PALICO

SECONDARY PRICING

REPORT H1 2019

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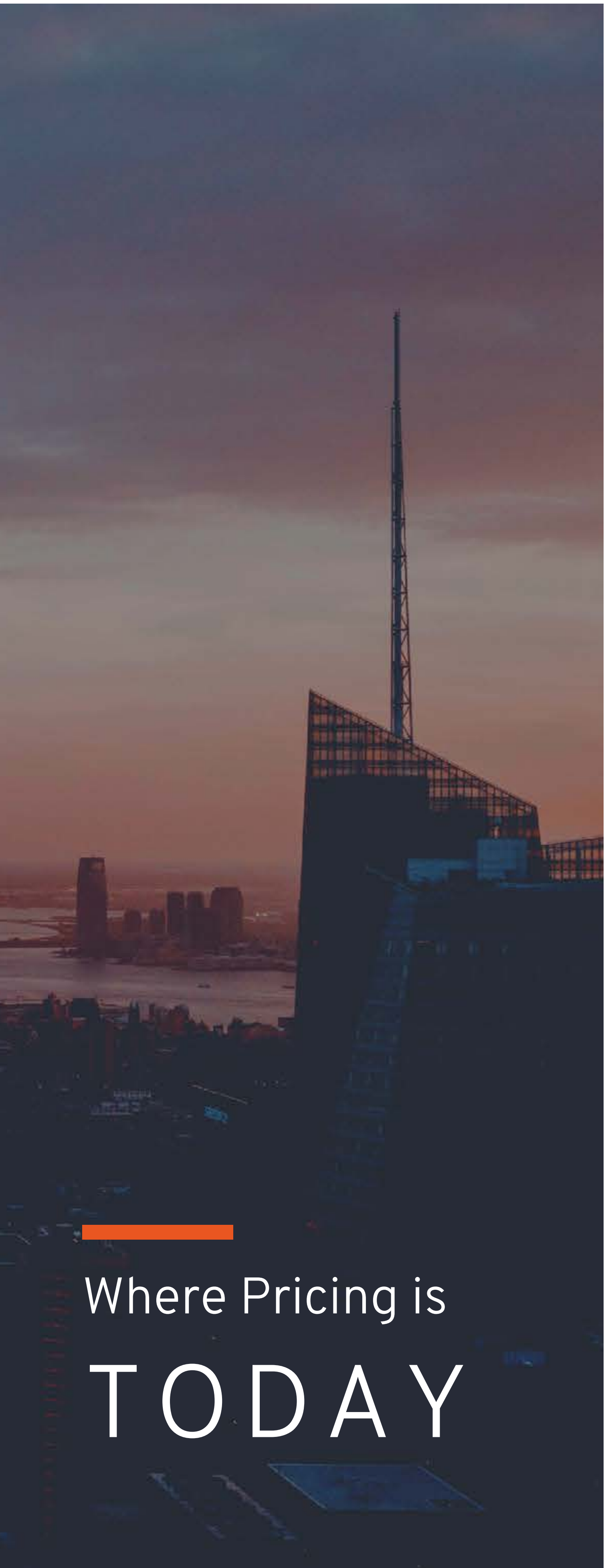

H1 2019

FUNDS SELLING AT PAR IN A MARKET POISED FOR RECORD VOLUME

Whether it's mean or median, the typical transaction on the private equity secondary market is valued at 100 percent of net asset value, according to a Palico survey of limited partners who've successfully purchased stakes in closed funds over the last six months. This is the third time in a row - and only the third time overall - that Palico's secondary pricing survey has recorded an average price of par or better. This is occurring in a secondary marketplace where average pricing has historically been at a discount to net asset value. The latest survey covers 36 funds of all types, from buyouts to private debt, infrastructure and energy.

FUNDS SELLING AT PAR IN A MARKET POISED FOR RECORD VOLUME*

Fund	Pricing (% of NAV)	Vintage
Advent Global Private Equity VII	105%	2012
Apollo Investment Fund VIII	102%	2014
Ares Corporate Opportunities Fund IV	102%	2012
Baring Asia Private Equity Fund VI	113%	2015
BC European Capital VIII	77%	2005
Berkshire Fund VII	93%	2006
Berkshire Fund VIII	103%	2011
Blackstone Capital Partners VI	105%	2010
Bridgepoint Europe IV	101%	2009
Bridgepoint Europe V	110%	2015
CDH China Fund V	100%	2014
Centerbridge Capital Partners III	104%	2014
Cinven V	111%	2013
Crestview Capital Partners III	95%	2015
CVC European Equity Partners VI	100%	2013

*Through June 28

Fund	Pricing (% of NAV)	Vintage
EnCap Energy Capital VIII	82%	2011
EnCap Energy Capital XI	96%	2017
Global Infrastructure Partners I	103%	2008
Green Equity Investors VI	109%	2012
GTCR Fund X	104%	2011
Hellman & Friedman Capital Partners VII	100%	2009
KKR Europe III	100%	2009
Lexington Middle Market Investors II	94%	2009
Madison Dearborn Capital Partners VI	96%	2010
New Mountain Partners III	100%	2007
New Mountain Partners IV	108%	2014
Oaktree European Principal Fund III	85%	2011
Onex Partners IV	98%	2014
Riverside Capital Appreciation Fund V	89%	2009
Riverside Capital Appreciation Fund VI	100%	2013
Silver Lake Partners III	98%	2007
Silver Lake Partners IV	104%	2013
TPG Partners VI	97%	2008
Vista Equity Fund IV	107%	2014
Warburg Pincus Private Equity XI	99%	2013
Waterland Private Equity Fund VI	121%	2015

*Through June 28

Nearly Two Out of Three Funds Sell at Par

The 64 percent of funds selling at par or better over the last six months show an average premium to net asset value of 5 percent. The 63 percent priced at par or better in the previous survey – covering the second half of 2018 - showed an 8 percent average premium. What explains the gap? Only 14 percent of the funds traded in the first half of 2019 qualify as early secondaries (funds that are no more than four years old), versus a third of funds in the previous survey. Early secondaries typically attract higher pricing than older funds since they are considered to have more potential upside. At the same time, almost a third of funds in the current survey are “tail-ends,”or funds that are at least 10 years old, versus 23 percent in the last survey. Tail-ends typically have just a few assets left in their portfolio; holding fewer investments increases relative risk compared to more diversified portfolios.

Discounts Remain in Single Digits Amid Record Demand

Despite a greater weighting towards older funds in the current survey, the average discount for funds selling below par has barely widened, with the typical portfolio selling at 92 percent of net asset value, down one percentage point from the second half of 2018.

Pricing is stable and attractive in part because demand for funds on the secondary market has never been higher. Dry-powder earmarked for secondary purchases amounts to almost $200 billion, i.e. almost 3 times last year’s record transaction volume of some $70 billion.

On Pace for Another Record Year

According to the latest industry estimates, the first quarter of the year saw some $18 billion in secondary volume, an all-time high for the first quarter. Given that 60 percent of transactions typically occur in the second half of the year, 2019 looks on pace for a new annual secondary volume record of about $90 billion. That would surpass the 2018 annual record by 29 percent. If such growth continues - even if delayed a year or two by a recession - the secondary market could easily surpass the $120 billion mark in two to four years.

Secondaries are Increasing PE’s Liquidity and Appeal

The desire to latch onto private equity’s promise of outperformance, and the likely pace of PE’s future growth, have been amplified by the asset category’s transformation over the last decade from an illiquid investment into one where funds can be sold quickly, and most crucially, at attractive prices.

Leverage: Another Factor Likely to Keep Secondary Pricing Attractive

In addition to the tremendous amount of dry powder earmarked for secondaries, another factor behind both secondary market growth and attractive pricing is the increasing use of leverage. Pitchbook notes that debt accounted for 23 percent of secondary market volume in 2017, compared to just 4 percent in 2013. Leverage augments buyers' potential returns, allowing them to offer sellers more attractive pricing than would otherwise be the case. This holds true, it would seem, not just in bull markets, but also during periods when asset prices are declining. Although some 53 percent of funds covered in Palico's last survey were sold during 2018's fourth quarter bear market, secondary pricing, expressed as a percentage of NAV, actually rose, thanks in part to the widespread use and availability of reasonable amounts of leverage.

The Secondary Market Has Plenty of Room to Grow

While the rapid growth of secondary volume over the last decade has increased private equity liquidity, and even encouraged investment in private equity's primary fundraising market, these are still early days. Secondary volume last year amounted to less than 1.4 percent of the $5.2 trillion in net asset value of private equity broadly defined (incorporating strategies focused on real assets, credit and venture capital, as well as buyout and growth). New and old private equity investors, recognizing the advantages of the secondary market for both buyers and sellers, should push this percentage considerably higher.

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> *- Julien Gervaz, CEO of Palico*