Intertrust

A 'new world' for private equity after a global pandemic:

North American Private Equity Outlook 2020

Introduction

The fieldwork for our Global Private Equity Outlook 2020 was conducted right in the midst of the COVID-19 outbreak. Despite this, we had around 150 private equity fund managers based in North America, EMEA and Asia respond to our survey. This report focuses specifically on our findings from 110 of our USA related findings coming from 110 private equity managers based in the United States of America and Canada.

COVID-19 has dramatically impacted the sector outlook for the year, with many private equity firms, their investment strategies and portfolio companies being severely tested. Well over half (61%) of our respondents[1] see the environment for private equity deteriorating over the next 12 months and of these, one in seven believes it'll deteriorate "significantly". Almost all respondents to our study – 90% – believe there'll be an increase in distressed fund transactions over the next 12 months.

But we also found a large number of industry professionals remain positive. Almost a third (31%) of private equity fund managers in North America think the environment for private equity will improve and around half (47%) say they are optimistic the industry will be able to face the pandemic and, ultimately, come out stronger over the next 12-24 months.

In the context of record levels of dry powder – Preqin reported at the start of the year that it rose for a seventh consecutive year to c. $276 billion in 2019, triple what it was in 2012 – it's perhaps unsurprising that many respondents see a rise in opportunities and potential deals. Over four fifths (83%) say that lower valuations present a buying opportunity for active investors.

There are three other clear trends we can distil from our survey, all of which, it could be argued, overlap with each other. Firstly, that Environmental, Social and Governance (ESG) considerations will escalate in importance, in terms of how firms run themselves and the companies they invest in. COVID-19 is widely seen as catalysing this shift as the world moves towards a 'green is good' mentality. Secondly, that the drive for greater transparency remains an absolute priority for firms and their stakeholders, particularly regarding portfolio performance.

And thirdly, that smarter technologies and digitisation will drive operational efficiencies and support the push for greater transparency – as well as investment opportunities. The vast majority of our respondents (81%) said they're optimistic that they'll benefit from digitisation over the next 12-24 months, with 31% being "very optimistic". Despite this positive outlook, our research shows North American PE professionals are slightly less optimistic than their European counterparts overall.

[1] Where we speak about '(all) respondents' we refer to all North America respondents unless mentioned differently

DO YOU EXPECT THE FOLLOWING TO CHANGE OVER THE COMING 12 MONTHS COMPARED TO THE PREVIOUS YEAR? *(select all that apply)*

92% Distressed fund transaction activity

59% Volume of GP-led secondaries to recapitalise portfolio companies and provide liquidity to LPs

56% Number of take privates

56% Cost of debt

38% Number of buy and build transactions

31% Deal flow volumes

27% Dry powder levels

25% Continuing existing fundraising activity

17% Availability of debt

13% Beginning fundraising for new funds from scratch

13% Fundraising volumes

Digitalisation has come to the fore during the COVID-19 pandemic – think how online collaboration tools such as Webex or Zoom have transformed remote working. In terms of the sector itself, there's been a normalisation of online due diligence, hosting of Annual General Meetings (AGMs), or the use of data rooms to share data with investors. At Intertrust, we've seen interest in digital platforms through which static and dynamic information can be shared as well as actual documents workflow tools.

For us, the changes impacting the sector have continued to drive the way we work with private equity professionals and support their business requirements and aspirations – particularly during times of profound disruption and market risks.

Our deep domain capabilities, coverage in more than 30 jurisdictions and leading tech-capabilities, has underpinned our own business growth and expansion. New requirements such as the demand for virtual board meetings and digital signatures, as well as the need for online business activity monitoring and investor reporting tools, are accelerating the digitisation of our own business (as an example, our GAAP consolidation tool). As financial markets move forward, private equity firms are realising that outsourcing – fully or partially – is a key opportunity when considering their future operations.

As the private equity sector grapples with great challenges and fund structures become more complex, we're exceptionally well positioned to help our clients navigate through and benefit from such a fast-changing world. Just over two thirds (68%) of respondents to our survey see a rise in early bird discounts and other deal sweeteners at first close by GPs to attract capital over the next two years. Almost a similar number (65%) expect GPs to offer co-investment rights to LPs. Just under half (46%) say that there'll be a rise in cross-border fundraising with GPs marketing to LPs in overseas markets. This will increase the complexity of the fund structure, which in turn increases operational complexity and regulatory obligations.

As such, Intertrust will remain a trusted partner for private equity firms, continuing to position ourselves at the forefront of the industry and helping clients to prepare for the 'new world' of private equity.

James Ferguson
Head of Americas
at Intertrust Group

The profound impact of COVID-19: risks and opportunities

The COVID-19 pandemic is a human tragedy on an unprecedented scale. The impact is likely to be felt for many years to come as people, societies, businesses and governments count the cost of what has become a truly historic crisis.

Managers have taken a pause as they wait for the global economy to reboot. Financing markets have been effectively closed and that will impact private equity transaction volumes. Across every sector, GPs are going to face challenges within their existing portfolios and many will have to inject cash to ensure businesses survive – and then hopefully thrive – as the environment normalises. More than half (53%) of respondents believe firms will be in 'defence mode' until the impact of the virus is fully understood.

WHICH OF THE FOLLOWING IS MOST LIKELY TO SHAPE SENTIMENT AMONG PRIVATE EQUITY FIRMS AS A RESULT OF THE CORONAVIRUS PANDEMIC OVER THE NEXT 12–24 MONTHS?

(select all that apply)

- 83% Lower valuations present a buying opportunity
- 73% Importance of stabilising financial health of portfolio companies
- 53% Most private equity firms will be in defence mode until impact of the virus is fully understood
- 46% Valuation expectations between buyers and sellers will restrict deal flow
- 44% Restricted financing is likely to limit new investments
- 42% Take privates will grow in popularity to capitalise on depressed stock prices
- 25% Greater focus on ESG investing as the role of business in society comes under increasing scrutiny

WHICH OF THE FOLLOWING MEASURES DO YOU EXPECT TO BE ADOPTED BY GENERAL PARTNERS (GP) OVER THE NEXT 12 MONTHS IN LIGHT OF THE IMPACT OF CORONAVIRUS AND CHANGING MARKET CONDITIONS?

(select all that apply)

76% Term extension for existing private equity funds nearing the end of their terms

71% Moving LP meetings to electronic formats e.g. webcasts

53% Greater information disclosure to LPs on portfolio company performance

45% Better opportunities to make deals in a declining economy, hence quicker investments

41% Reallocation of unfunded commitments into new distressed or non-traditional strategies

32% Delayed reporting of financial statements due to delays at GP and portfolio company level

31% Valuation provisions in fund documents in case changes impact calculation of management fees, distribution waterfalls and clawbacks

29% Increased use of leverage through existing subscription line facilities

27% Reviewing insurance cover at manager and portfolio level to check what claims are available under existing coverage

26% Warehousing provisions in fund documents to allow GPs to warehouse investments if they're unable to financing for an acquisition

13% Greater uptake in fund administration outsourcing to alleviate in-house operational challenges and to allow for greater transparency

0% N/A – it'll have no impact

DO YOU EXPECT THE FUNDRAISING CLIMATE TO CHANGE FOR THE FOLLOWING TYPES OF PRIVATE EQUITY STRATEGY OVER THE NEXT 12-24 MONTHS? *(select all that apply)*

81% Distressed

65% Specialist sector-specific (e.g. healthcare, technology)

44% Debt

38% Impact

36% Infrastructure

33% Mezzanine

33% Buyout

23% Growth

18% Mid-market

17% Large-cap (€1bn+)

13% Venture capital

12% PERE

'Distressed' is, perhaps unsurprisingly, one of the more common words in our 2020 survey. Almost all North American respondents to our study – 90% – believe there'll be an increase in distressed fund transactions over the next 12 months – a near consensus in terms of sentiment. Likewise, 39% see the fundraising climate for distressed opportunities "significantly" improving; a further 41% see it slightly improving (80% in total).

> 41% believe that the pandemic-led market environment will see a reallocation of unfunded commitments into new distressed or non-traditional strategies

Over three quarters (76%) of private equity professionals in North America say that, in terms of measures being adopted by GPs over the next 12 months directly in light of COVID-19, term extensions for existing private equity funds nearing the end of their term will be most likely. 41% believe that the pandemic-led market environment will see a reallocation of unfunded commitments into new distressed or non-traditional strategies.

The move towards term extensions is highly likely, given the severity of the current market environment. Such extensions would allow more cash flow breathing space for LPs and would also allow GPs to take longer before deploying capital if they believe investment prices will decrease. 2020 could also prove to be a very awkward time to divest assets. We'd expect to see some managers looking to fold assets into a new fund or extend a current vehicle to extract most value. The latter is in the interests of LPs too.

Fundraising will also be challenging – irrespective of the market opportunities, investor appetite will likely be diminished to some degree. Over two thirds (68%) of North American respondents see a rise in early bird discounts and other deal sweeteners at first close by GPs to attract capital over the next two years. Almost a similar number (65%) expect GPs to offer co-investment rights to LPs. And just under half (46%) say that there'll be a rise in cross-border fundraising with GPs marketing to LPs in overseas markets. This will increase the complexity of the fund structure, which in turn increases operational complexity and regulatory obligations.

While the market has been altered profoundly, one of the many strengths of private equity is that investing in close-ended funds mitigates volatility. Now, more than ever, this resilience should support the industry and help manage many of the risks that more open-ended funds are experiencing in the current crisis. For GPs, time is on their side and they can manage their assets through the crisis.

Operational excellence has always been core for a lot of buyout firms and in a difficult financing market, it'll only become more so. Improving margins organically through, for example, technology efficiencies, will be key to sustaining correct use of data in decision making as well as asset performance.

Private debt – a growing interest

We asked practitioners about diversification and the opportunities firms see in the market. While almost two fifths (39%) stated that they aren't planning on diversifying over the next 12-24 months, of those that are, the biggest area of diversification will be into private debt. Just under a third (29%) of respondents say they're planning to move into direct lending over that timeframe. This was followed by buyouts (23%) and growth equity (19%).

Private debt is an exciting area for many firms, and we believe that the largest direct lending firms with distressed situation capabilities will be well placed to capitalise. A lot of those managers have the benefit of surviving after the 2008 global financial crisis and offer in-house expertise. Others will be raising new capital in anticipation of upcoming opportunities. The record levels of dry powder will help to act as a catalyst in this respect. In the context of COVID-19, some banks are already writing down many of their loan books, which could represent prime assets for private debt GPs to buy.

WHICH IF ANY OF THE FOLLOWING ARE YOU PLANNING ON DIVERSIFYING INTO OVER THE NEXT 12-24 MONTHS?

(select all that apply)

31% Private debt

16% Venture capital

21% Growth equity

16% Infrastructure

20% Buyouts

36% We are not planning on diversifying over the next 12-24 months

18% Real estate

Investor reporting and transparency remains top of the agenda

The drive towards far higher levels of investor reporting and transparency had been a key aspect of the private equity industry long before the current economic crisis. We believe very strongly that it will remain top of the agenda, with stakeholders such as regulators and clients demanding ever more granular levels of reporting and portfolio insight. The firms providing this will likely attract higher levels of capital.

80% said investors are demanding increased levels of transparency from managers with regards to the performance of underlying assets in each portfolio; just over two thirds (68%) said private equity managers are prioritising greater transparency in the level of information supplied (such as Institutional Limited Partners Association (ILPA) reporting templates). More than half (55%) cited the need for "real time" information. And, recognising the growing demand towards ESG, over two fifths (44%) said that increased levels of transparency are needed if the industry is to fulfil ESG-specific requirements.

At the heart of the need for greater transparency lies technology, with digital tools seen as playing the major role in the industry. Historically, fund administration and investor reporting has been paper-driven, but GPs and LPs now need access to ever greater levels of quality data. From a fund accounting and portfolio management perspective, GPs are collecting much more information from their investments and sharing a portion of it with their LPs. The quality of that portfolio company data has become highly significant as good and homogenous data allows managers to quickly identify risks and exposures. And in the future, managers will insist data is provided in a certain format.

As example of industry response to data, Intertrust has itself placed a significant focus on delivering sophisticated data solutions to our clients as we see this as underpinning our growth. Our own process automation platform allows managers to view all documents relating to underlying entities such as director resolutions. We're investing a huge amount of resources into data aggregation, through our client portal IRIS, giving our clients complete visibility over their entire portfolio.

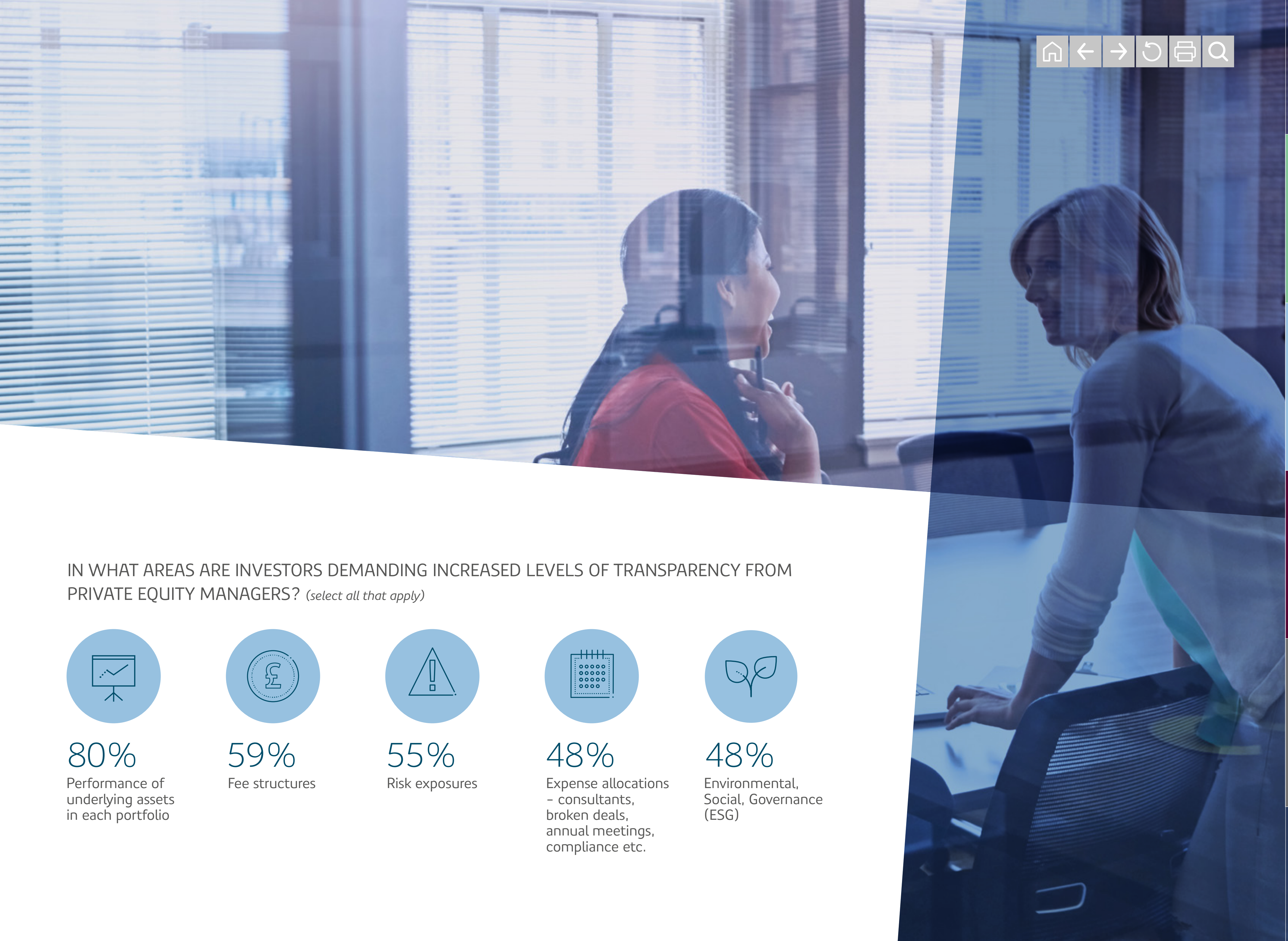
DO YOU AGREE WITH THE FOLLOWING STATEMENTS? *(select all that apply if you agree)*

- **79%** There will be a drive for greater transparency over the next 12 months among LPs on portfolio company performance
- **70%** There will be growing demand for more sophisticated data solutions among LPs
- **61%** Increasing regulatory burden is leading to time and cost constraints
- **54%** KYC and AML searches will become increasing complex for GPs managing stakeholders across multiple jurisdictions with different requirements
- **50%** Investor reporting is one of the biggest pain points facing private equity CFOs

WHICH OF THE FOLLOWING INVESTOR REPORTING IMPROVEMENTS ARE PRIVATE EQUITY MANAGERS PRIORITISING?

(select all that apply)

- **66%** Greater transparency in the level of information supplied, e.g. ILPA Reporting templates
- **56%** Technology – anytime access to financial information via a dynamic portal
- **34%** Frequency – enabling reporting to be produced more frequently than quarterly
- **27%** Reduced LPA timeline for valuation/quarterly reporting, i.e. 45 days rather than 90 days
- **26%** Customised templates dealing with side letter requests



IN WHAT AREAS ARE INVESTORS DEMANDING INCREASED LEVELS OF TRANSPARENCY FROM PRIVATE EQUITY MANAGERS? *(select all that apply)*

80%
Performance of underlying assets in each portfolio

59%
Fee structures

55%
Risk exposures

48%
Expense allocations – consultants, broken deals, annual meetings, compliance etc.

48%
Environmental, Social, Governance (ESG)

ESG: the defining business trend of the decade

Mirroring the wider economic, social and political momentum behind ESG that was the hallmark of 2019, it's clear from our latest research that ESG considerations will grow in significance for the private equity industry – and that COVID-19 has accelerated that trend.

Before the COVID-19 outbreak, climate change had risen to the top of the political and business agenda; in tandem with the virus and its impact on society, climate change is unlikely to disappear from the economic narrative and is expected to dominate it for years ahead.

What will ESG mean in the context of private equity? Some 88% of our respondents expect private equity firms to change the focus of portfolio companies with regards to ESG considerations over the next 12-24 months.

Almost half (47%) accept, however, that using in-house ESG scorecards and methodologies will leave the industry open to accusations of 'greenwashing' – putting the onus on tech-enabled service providers to deliver flexible solutions that can provide independent assessments and benchmarks as well as offer GPs flexibility in adhering to different standards that are constantly changing.

But it's clear that many see the push into ESG as a long-term evolution of the sector. On average, respondents think it'll take just over five years before ESG data across portfolio companies becomes fully standardised – with quantifying and monitoring the ESG implementation process, and the costs of any ESG-specific programmes, viewed as the biggest obstacles. For service providers, such as Intertrust, this has become a compelling opportunity to help clients lead the sector.

> “Some 88% of our respondents in North America expect private equity firms to change the focus of portfolio companies with regards to ESG considerations over the next 12-24 months.”

HOW LONG DO YOU ESTIMATE IT WILL BE BEFORE ESG DATA ACROSS PORTFOLIO COMPANIES BECOMES FULLY STANDARDISED, ALLOWING INVESTORS TO MAKE BETTER INFORMED INVESTMENT DECISIONS?

6%	67%	17%	11%
1 – 2 years	3 – 5 years	6 – 9 years	10 years plus

WHAT DO YOU SEE AS THE BIGGEST OBSTACLES PREVENTING THE ADOPTION OF ESG PROGRAMMES IN PRIVATE EQUITY?

(select all that apply)

29%	28%	17%	16%	7%	3%
Quantifying and monitoring the ESG implementation process	Cost and resource constraints	Complexity of managing multiple sources of ESG data	Shortage of knowledge and expertise at GP level	Shortage of knowledge and expertise at portfolio company level	Additional restrictions ESG places on the investment process

Conclusion: a tech-led future for private equity

The private equity industry has faced many tests and, while the COVID-19 pandemic may represent one of the biggest tests of all, the sector has so far proved itself to be resilient, adaptable and opportunistic in the face of such risks.

For instance, while the private debt sector has been growing significantly for the past five years, the notable escalation in focus on it as a growth opportunity is a testament to this mindset and refocused business models.

Building further on this resilience is likely to be a key sector trend going forward in 2020 and beyond; in particular, greater use of technology and digital functionalities to strengthen business models and help firms accommodate and capitalise on new requirements such as ESG benchmarking.

CONSIDERING THE FOLLOWING DISRUPTORS TO THE PRIVATE EQUITY INDUSTRY, WHICH ARE YOU CONFIDENT WILL BE ABLE TO FACE AND ULTIMATELY BENEFIT FROM THEM OVER THE NEXT 12-24 MONTHS?
(select all that apply)

81%
Digitisation

60%
Changing consumer behaviour

48%
ESG

47%
The coronavirus pandemic

26%
A synchronised downturn

> 81% see digitisation as a core enabler for growth over the next 12-24 months.

Select and cautious opportunities in the sector, particularly distressed-led activity, is expected to be a signature theme for the year. High levels of dry powder across markets will act as a catalyst for some expected high-profile market transactions.

Many large private equity managers are looking at new investment opportunities in countries that are starting to recover post COVID-19. For example, we've already seen an increase of investment activity in China as its financial sector has rapidly opened back up to foreign capital.

According to our research, the biggest threat to growth is seen as a synchronised economic downturn across markets: this is viewed as almost twice as challenging as the COVID-19 pandemic, for instance.

Digitisation, in contrast, which has been viewed by many prior to the pandemic as a major sector disruptor, is seen as the least threatening – indeed, the majority of respondents in North America (81%) see it as a core enabler for growth over the next 12-24 months. This isn't just in terms of portfolio company opportunities but in how private equity firms themselves use digital technologies to deliver enhanced returns and become more efficient.

Our extensive work with the global private equity industry has resulted in a strong technology-led product and service ethos at Intertrust. Even before COVID-19, Intertrust was seeing a growing number of requests from private equity and larger financial institutions with regards to outsourcing. As financial markets move forwards, private equity firms are realising that outsourcing - fully or partially - is a key opportunity when considering future operating platforms.

Over the next five to ten years, we expect that most support functions will likely be outsourced – leaving firms and managers free to focus on core activities. We believe the industry is about to go through a shake-up seeing a tangible shift towards outsourced models. Business continuity plans, for instance, are being played out, showing that the traditional "office" may become a thing of the past.

For Intertrust this is very much the reality of today, not the future.

About us

Intertrust is a leading provider of tech-enabled corporate and fund solutions to clients operating and investing in the international business environment. We have over 3,800 employees across more than 30 jurisdictions in Europe, the Americas, Asia Pacific and the Middle East.

With offices in 7 countries across North and South America, our experts in the Bahamas, Brazil, BVI, Canada, Cayman Islands, Curaçao and USA are experienced in helping private equity managers overcome their operational challenges. With expertise in all private capital asset classes, you can rely on our end-to-end capabilities, expert teams and state of the art technology to provide a truly customised offering.

$460 billion assets under administration

We work with 80% of the private equity international 300

3,800+ employees globally

Our services

- Private capital fund administration
- SPV and loan administration
- Corporate services
- Middle office and shadow accounting
- Technology services
- AIFM ManCo services
- AIFMD Depositary services
- Independent directorships
- Regulatory and compliance services

For more information on our fund services, or to get in touch with us, click here.

Methodology

Research was carried out in April 2020 by Citigate Dewe Rogerson, on behalf of Intertrust. A total of 143 responses were gathered from private equity fund managers across Europe, North America and Asia via an online survey sent to a global database of private equity professionals provided by Intertrust and Preqin.

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