ASANTE Q2 2023 NEWSLETTER

Asante Capital is a leading independent private equity placement and advisory group focused on partnering with best-in-class managers and limited partners in both developed and emerging markets.

STATE OF EUROPEAN PRIVATE EQUITY

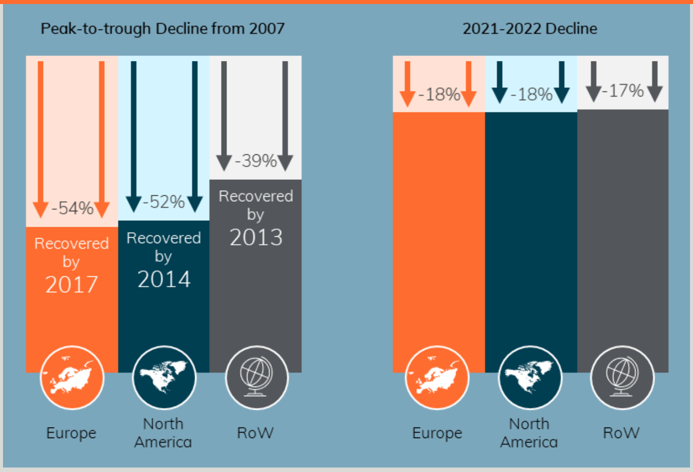
Global private equity is operating in a period of deep uncertainty, and if we aren't already in one, all roads point to an economic recession. Globally, both deal volumes and values fell in 2022 and that trend has continued into 2023, with Europe being affected more dramatically because of its proximity to the war in Ukraine and reliance on Russian-imported energy leading to significantly higher inflation and interest rates. These factors have hit Europe's consumer and investor confidence the hardest[1]. However, there are reasons to be optimistic, and many expect Europe to be the first to come out of a global recession with the right interest rate and policy choices[2]. Private equity managers are seeing new opportunities for transactions emerge, particularly within take-privates and carve-outs amid a wave of public markets repricing.

In this newsletter, we will use history to evaluate the current European market considering the last downturn in 2007-2008, as well as highlight the trends and opportunity set going forward through the lenses of deal activity, performance and fundraising.

EUROPEAN REBOUND THEN VS. NOW

DEAL VOLUMES

During the GFC, deal volumes declined significantly across geographies, and the level of decline in Europe was similar to that in the US. However, the US recovered much quicker in 2010 (71% vs 45%) and also recovered back to its pre-crisis levels three years earlier than Europe (2014 vs 2017 in Europe). In contrast, RoW reached pre-crisis levels the quickest in 2013, driven predominantly by China, which had recovered by 2010.



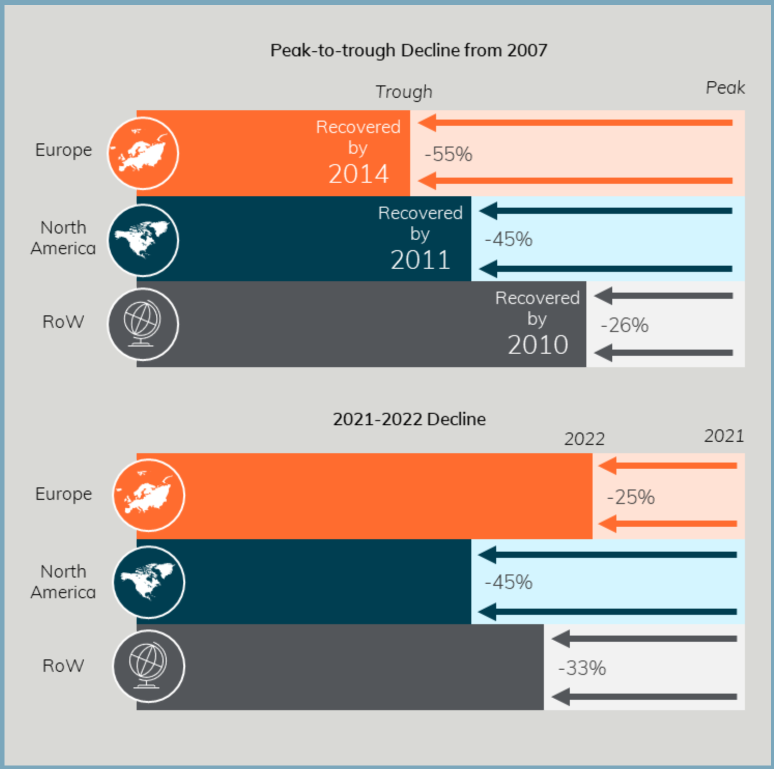
In comparison, the drop in deal volume in 2022 was also consistent globally, however so far has been less sharp than the one seen in 2008. For 2023, we expect deal volumes to remain below their 2021 peak in Europe as interest rates are expected to continue rising, leading to a lack of cheap and obtainable debt financing.

In the meantime, with reduced valuations and weakened European currencies, we are seeing global and US managers turn their focus to Europe: US-backed acquisitions of UK companies, for example, had increased by 35% in 2022[3].

1 Fortune Magazine: Recession or resilience? Here's how the U.S., Europe, and Asia stack up; September 2022
2 Lazard Asset Management: Outlook on Europe; April 2023
3 White & Case: Hitting the brakes: European leveraged finance battens down the hatches; January 2023

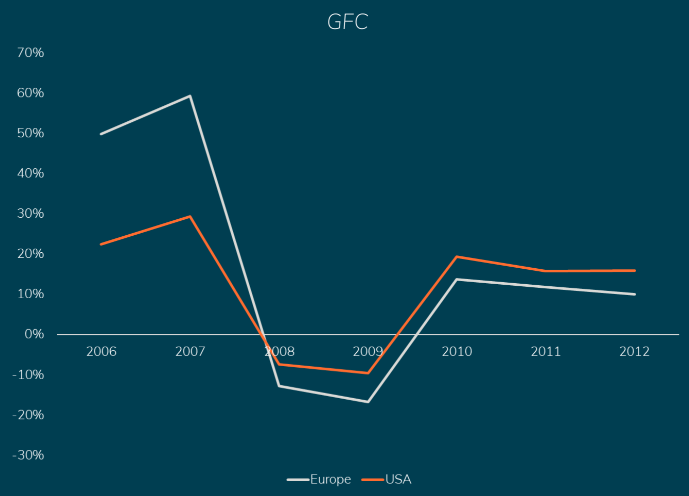
EXITS

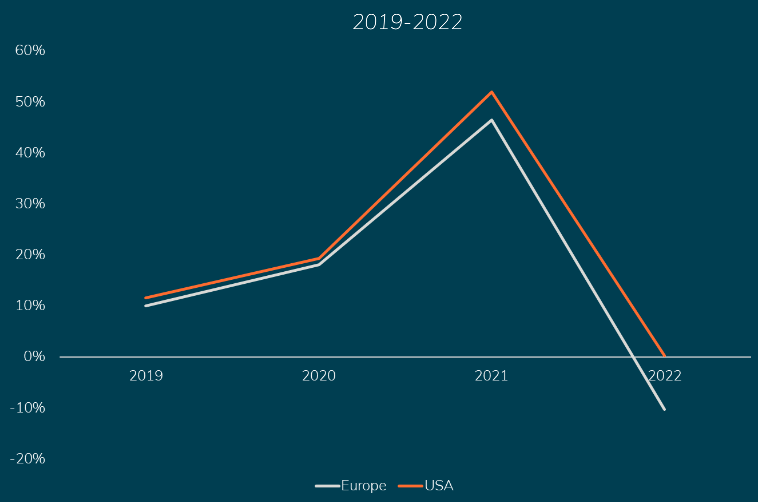
Like deal activity, exits also fell during the GFC but picked up again from 2010 onwards globally – and generally did so more quickly than deployment pace, which is explained by an uptick in strategic acquisitions (from PE) rather than secondary deals between PE firms. As with deal activity, Europe took the longest to recover, only reaching their pre-crisis levels by 2014. In comparison, the US recovered three years faster, and RoW recovered the quickest. The latter was driven predominantly by China's exit volumes growing by nearly 12x between 2007 and 2014[4]. In contrast, the drop in European exits in 2022 was less sharp than in the US and RoW, both of which declined more than their GFC levels.



PERFORMANCE

ANNUAL CHANGE IN NAV (UNTIL END Q3)





Deals completed post 2008 during the downturn generally delivered excellent returns, driven by lower valuations in 2009 - 2010 and a resilient decade of high growth up to and during the COVID-19 pandemic. As a result, investors who continued deploying consistently through the two year recovery period after the GFC generated the best returns. We expect the same to hold true for the next period of relative growth, although the buyer/seller valuation gap first needs to narrow for M&A activity to pick up, which in turn will allow this new cycle to start taking shape. Relative growth will however be less than post GFC, given the shallower recession and expected continued higher interest rate environment.

It was during the GFC that performance in Europe started to lag compared to the US, which had a faster recovery and stronger growth following the crisis. In Europe, as valuations remained lower and exits remained challenged (until 2014 when they recovered to pre-crisis levels), managers also held onto their investments for longer, reducing IRR according to Pitchbook data[5].

4 White & Case M&A Explorer; Accessed June 2023
5 Median IRRs for 2008 vintages: 9.2% (Europe), 14.9% (US). 2009 vintages: 9.1% (Europe), 14.9% (US)

So far in this downturn, while performance of US funds was generally flat (indicated by the 0% change in NAV) relative to 2021, European funds were down 10%. We are seeing longer hold periods in 2023 and expect the same in the following years, as groups will need more time to generate value and are hesitant to accept/crystallise any multiple compression. The two exceptions here being:

- Groups less reliant on financial sponsors with unique angles to exit their businesses via strategic trade routes.
- GPs using continuation vehicles to crystallise fund returns while still maximising longer value creation. GP-led secondary volume had risen by 54% from 2020 to 2022, and we expect this to only increase going forward, following a quiet period in H2 2022 whilst valuations were unpredictable.

The turn to alternative exit paths rose as part of a global slowdown in M&A and IPO activity. IPO markets were particularly challenged by geopolitical tensions, inflation and rate hikes in Europe, where listings fell by 78% from 2021 to 2022[6]. A large share of companies and sponsors have postponed IPO plans, which are expected to begin emerging in H2 2023[7].

In any case, PE is very much a long-term game, and while many vintages of US funds have outperformed European funds, aggregate returns in Europe over a 20- and 25-year horizon have been higher than in the US[8]. European groups that have demonstrated the ability to generate relative outperformance in previous cycles, whilst evolving with the market, are well-placed to outperform in this vintage.

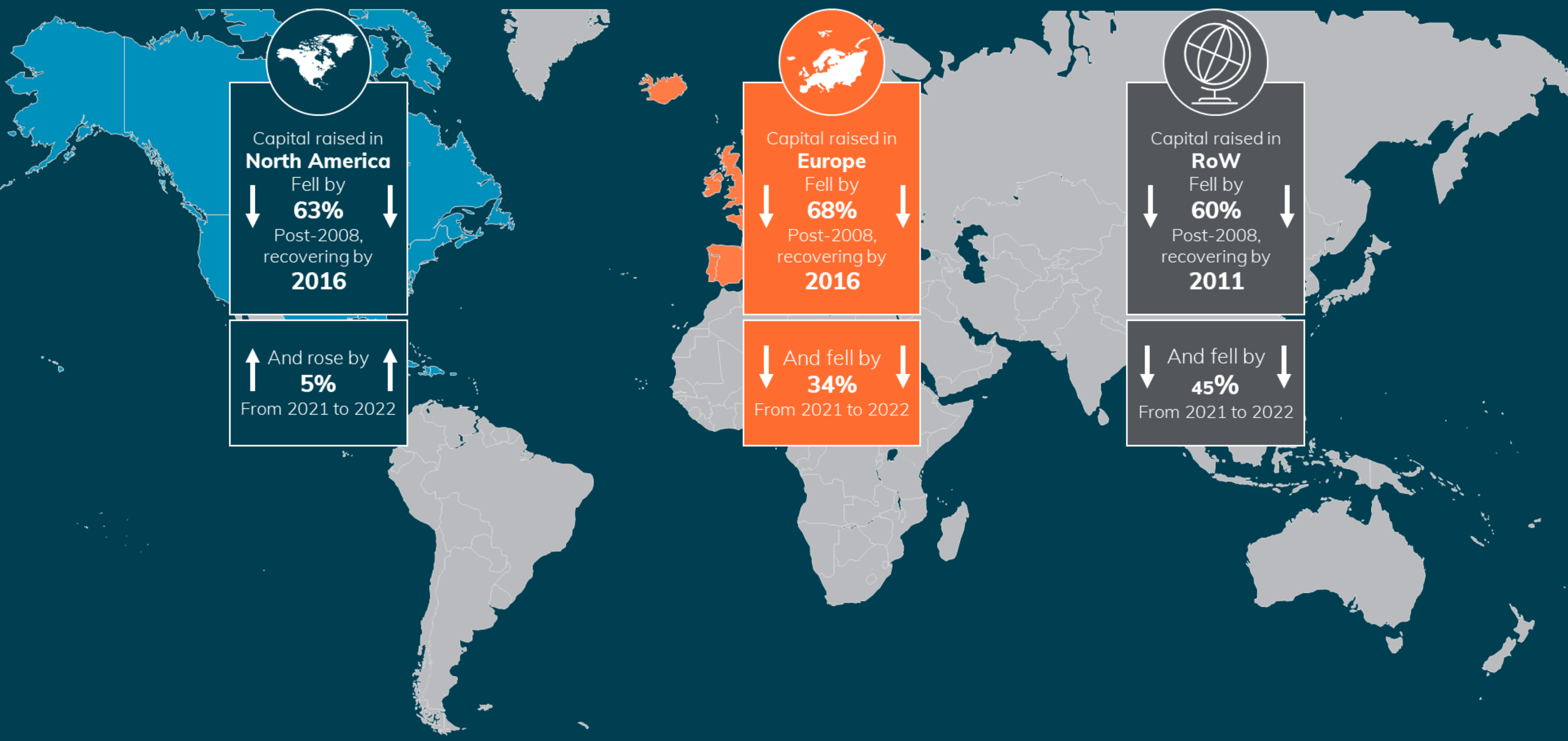
TRENDS TO LOOK OUT FOR IN EUROPE

MARKET SNAPSHOT

LP Allocations	**Real Assets and Infrastructures** The sectors benefit from degree of insulation from inflation, and with pooled returns of 19% and 9% respectively. Real Assets and Infrastructure were the highest performing asset classes in 2022.	**Private Debt** We expect private debt funds to continue gaining market share from banks lending in LBO markets due to tightening capital requirements and significant capital inflows to private credit managers.
Deal-Making	**Pricing** European public markets forward PE ratios falling from 23x in 2020 to 17x in 2021 and 12x by year-end 2022[9].	**Leverage** With unitranche debt becoming more expensive and leverage multiples at significantly lower levels, we see a return of structured financings, including subordinated debt.
Deal Types	**Carve-Outs** A shift in balance to proprietary deals and carve-outs as acquiring from sponsors is challenging during a period of reducing valuations. PE carve-out deal value is likely to account for more than 15% of aggregate PE deal value.	**Take-Privates** Take-private deal value is likely to reach €30 billion, with fewer 40 PE-backed public listings likely to take place.

6 Consultancy UK: Global IPO market endured meltdown in late 2022; Accessed June 2022
7 EY: Global IPO Trends Q1 2023; Accessed June 2022
8 Cambridge Associates benchmarks as at Q3 2022
9 Siblis Research: Europe P/E Ratio – European Equity Valuations; Accessed June 2023

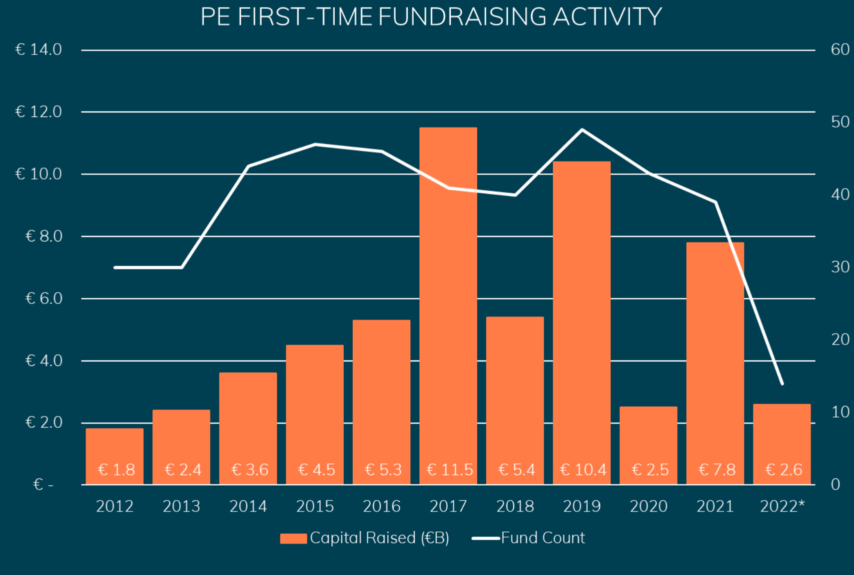
FUNDRAISING - THEN VS. NOW



From a fundraising perspective, there was significantly less capital raised by European PE GPs in 2022 relative to the year prior ($114bn in 2022 vs $171bn in 2021), as investors took a more cautious approach to the region with the onset of the Ukraine invasion and inflationary pressures. In contrast, there was a shift in allocation to North American groups who managed to raise more capital in 2022, driven by a “flight-to-safety” at a regional level.

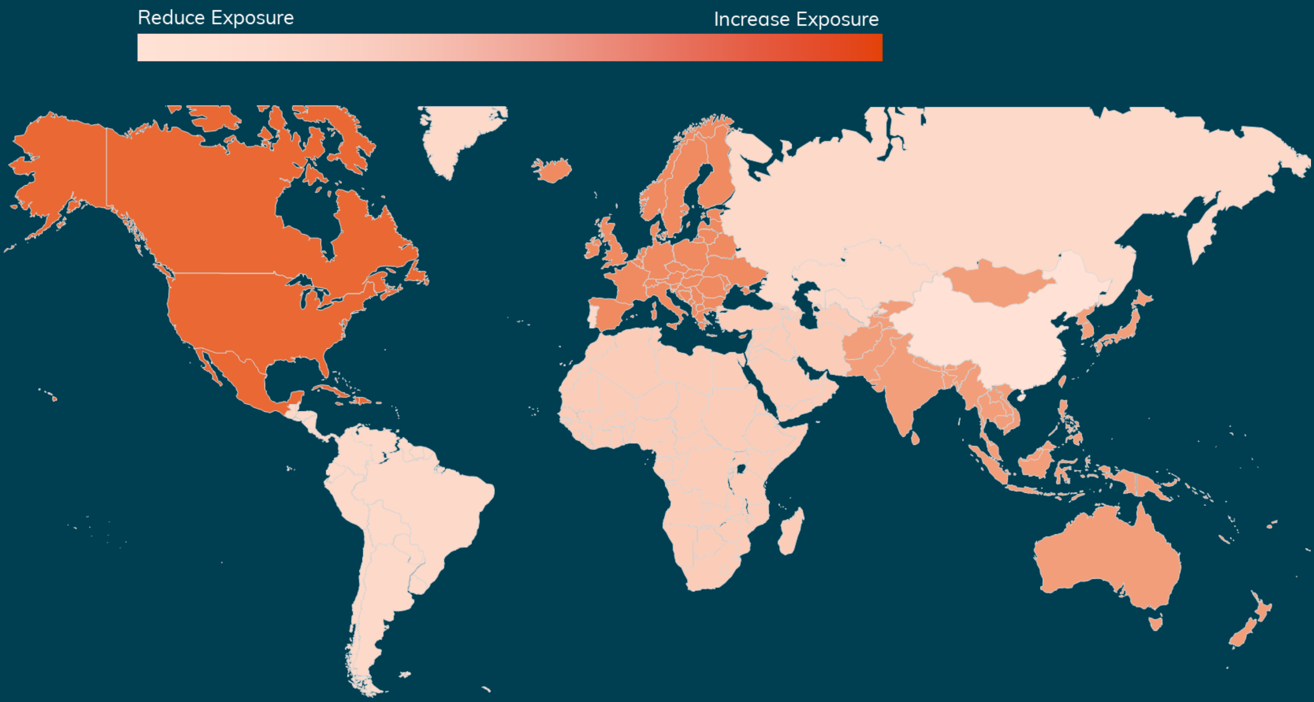
FIRST TIME FUNDS FALL ON HARD TIMES

PE FIRST-TIME FUNDRAISING ACTIVITY



European first-time funds have suffered the most, falling to their lowest count since 2006 in terms of number of funds raised (14 funds or 15% of all new funds), and back down to COVID-levels in terms of total capital raised (€2.6bn). Only one out of all funds closed in 2022 closed above €500m as a first-timer: Nextalia, in Italy.

While 41% of LPs expect to increase their PE exposure in the US, Europe follows closely in second place with 36% of LPs looking to increase exposure to the region (according to Asante survey data).



Despite uncertainty in Europe, both the US and Europe have been near neck-and-neck in prior years and continue to be viewed as robust economies that offer a sense of security. However, in 2022, there has been a shift away from Europe with investors (including European LPs) favouring North America in terms of adding new PE exposure. This may be driven by memories of a swifter recovery in the US, after the GFC, than in Europe.

As a result of this recent shift, we may see the pendulum swing in the other direction over the next five years as LPs look to rebalance their portfolios back towards Europe to meet allocations. With that said, allocations for the US significantly outweigh Europe and slots for new groups remain limited. Additionally, as US and global GPs increase exposure to Europe at a portfolio level, LPs are comfortable with their European exposure being met through global and transatlantic managers. As a result, we expect smaller European GPs to continue to struggle to raise capital in the short-medium term.

While uncertainty remains, the economic environment in Europe is showing signs of stability in a recessionary environment, with the annual inflation rate in the Eurozone falling from 8.5% in February 2023 to 6.9% in March[10]. After much time spent on the sidelines in recent months, the stage is set for a resurgence of European PE deal activity and fundraising. The key question for both GPs and LPs will be what this recession will look like, particularly in the form of fund manager portfolios in terms of volatility, company revenues and earnings. This, in turn, will impact allocations for 2024 and the years to come.

10 Eurostat: Annual inflation down to 6.9% in the euro area; Accessed June 2023

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