spreads in the senior debt of the CLOs widened when the market froze up, "that was only a measure of liquidity risk – not true credit impairment," Sloan says. Spreads have since come back in.

Nevertheless, "the pace of the loan downgrades took everyone by surprise," says Pratik Gupta, a CLO/MBS strategist at Bank of America Securities. From March to the end of May, nearly 30 percent of the leveraged loans in CLO portfolios were either downgraded or placed on CreditWatch with negative implications by S&P Global.

That caused the AAA and AA debt tranches to breach their tests, Gupta says. As of June 5, 19 deals were failing their AAA or AA overcollateralization tests, while 43 were failing their single-A tests and 121 their BBB tests, per Bank of America Securities.

Typically, failure of tests on the highest rated debt would result in coupon payments to mezzanine tranches being deferred until the breach is corrected, or interest payments on the loans that would ordinarily go to equity holders being diverted to paying principal on the higher-rated debt.

Because of the economic paralysis created by the response to covid-19, the share of loans in CLO portfolios that are rated CCC, or extremely high risk, tripled from 4.13 percent at the beginning of March to 12.12 percent by May 31, per S&P Global.

Rising risks

The rise in ratings downgrades on CLO portfolio loans and their debt will undoubtedly continue to pressure pricing, as will any bankruptcy-related defaults. Indeed, American Airlines, which is reportedly nearing a bankruptcy filing, is instructive. Fitch Ratings downgraded the carrier's $34 billion of debt twice in two months, to single-B in late April, amid a steep fall in travel. The price of American's credit default swaps has skyrocketed 4,000 percent over the past three months.

Trepp's CLO data show the airline is represented in the CLO market by four loans, each more than $1 billion. The trading price of its $1.8 billion American Airlines Term Loan, which Trepp said is held by more than 250 CLO vehicles, plummeted from at or around par in February to the mid-$60s in mid-May, per IHS Markit.

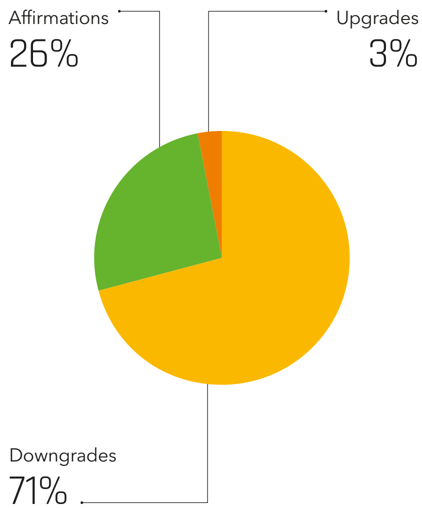
KKR Leveraged Credit noted in its first-quarter letter in April that it expects the downgrades "to continue to pour in, and this will create technical selling pressure in the CLO community, which represents about 60 percent of the leveraged loan buyer universe." Moreover, the letter went on, "the sheer volume of downgrades across this very large buyer pool of the loan market" will add to the market's continued price pressure. KKR noted that while 10 percent of the bank loan market was trading below $90 at the end of 2019, a full 95 percent of the Leveraged Loan Index was under $90 on March 20.

This spells trouble for the lowest levels of the CLO capital stack. "This time, CLO equity is going to suffer a lot worse returns than 10 or 11 years ago," Gregory Racz, president of MGG Investment Group, said in a virtual roundtable on the pandemic and the credit crisis hosted by Clade and Boston Private.

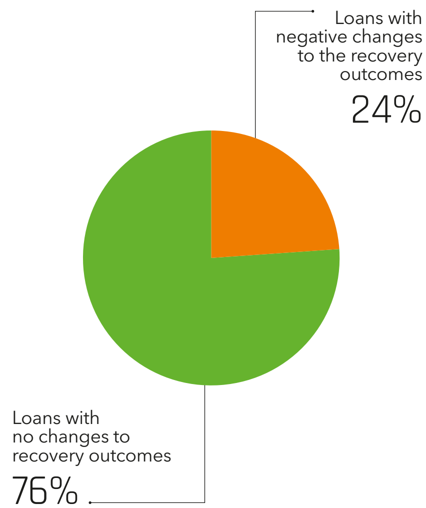
He cited the worst economy and unemployment levels since the Great Depression, record-high consumer debt and higher corporate debt with poorly structured covenant-lite loans.

"A tremendously leveraged loan market intersected with a tremendously bloated CLO market," said Daniel Zwirn, chief executive and chief investment officer of Arena Investors, at the same roundtable. "Every rational speed bump got kicked away, and now you're seeing the chickens come home to roost."

Issuer credit rating changes on CLO collateral from Feb 3 to May 28* comprising 658 ratings actions in total



More than 75% of loan recoveries are not negatively affected by ICR downgrades comprising 466 downgrades in total**



* Rating actions on BSL collateral pools from Feb 3 to May 28 excluding withdrawals
** Negative changes to recoveries include changes in recovery ratings and reductions in rounded recovery point estimates
Source: S&P Global

INVESTING IN TECHNOLOGY

An 11-page special report

Mining data from a remote universe

The migration to at-home work, learning and e-commerce is creating opportunity for technology investors, writes Milana Vinn

As the world slowly reopens from the pandemic shutdown, investors are reassessing their views of the opportunities in tech, showing preference for more resilient end-markets and stable business models with recurring revenues.

Tech investors at Great Hill Partners, TCV and TPG Growth talked to PE Hub about post-covid trends as they scout for opportunities in cybersecurity, workflow automation, consumer internet and other tech segments.

For Great Hill Partners, investing post-covid will look similar, surprisingly, to the times before the coronavirus. The firm's portfolio has proven its attractive positioning amid the pandemic, says managing director Chris Gaffney.

"Because so much of our portfolio is doing so well, it will be just going deeper into the themes that we've already been investing in," he says. "Whether it's cloud, or automation, or e-commerce, or collaboration, or remote services – all of these companies are doing well.

"So we are looking for both add-ons to our companies to make them bigger but also to new platforms that we can make investments in."

Two-thirds of Great Hill's portfolio shows a median growth rate of greater than 15 percent for 2020, Gaffney says. That number is down from last year, when half the firm's portfolio grew at nearly 30 percent.

The firm sees significant demand in businesses that provide cloud services; automation and workflow support; and cost-saving benefits, Gaffney says. Specific examples include portfolio companies Evolve IP, Mission, EnterpriseDB, Mineral Tree and Versa Pay.

"For example, EnterpriseDB, which optimizes open-source database management, is providing cost savings over legacy providers," he says. "It is pacing better than our original expectations for the year and growing at well over 30 percent."

Workflow software

Great Hill's Mineral Tree and Versa Pay – which manage accounts payable and accounts receivable, respectively – have also been extremely popular as corporate clients turn to remote cloud-based workflow automation services, Gaffney says.

Indeed, Mike Zappert, partner at TPG Growth, says the segment of technology that provides core workflow software for CFOs and their financial teams has seen tailwinds as corporate offices reassess the quality of their technology.

Some of those companies saw demand slow at the beginning of the pandemic as many financial teams prioritized more urgent work (like covid-19 reforecasting, for example). Now that that work is done, those businesses are seeing a full recovery in terms of interest in their market.

"Those CFOs and finance teams really recognize that there are a lot of gaps in their business processes that are not covered by software," he says. "They want the ability to leverage the next generation SaaS and tools to be able to manage their core workflows across accounts payable, receivable, treasury – a lot of those companies we talk to in the market really see nice tailwinds."

EdTech

EdTech companies that deliver learning services and educational content digitally have also seen traction in the remote environment.

TCV owns Varsity Tutors, a tutoring and online learning platform, and Newsela, an educational content platform. Both businesses have seen demand pick up during quarantine.

Younger generations who consume content from mobile devices are changing the delivery of education, says Neil Tolaney, general partner at TCV. "We had this thesis on EdTech coming into the pandemic and we continue prosecuting on this effort," he says. "We are fortunate to have portfolio companies in which we invested on a pre-covid basis that have facilitated this consumer need."

> *"We had this thesis on EdTech coming into the pandemic and we continue prosecuting on this effort. We are fortunate to have portfolio companies in which we invested on a pre-covid basis that have facilitated this consumer need"*
>
> **NEIL TOLANEY**
> **TCV**

For Great Hill, handling the pickup in demand for its EdTech portfolio company Examity, which provides online testing and proctoring services for colleges, universities and employers, has become a task of its own.

During quarantine, Examity saw demand levels from some of its customers reaching 10 times the level of last year. "The biggest issue for Examity is putting together the capacity to satisfy this demand," Gaffney says.

Security and identity

TPG's Zappert says covid-19 also accelerated the growth of certain trends within technology related to security, DevOps and the so-called Office of the CFO segment. He says TPG will be spending time in those areas as the world re-opens: "It's important that there is a recognition for the buyers that the tools these companies provide are more in demand now than they were before."

Security, for example, is poised to benefit from the remote environment, as society shifts toward more flexible workspaces.

"This is the environment that is totally different than what the companies are used to," says Zappert. "Now people are working from home, they are working from their vacation homes, they're working from friends' and family homes, so there is a whole range of new environments people are accessing their devices from, their corporate systems from. So the need for authentication tools and identity tools to understand what's happening on the companies' network and what's happening within the companies' systems is much more."

As a result, Zappert says, enterprises such as MacAfee, a security company backed by TPG Capital, and Tanium, a computer security business backed by TPG Growth, both saw tailwinds in data security.

Macro view

As pandemic restrictions around the world loosen up, firms are seeing that geography is dictating opportunity.

Covid-19 has affected M&A activity in various parts of the world differently, presenting a more favorable landscape for deals in Europe, says a partner at a tech-focused growth equity firm: "There is less impact there. If I just look at our current pipeline, we are definitely seeing more opportunities in the UK and in Europe, in part because they've done a better job in putting down covid, and here in the US we are still very much in the grips of that."

Despite the global shutdown influencing growth in certain companies, taking a macro approach and assessing whether that growth can be sustained after the pandemic becomes crucial, says TCV's Tolaney: "There are many companies… with very high acceleration in this time period. But for us, as long-term investors, we want to ensure there is sustainability over multiple years.

"As long-term investors, we are focused on how companies could enjoy sustainable growth and adoption with enhanced brand awareness in this time period and the future." ■

Q&A

Scale and ability to process data are the keys to success in the future of fintech, says Blythe Masters, industry partner at Motive Partners

Q Which emerging technologies have the greatest transformative potential for the fintech sector?

We have been talking about the application of big data, AI and distributed ledger technology to financial services for some time. In many areas we are reaching tipping points where these technologies will become pervasive. Combining real-time data flows and advanced analytics that leverage AI and machine learning has the potential to transform personal and institutional financial services. Both capabilities have so far been adopted largely as point solutions; by putting them at the heart of a financial organization it is possible to open fundamentally new business models that are truly transformative. From the perspective of enterprise, DLT and the resulting operational advances from straight-through processing and elimination of reconciliation offers great untapped potential that will depend on the large-scale platform fintech businesses offering compelling network effects to offset the costs of adoption.

Q The crisis and shift to remote working have heightened cybersecurity concerns; what does this mean for fintech going forward?

Cybersecurity is of critical importance to all financial services firms, and the recent changes have only heightened focus on this space. A less explored area where we believe fintech has potential is on the insurance side of cybersecurity. Being able to more accurately predict, size and

"The current climate is accelerating the shift to a more digital financial services industry, with greater personalization for the individual and greater efficiency for enterprise"

transfer the risk of systemic cybersecurity events is a structural need that fintech can help to address.

Q Which sub-sectors offer the most interesting prospects in the near- to medium-term?

Our focus is on infrastructure-like technology businesses that have the capacity to scale and offer the business services and insights needed to drive transformation within financial services. Within this space we see a lot to be excited about. The current climate is accelerating the shift to a more digital financial services industry, with greater personalization for the individual and greater efficiency for enterprise. We are exploring exciting prospects that fit within this trend, running from next-generation core banking technologies, through to capital markets platforms offering straight-through processing and end-to-end transaction lifecycle management.

Q What do you expect the industry to look like by 2030?

The value of data monetization and business facilitation derived from large-scale platform businesses has been more than proven over the prior decade. Indeed, the world's most valuable companies are such big tech platforms. By 2030 we believe more fintech platforms will join that roster. The consumer will look for a solution to their problem, not a particular product. The well-defined platform will deliver that solution, which will be far more important than the particular wrapper of insurance or wealth management. The traditional verticals across the industry will begin to blur, and scale and ability to access and process data will be increasingly essential. Individual data sovereignty and privacy protection will also likely be a feature of winning financial services platforms. ■

KEYNOTE INTERVIEW

The industrial digital revolution

The arrival of the pandemic has spurred digital transformation, accelerating trends already in motion, says Tariq Osman, partner and co-founder at Argand Partners

For office staff, the transition from what were once manual, offline processes to more streamlined digital work-from-home workflows during the covid-19 crisis has been less painful than many would have imagined possible just a year ago. But how have the manufacturing and industrial services sectors adapted?

While many industrial businesses have been relatively slow to adopt digital technology and automation, the pandemic, combined with existing macro trends, looks set to hasten the arrival of more modern infrastructure and less dispersed supply chains.

SPONSOR
ARGAND PARTNERS

Q How do you define industrial technology?

For one thing, it can mean investing in the companies that provide industrial technology. There is plenty of opportunity there. But more often, we see opportunities in far less obvious areas, such as traditional manufacturing and service businesses where investors can apply new technologies to take them to the next level. These are often businesses or entire supply chains that have not yet invested in digital technologies and automation and have not reaped the efficiency and process improvement benefits that these investments unlock. By bringing in modern production capability and by deploying technologies based around data analysis, processing power and storage, investors can build companies that have a significant competitive advantage.

One example of this is Sigma, a manufacturer of high precision metal components. Under Argand's ownership, the company has invested in automated manufacturing robotics, 3D printing capabilities and unmanned vehicles – something that has enabled its production facilities to achieve world-class safety standards and unmatched quality levels while remaining highly competitive against low labor cost competitors in China. These pioneering investments have brought industrial technology to a sector that has been around for decades.

Q What is driving the deployment of technology in industrial applications?

Even before the pandemic, there were

three main drivers. The first is trade tariffs – and these started before President Trump accelerated the trend. The second is that the Chinese labor market has tightened over recent years so that it has become more expensive to manufacture goods and provide services there. It is no longer the competitive market it once was. And the third is the growing mainstream awareness of environmental issues.

These were already prompting industrial companies to digitize their organizations to reduce their carbon footprints. Companies have been looking to onshore or near-shore their manufacturing to avoid tariffs, in response to rising labor costs and to avoid the logistical and environmental costs of moving goods around the world. Hardware and software investment were already either being considered or underway to automate more processes as well as to address the need to use more sustainable materials for production—to make aircraft, ships or phones lighter and more durable, for example.

Deploying energy-saving technology can also have a significant impact on costs in manufacturing. One of our portfolio companies, Brintons, has a carpet-weaving factory in Poland close to the Russian border. It's a vast, Soviet-era building, that historically had the highest energy costs across all of Brintons' global manufacturing facilities. We have been working with Siemens to put in place energy-saving building automation systems for heating, ventilation, air conditioning, and cooling applications, and for each weaving machine. These investments have improved efficiency, reduced cost and have made the site more comfortable for our workers.

> *"Companies that are more advanced in their digital transformation are more resilient"*

The covid effect

The pandemic will likely accelerate deployment of technology in industrial applications

We've seen that companies that are more advanced in their digital transformation are more resilient, so I think there will be two big trends that will get a lot of attention in the next two years – with positive and negative consequences.

The global logistics sector has been in structural decline for several years now and the pandemic has highlighted the risks of dispersed supply chains. So, we will see more manufacturing hubs in locations such as Mexico for the US market and countries such as Poland and Turkey for Western Europe. The move closer to home may be seen as positive but it does have implications, and this is the second major trend – that some human labor will be displaced by automation.

We expect robots to be cheaper than human labor in most applications by 2025 and our research suggests robot hours will increase from roughly 1 percent of total manufacturing hours worked currently to around 15 percent by 2030 and up to 50 percent by 2050.

We're still in the eye of the cyclone right now in terms of the pandemic, so further trends have yet to be fully fleshed out, but it does look as though companies that have invested in technology deployment are most likely to gain market share.

Q What types of technology do you see as having the most disruptive effect?

The industrial sector has been the slowest to reap the full benefits of artificial intelligence. It is very much at the early stages, but the opportunity can be massive, and it can be a big competitive differentiator. For every 10 industrial companies we look at, we are lucky to see one that has already invested in AI. Yet industrial companies can use sensors, machines and IT systems powered by AI throughout the value chain.

For example, you can now use this to track items from, say, a factory in China through the logistics chain, landing in Mexico, right through to a consumer based in New York. Previously, this technology was being used just at a manufacturer or a warehouse, but now it is all connected across multiple companies and the data is being gathered and shared – you can lower costs, improve customer service and provide information on when an item needs maintenance or replacement. This provides an opportunity to invest in companies that use this technology but also in companies that make the sensors and semi-conductors that gather and analyze this data. And many opportunities are in areas where you would least expect them to be.

Q Can you give an example?

Well, you wouldn't expect the honey business to benefit significantly from the use of AI, but one business we looked at sources honey for food manufacturers. Honey is sourced worldwide; it has different taste profiles depending on where it comes from and prices fluctuate according to yield and demand. The company has invested in AI to capture data from apiaries around the world, which helps formulate the right palate through blending the different honeys and uses algorithms to optimize a business that is run by chains of brokers worldwide. This reduces the cost, improves the quality and, because the technology can identify the source of honey down to apiary level, it is helping to root out fake honey, which can be made in a laboratory.

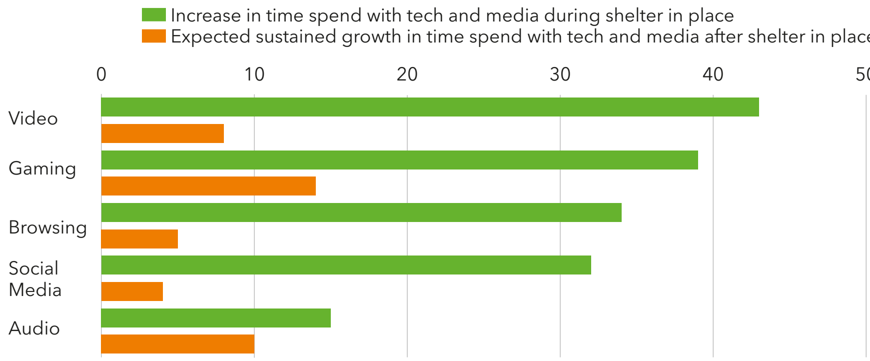
Q What about investments in the technology itself?

We recently invested in a business called Cherry. It's a really interesting business because, even though we started the investment process in September, we completed the deal during the lockdown so we have had a real insight into how the pandemic is playing into some of the trends we've just talked about.

Cherry manufactures high-precision keyboard switch technology that is used in video gaming and professional use peripherals. One application is the use of these keyboards in healthcare, which, pre-covid-19, had been moving slowly towards digital healthcare records. The pandemic has accelerated this trend by 10 years or more as non-urgent healthcare had to be delivered remotely. The digitization of healthcare records allows people to use smartcards that store all their health data and the peripherals Cherry produces – which have antibacterial and cybersecurity features, by the way – can read these records.

> *"I think the issue moving forward will be how deals get done in the future if travel is less possible"*

The covid-19 pandemic has seen significant growth in time spent gaming (%)



Source: Rewire to Restart: The Post-Covid-19 Agenda for Technology and Media Companies, Activate Consulting

The business also plays into the increased demand for video gaming during lockdown as people looked for things to do. While TV streaming was an option, companies such as Netflix are dependent on Hollywood and sports were cancelled, and so you had a situation where Verizon, for example, saw a 75 percent increase in data transfer linked to video gaming. Demand for video gaming keyboards using Cherry technology has soared, especially as these products can also be used for work, and that demand will continue to be high as people continue to work at least some of the time from home and as digital entertainment is boosted by any pandemic-induced economic downturn.

According to a recent study by Activate Consulting, time spent with video games increased by nearly 40 percent during covid-19. Video games are expected to retain higher growth versus other media after shelter in place ends.

Q What were the challenges to getting a deal across the line during lockdown?

The fact that we'd started evaluating the business last September clearly helped as we'd already had the chance to visit the management team and manufacturing facilities. However, we were a little nervous around February and March as we weren't sure how the business would be affected by the pandemic. We took a brief pause, especially as the business has a global supply chain and with key suppliers in China and northern Italy. Yet we could see the business had four months of inventory and actually, once we saw the trends start playing out, it became apparent it was an opportunity to grab with both hands. I think the issue moving forward will be more how deals get done in the future if travel is less possible.

Q How do you see deals of the future getting done?

We are starting to experiment with tools to do some of the work remotely, with the use of video-conferencing, for example, and drones. They clearly have some limitations and remote meetings cannot replace the barstool due diligence that helps build trust and relationships, but these tools can improve the efficiency and productivity of due diligence processes.

Drones and the use of body camera footage is interesting because you have the ability to pause and replay sections and that can enable you to see more, and from a different perspective, than if you conducted an on-site visit in some ways. In the past, we looked at a company that provided drones to the mining industry to safely pinpoint where ores are, so we know these technologies can be effective. ■

Why fintech still looks fruitful

The fintech sector has become fertile hunting ground for VC and private equity investors in recent years, and covid-19 is set to unearth new opportunities in this maturing market, writes Vicky Meek

Back in 2011, Marc Andreessen, co-founder of Silicon Valley venture capital firm Andreessen Horowitz, proclaimed that "software is eating the world." The past decade or so has demonstrated he was right in many areas, not least in financial services, where fintech companies are transforming the way we pay for products and services and manage our money, while insurance companies, banks and asset managers are facing significant disruption from digital challengers.

"Andreessen's comment describes how we've seen software move from being a separate category to infusing all sectors, from healthcare and agriculture through to real estate," says John Coelho, partner at StepStone.

"Financial services is the largest sector by a number of measures in many economies – and it's one where many of the incumbents have been loath to become more tech-enabled. Fintech is disrupting the sector, with some explosive results."

He points to payments as the earliest part of the sector that has faced nimble, tech-enabled competition. PayPal, for example, has a market capitalization of well over $150 billion, while Worldpay was acquired last year by FIS for $43 billion. Yet, he adds: "Payments is the most obvious space – there are so many other categories being transformed by technology."

"Technology is now being used across the board," says Steve Pierson, managing partner at Lovell Minnick Partners. "You can't be in financial services today without using a heavy dose of tech, deployed across customer-facing interfaces through to back and middle office."

The acceleration of technology in financial services is a trend that many investors believe has real legs. "The transformation of financial services and products through technology has been going on since the late 1990s and it will continue for the next 20-30 years," says Per Nordlander, partner at Verdane. "It's such a deep and wide space."

Beyond VC

The potential for creating unicorns has clearly attracted venture capital interest, with $41 billion invested by VCs in 2018 and $35 billion in 2019, according to CB Insights figures. But as the sector matures, growth capital and buyout funds have also got in on the act.

Again, payments has been the hottest part of the sector for many players. "Payments went from being considered a bit of a backwater to an exciting sector," says Aaron Goldman, managing director and co-head of financial services at General Atlantic. "There has been a lot of value created and so it's a part of the market that has had a lot of attention. Payments is definitely a competitive area for private capital."

Indeed, the number of private equity payments deals in North America and Europe grew by 7 percent per year between 2006 and 2019, according to Bain & Co, with aggregate deal value growing five-fold in the same period. And for good reason – Bain suggests that buyouts involving payments companies have generated a gross pooled multiple of invested capital of 2.7x, outpacing technology investments.

Its attractiveness is evidenced by the fact that in June this year (even as travel restrictions remained in place), Nordic Capital announced a strategic minority investment by a number of investors, including BlackRock Private Equity Partners, in portfolio company Trustly, an online banking payments company.

Fredrik Naslund, partner at Nordic Capital, says there was "a huge amount of interest in Trustly from both strategics and other financial sponsors."

Much more to come

There is little doubt that far more fintech opportunities will arise as transformation across all parts of financial services continues. "There are a lot more investment opportunities for us today than there were five to 10 years ago," says Verdane's Nordlander.

"Back then, there was a lot of hype around fintech but very few investable companies, with a few notable exceptions, that grew rapidly," Nordlander continues. "Over the past two years, it's become much clearer which ideas and businesses have potential for success and so the investment space for us has increased dramatically."

Nordlander points to a number of areas where his firm sees potential: "Certain areas in fintech are very crowded, in particular where companies are providing financial products to retail customers. We believe there are selective opportu-

LPs tap into direct investments

Some of the world's largest LPs are investing directly

Singapore's GIC has made several fintech investments, including leading a $102 million round in artificial intelligence-driven asset management company Pagaya this June, and participating in a $230 million funding for payments solutions business Checkout.com in May. Its fellow state investor Temasek is also active in the sector, such as its February 2020 investment in wealthtech firm FNZ.

Meanwhile, Hamilton Lane is investing balance sheet capital in strategic direct investments in fintech companies that focus on improving the efficiency of the asset management industry. One recent example is a Series A investment in Canoe, which specializes in automating and improving alternative investment operations for LPs. The firm has since implemented Canoe in a bid to streamline internal processes.

"The private markets are largely in the Stone Age when it comes to systems and communication – many firms still use emails, Excel, PDFs, all of which are manually intensive and contain unstructured data," explains Griffith Norville, managing director, strategic technology at Hamilton Lane. "So, for example, we're investing in companies that deploy machine learning and optical character recognition to extract information from these sources of information."

The need for improved and efficient solutions is growing as LPs require increased amounts of data to support their decisions, says Norville. "LPs today need to understand the different liquidity and return profiles of various options when thinking about portfolio construction. When they are making investment choices, where previously LPs would rely on benchmarks, today they look through to the portfolio company level, at cashflows and transactions and compare GP performance across very granular measures."

"You can't be in financial services today without using a heavy dose of tech"

STEVE PIERSON
Lovell Minnick Partners

nities in this space as there is still a large amount of profit that can be taken from the incumbents, and a large addressable market. But the main area we see opportunity in is the SME banking and technology areas around segments such as niche banking platforms and regtech, where AML and KYC processes can be streamlined and where technology transformation, combined with continued regulatory pressure, will create further market expansion potential."

Insurtech is another possible new area for buyout firms. The success of upstarts such as Lemonade, which filed for an initial public offering in June, points to significant disruption in the insurance industry, a sector where many buyout firms have had experience and success.

"We may well see a wave of insurance deals done by buyout houses," says Coelho. "There are many old-style incumbents that need to upgrade legacy systems and technology to adapt and stay relevant. There could be a lot of value in taking control of an insurance platform and then integrating technology to create an efficient, modern business."

Pushed by the pandemic

As with many technology-related sectors, the arrival of covid-19 and the associated lockdowns have hastened existing trends in fintech.

"The pandemic has rapidly pushed more consumers to use digital tools such as online banking, transactions and savings," says Naslund. "And although it is too early to say how permanent the shift is, it seems as though at least some of this behavior is here to stay. Those who might have been more reticent to use digital technologies now see the benefits. In this part of Nordic Capital's portfolio – where newcomers are challenging incumbent financial services companies – we are seeing all-time high volumes and all-time high customer wins."

The crisis has had an impact on investment levels, however, particularly in VC. According to CB Insights data, just 404 global fintech VC deals were announced in Q1 2020 (a period that only captures the beginning of the lockdown in most countries), the lowest number since 2016.

"We've seen many fintech companies respond to the crisis with agility"

MIGUEL LUIÑA
Hamilton Lane

Yet investment figures only tell part of the story. "We have seen many fintech companies respond to the crisis with agility," says Miguel Luiña, principal in the fund investment team at Hamilton Lane. "For some, this has meant cost-cutting and reducing cash burn to position themselves well and give themselves a long cash runway. In others, we have seen companies replace revenues in other ways by creating solutions for their end markets. For example, a point-of-sale software system that focuses on restaurants shifted to become a platform for online orders and delivery – it became part of the solution.

"Many VCs are very well positioned to take advantage of new segments where companies have had to pivot or create new businesses to meet new needs or as a result of shifts in behavior."

Many buyout houses will also be looking for opportunities that may not have been evident before covid-19 struck.

"VCs had been pouring money into early-stage fintech businesses, and these may well struggle as they will not be profit- or perhaps even revenue-generating," says Naslund. "We will see some private equity portfolio companies be able to pick up some of these early-stage technologies."

They may also encounter rather less competition than previously. The number of fintech M&A deals fell by 40 percent year-on-year across Europe and the US in March 2020, according to a report by Houlihan Lokey. The report states: "Going forward, private equity buyers' record amount of dry powder ($1.5 trillion) lends itself to the opportunity to deploy capital in the high-growth fintech sector at a steep discount to recent prices."

With so much growth potential in the fintech space, it seems as though the post-covid environment could provide buyout executives with a number of opportunities. ■

Peering through the pandemic fog

Having managed to value their portfolios in the first quarter, firms have some clarity going forward, but there are still unknowns, writes Marine Cole

It's undeniable that the first quarter of the year was one of the most challenging quarters ever for valuation experts.

Little clarity emerged around the full extent of the impact of covid-19 on the economy and businesses by the time many firms had to publish their March 31 marks. And while there may be better visibility in the second quarter as markets stabilize and businesses reopen, uncertainty remains.

"Many funds had to take a hard look at their portfolio multiple times throughout the month of March to culminate with a fair value conclusion at the end of the quarter," says David Larsen, managing director, alternative asset advisory at Duff & Phelps, adding that GPs couldn't afford to stay passive.

"Wait-and-see is not compliant with generally accepted accounting principles. GAAP says you need to estimate fair value each time you report to your investors."

It's no surprise that valuations in private equity overall were down in the first quarter.

John Stake, a principal at Hamilton Lane's fund investment team, noted in a recent interview that as of the beginning of June, valuations for private markets as a whole, including buyouts, venture capital, credit and real assets, so far indicated they will be down about 9 percent in the first quarter.

In a Duff & Phelps poll conducted on June 10, nearly 53 percent of respondents, in a pool of more than 300, said first-quarter fair value estimates were down between 11 and 20 percent. Another 11 percent said there was a more than 20 percent decrease. About 26 percent said the decrease was less than 10 percent.

An uneven crisis

But the drop was not the same across industries and companies. Some industries including retail, travel, events and energy took a harder hit. Others benefited from the crisis and saw their valuations rise.

Specifically for buyout managers, valuations of smaller funds have been less impacted than for their larger counterparts. "In our view, one main reason for this is that smaller groups tend to use discounted cashflow methodology more heavily than larger groups, which typically tend to focus much more on public comps," Stake says.

The Dow Jones Industrial Average was down more than 23 percent in the first quarter. Funds putting more emphasis on

DCF for their valuation took a longer-term view and were less impacted by the sudden drop in public equities. But even GPs that relied more heavily on public market valuations had to take them with a grain of salt, considering the distressed environment of the first quarter.

"One of the main reasons for investing in private equity is that it doesn't have the same volatility that public companies have," says Tom Angell, a partner with Withum. "Public companies took a hit in March because panic selling was going on. It was happening in the equity markets as well as the debt markets. Private equity managers looked at the decrease in their public comps for valuation purposes but understood that those valuations were the result of a disorderly market."

According to GAAP's ASC 820 on fair value, managers don't need to mark to fire sale prices, which is how many described the pricing environment in Q1. Instead, they have to figure out what a market participant would pay in an orderly transaction.

Better visibility for some

It's still unclear where valuations will stand for the second quarter. Almost a quarter of market participants polled by Duff & Phelps said they expect Q2 fund net asset values to be up 1-5 percent, while another 22 percent anticipate they will be down 6 to 10 percent in the second quarter.

Hamilton Lane's Stake suggests that GPs that rely more on public comps may see their valuations remain flat or increase slightly if public markets stay above March lows. "For many, Q1 operations were only impacted for a few weeks but will be impacted for most if not all of Q2," he says.

"For example, some of the managers that used public comps and took more of a mark-down in Q1 are likely to be up, as the markets have recovered quite significantly. Some of the other groups that have used other methodologies may have been down less in Q1 and may see a higher mark-down in Q2 despite where public marks are now."

"Now you have a little bit more visibility. You know more but you still have uncertainty in the future that needs to be considered"

DAVID LARSEN
Duff & Phelps

And though at the time of writing, markets were still well above the March nadir, they were still volatile. On June 11, the DJIA fell more than 1,800 points after a relatively steady rise since late April. "Public markets remain volatile and their impact on private market valuations at June 30 will not be known until June 30," says Larsen.

Even if the public market recovery is sustained, a broad rebound doesn't reflect the fact that some industries or specific businesses have been severely impacted by the crisis longer term.

GPs and businesses generally may have acclimated to the operational difficulties brought on by a sudden shutdown, changing the way they do business, the way their employees operate, and in some cases even their business strategies. Many are better able to identify the cost of that adaptation and predict liquidity going forward.

Lingering unknowns

But lingering uncertainties means valuations work for the second quarter won't be much easier. "Now you have a little bit more visibility," says Larsen. "You know more but you still have uncertainty in the future that needs to be considered."

Some of that uncertainty revolves around the schedule of reopening in different parts of the country, the impact of a potential second wave from the virus, and the timing of a widely available vaccine.

It's also unclear what the depth and ramifications of a recession in the US and globally will be, or where unemployment actually stands. Despite the unprecedented character of the current crisis and the resulting challenges in terms of valuation, most fund managers appear to have remained disciplined, sticking to their valuation methodology while at the same time adapting to rapidly changing market conditions. GPs have, for the most part, also managed to report valuations in a timely manner.

In addition, a decade of increased transparency and communications between GPs and their limited partners has also helped to avoid major surprises.

"We are having more calls with GPs than we've ever had before," says Stake. "In many cases, we're shifting to every-other-week updates with our core managers, while before it was almost on a quarterly basis with check-ins along the quarter for anything material. Managers want to discuss what is going on in their portfolios, which is driving how they're going to mark those valuations."

"There's been a lot of transparency because LPs want information," adds Angell. "There was no surprise or shock as to what would be happening with valuations. GPs were trying to secure cash for their portfolio companies either through additional leverage or additional equity. A lot of the conversation was around what the GPs' plans were regarding keeping the portfolio companies healthy through the downturn." ■

Life under quarantine
Mark Carter

The co-head of TA Associates' North America Healthcare Group on staircase multitasking, boxer puppies and unruly beards

From the beginning of lockdown, some private equity execs traded in their suits for sneakers and sweatpants, taking to socially-distanced walks that mix business with some much needed fresh air and real life interaction, ***writes Sarah Pringle***.

"A bunch of us in the Boston community – as opposed to Zoom – we've been going on six-foot-distanced PE walks," says Mark Carter, co-head of TA Associates' North America Healthcare Group. "We're trying to help each other out and share best practices."

On calls for most of the day, Carter has found other ways to stay active and multitask in his home in Wellesley, Massachusetts. "The Carter stairs are getting exercised," the managing director said, recalling his wife's puzzled reaction the first time she caught him breaking a sweat on the staircase. "Things you can accomplish in an hour face-to-face just seem to take longer, so in order to make time for exercise, I put in EarPods [during work calls] and walk up and down the staircase."

The home office has also created a new, and sometimes comical, backdrop for Carter. "I'm here with three kids," Carter says, speaking from his attic, where he often sits posted up at an old card table with a pink lamp his daughter had in her room several years ago. "School comes first, so all the kids have been taking over the home office."

And the family's new boxer puppy – which the Carters welcomed just as the crisis was beginning to escalate – has become a regular attendee of all Zoom calls.

By design, Carter's work-from-home setup is geared to virtually invite people into his home. "You might think it's distant and cold on the computer, but if you set it up such that it's warm, inviting and a glimpse of your life, it can be disarming," he says.

TA also has strategies to engage more junior people at the firm, including a beard-and-mustache-growing contest. Carter, admitting he only lasted about three weeks, says whoever claims victory with the biggest or best facial hair will donate the pool of winnings towards the charity of their choosing. "People are just burly… it's actually unruly," Carter jokes, recalling a recent video call with a foreign management team, where his colleague went to great lengths to explain the rationale behind his peculiar handlebar mustache. ■