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MULTIPLICITY INSIGHTS

Q3 / 2019

PRIVATE EQUITY SECONDARY MARKET PRICING AND VOLUME

IT'S HIGH TIME TO SELL LP INTERESTS

Average discounts to NAV widened slightly by year-end 2018 for buyout, venture, and private equity fund-of-funds. Multiplicity's Secondary Market Value Index indicates near-record pricing levels across buyout and venture capital.

When one takes a longer-term, rational perspective, selling a top-quartile fund at a substantial premium tends to be a much worse deal than selling a bottom-quartile fund at a discount.

There are specialised buyers even for small private equity fund interests below USD 1 million.

After soaring throughout most of 2018, public equities went through a correction at the end of that year. Private equity funds followed along, and fund valuations were only modestly affected by the public equity market correction.

Average discounts to NAV for buyout, venture and fund-of-funds continue to narrow.

The private equity market continues to be in rude health

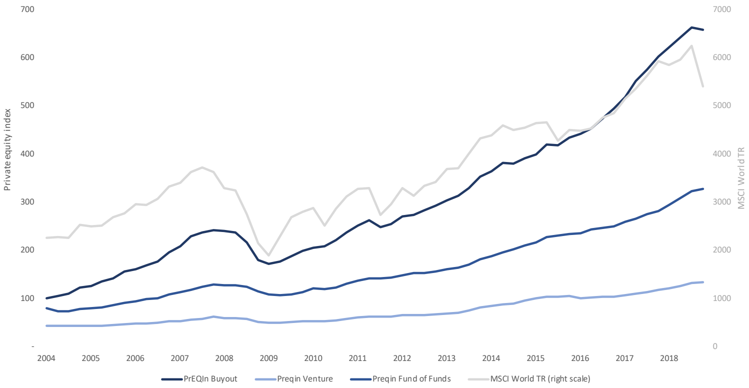

Figure 1: Performance indices for average private equity funds, 2004 to 2018; source: Preqin, Bloomberg

In 2017, pricing in percent of Net Asset Value (NAV) had hit a new peak since the days preceding the global financial crisis. Despite undergoing a small correction last year, pricing remained strong in the historical context.

Market participants have not been able to agree on the cause of the slight dent. We believe that a higher proportion of very mature funds in tail-end situations, and potentially also the increase of lower quality names in the market, may have played a role, as well.

Average discounts to NAV for buyout, venture and fund-of-funds remain narrow

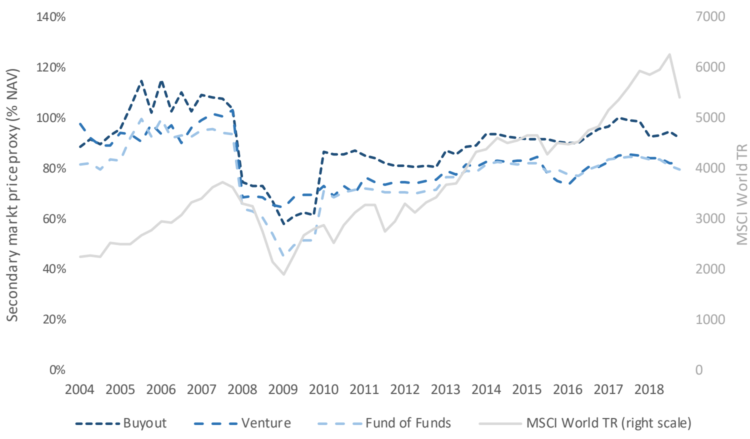

Figure 2: Secondary market pricing proxy index; source: Multiplicity Partners' calculation using various publicly available and internal data sources

To determine the absolute value of the secondary market, we have again calculated the Secondary Market Value Index. It combines private equity performance data (Fig. 1) with the discounts to NAV as illustrated in the secondary market pricing proxy index (Fig. 2).

Not unexpected after what we stated above, we can observe record pricing levels in the third quarter of 2018, and an ensuing slight correction in the last quarter of that year.

The case for selling private markets fund interests is as strong as ever

We stand by our assessment: the factors for sellers are compelling. Our proprietary Secondary Market Value Index points to record pricing levels.

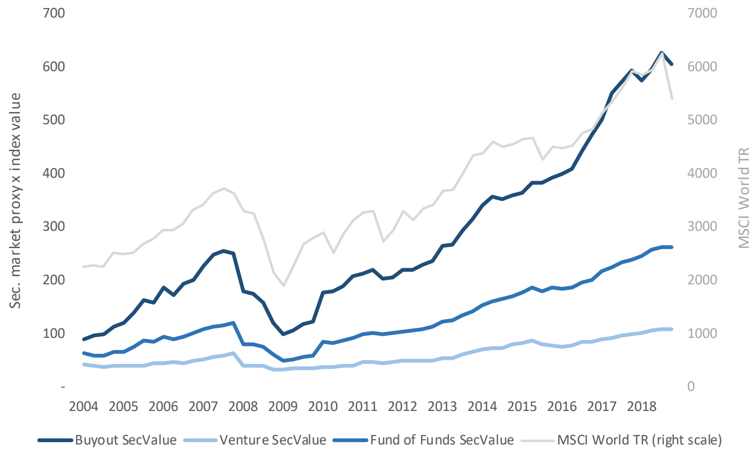

Figure 3: Secondary Market Value Index; source: Calculated using Preqin's performance index and Multiplicity Partners' secondary pricing proxy index

According to estimates by various market participants, and adjusted for our observations, the private equity secondary market volume set new records in 2018.

Cautiously extrapolating the USD 42 billion volume the market reached mid-year, we believe the industry is well on track to reach, or even surpass the USD 73 billion mark again by the time 2019 concludes.

Secondary deal volume firmly surpasses previous records

Secondary market volume set to hit record levels, again.

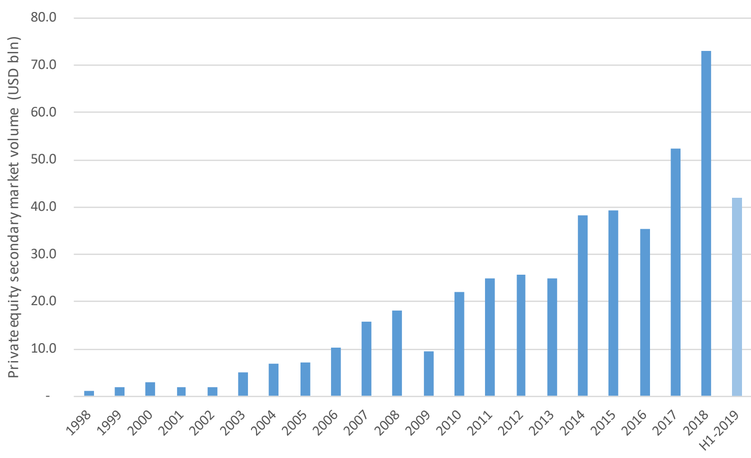

Figure 4: Global private equity secondary market volume; various sources

As a) private equity funds having posted strong returns, b) company valuations remain at elevated levels, c) discounts are tight in the secondary market and d) record amounts of dry powder have accumulated, it's becoming challenging to argue against selling limited partner interests today.

THE NET ASSET VALUE IS JUST A NUMBER

Private equity secondary funds have performed well in the past. They have done so both in absolute terms, and when compared to private equity primary funds. Even more so on a risk-adjusted basis.

Many primary investors underperform secondary investors because they approach the secondary market with an accountant's perspective

Traditionally, the J-curve mitigation effect, the ability to buy fund interests at a discount, and superior investment selection skills are used to explain the higher internal rates of return (IRR) of secondary funds vs. primary funds.

We believe that many primary investors underperform secondary investors because they approach the secondary market with an accountant's perspective. We observe that a majority of sellers are fixated on their investments' book value, represented by the net asset value (NAV).

Interestingly enough, clinging to the concept of NAV is entirely at odds with the asset buyers' perspective. All the latter care about are expected future cash flows.

This mindset can lead to limited partners parting with some well-performing funds at a price at (or around) the NAV, even if they are very likely to leave substantial money on the table.

To confirm this, we used Preqin data to estimate future recovery values for funds. While there are endless ways of slicing and dicing the datasets, we think it's particularly relevant to analyse the results across different performance quartiles. Since the performance figures of early-stage funds are less reliable, we focus our analysis on more mature funds.

The chart (next page) shows the average total value to paid-in (TVPI) of private market funds over their remaining life in % of their NAV in year 8 to 9.

Average TVPI of private market funds over their remaining life, in % of their NAV in year 8 to 9

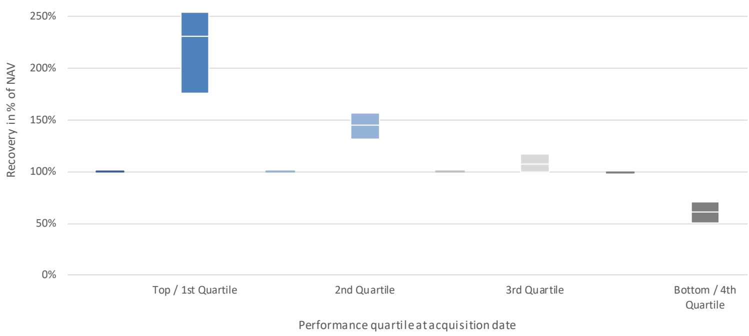

Figure 5: Average TVPI of private market funds over their remaining life, in % of their NAV in year 8 to 9, source: Preqin Ltd., 1999-2011 vintages, with ending values measured at 30 Sep. 2017

While this model may not exactly match final realisations, we believe it is a reasonable proxy for post-sale cash flows.

As counterintuitive as it sounds, a seller would often have been better off getting rid of the worst performers than holding on to the top funds.

A seller would often have been better off getting rid of the worst performers than holding on to the top funds

Or to put it in terms of loss-aversion: selling a top-quartile fund at a substantial premium, e.g., 120% of NAV, appears to be a much worse proposition than selling a bottom-quartile fund at a 60% discount when you take a longer-term and rational perspective.

VENTURE - GREAT LIQUIDITY, BUT NOT YET FOR INVESTORS

The venture capital industry has enjoyed a ten-year bonanza. Buoyed by the success of former unicorns such as Alphabet/Google, Amazon, Facebook, Snap Inc, and the valuations of contenders such as Uber, WeWork and Airbnb, the industry's deal volumes soared in the last few years, reaching an all-time high in 2018.

2018 also marked the fifth consecutive year where venture capital fundraising surpassed USD 30 billion

US Venture Capital deal activity is in a frenzy

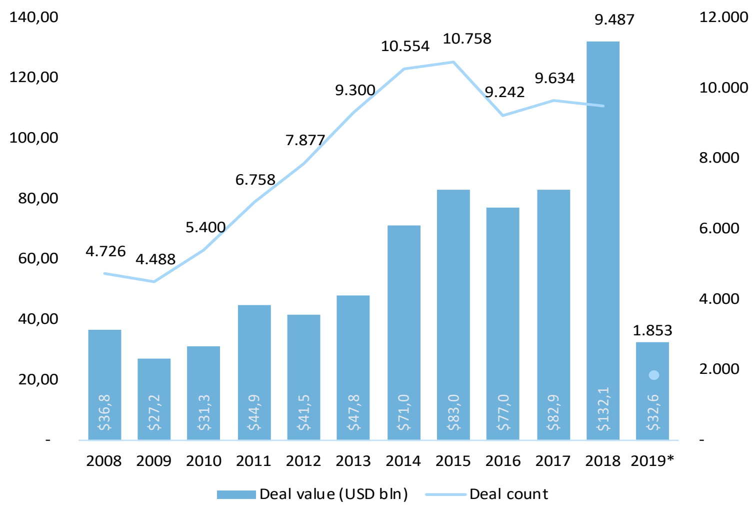

Figure 6: US Venture Capital deal activity; source: PitchBook-NVCA Venture Monitor; *data as at 31 March, 2019

While recognizing that pipelines remain strong with unicorns and mega deals, market observers lamented a slowing of the venture deal activity in the first quarter of 2019 (EY – Global IPO Trends Q1 2019).

Players in the venture space have come to accept the fact that the first quarter is traditionally slow. It may be a telling sign, however, that despite adverse factors (such as the shutdown of the US government early in the year) the deal flow quickly recovered. Compared to the previous first quarters it even set a new historic high.

Average deal sizes continue to increase as well. Deals above USD 50 million have enjoyed a market share of 40% and more since 2014. Since 2018, such large transactions have represented even 60% and more of the deal volume.

Since 2018, deals above USD 50 million represent 60% of the market

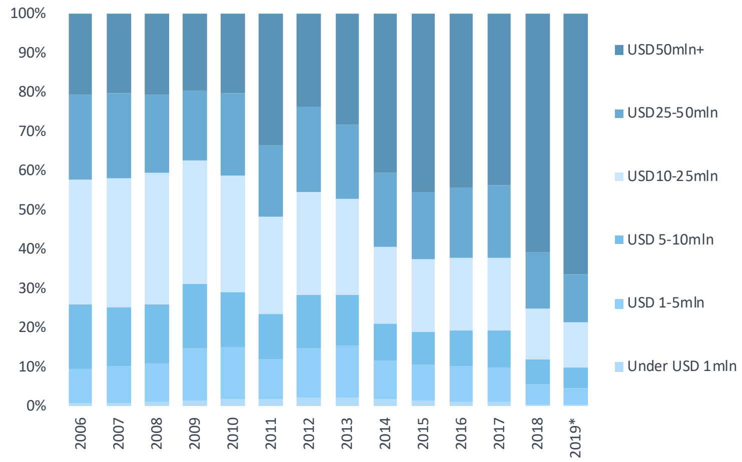

Figure 7: Deals above USD 50 million; source: PitchBook-NVCA Venture Monitor; *data as at 31 March, 2019

Other tell-tale signs that we could be in what we called a hype earlier this year (February PE secondary market update 2019 – pricing and volume) is that there seems to be no rush for the traditional exits in venture capital, i.e., the IPO or the trade-sale.

There seems to be no rush for the traditional exits

Instead, companies are waiting longer to go public, which is also reflected in record deal sizes of late-stage venture funding rounds.

Another reason many founders and backers saw no reason to head for the exit by floating stocks was that Series D+ pre-money valuations have soared for a few years now despite high levels of dry powder. And those who did go public did so with more capital backing than ever before. The resulting, and increasingly common, late-stage mega-rounds are also known as private IPOs.

Average late stage deal sizes have soared

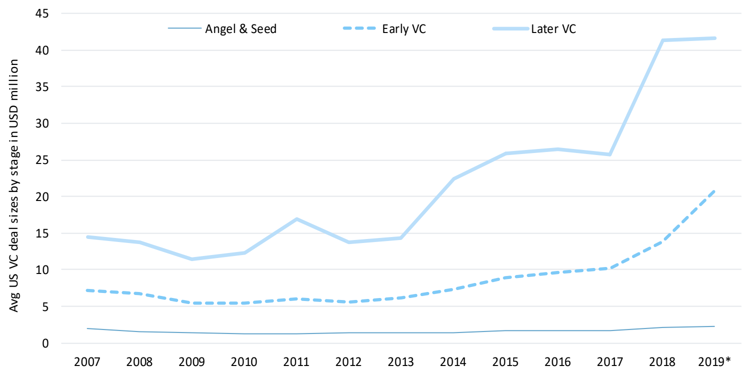

Figure 8: Average late stage deal sizes; source: PitchBook-NVCA Venture Monitor; *data as at 31 March, 2019

What are those early backers, founders, and their employees to do, i.e., those who wish to take at least some of the proceeds off the table in times when a significant down-round could spoil the party? One is to hope that the valuations of certain unicorns will make them entirely unpalatable for any other exit than an IPO.

Another way to pursue liquidity before listing would be in the venture capital secondaries market. It has matured and shows occasional signs of liquidity. As buyers of such fund interests, we monitor the current exuberance in the primary space, yet fail to notice a profound impact on the secondary market.

US VC Median Pre-money Valuation (USD million) by series

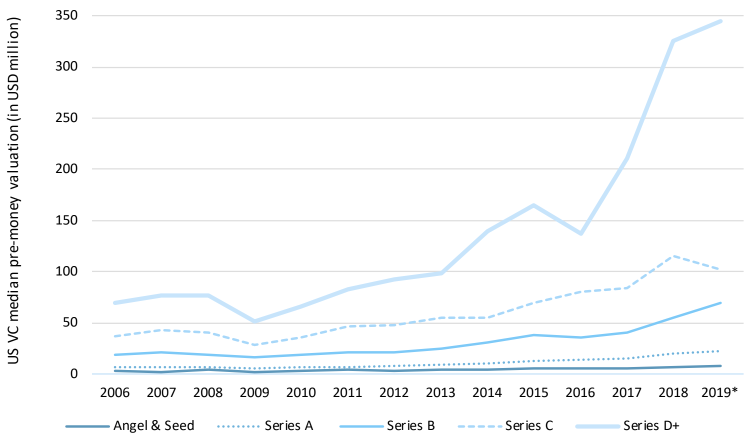

Figure 9: US VC Median Pre-money Valuation (USD million) by series; source: PitchBook-NVCA Venture Monitor; *data as at 31 March, 2019

The venture secondary market seems unfazed by the current primary market exuberance

Earlier this year we noted that, except battle-hardened specialists, not many secondary buyers are proficient in catching a falling knife. The market is flush with old vintages with plenty of portfolio companies across various stages, often ranging from stagnation to run-off.

Anyone hoping the venture capital secondaries market might reach a similar stage of maturity as the buyout market soon is well-advised to exercise some patience.

There are specialized buyers even for sizes below USD 1 million

Today, any private market fund interests can be sold competitively. There are a sufficient number of specialized buyers in any market segment, be it private equity, real estate, infrastructure, tail-end situations and for sizes of below USD 1 million to USD 1 billion+.

Would you like to receive a quick indicative pricing for your asset? Or share your views on this article? Please write to Andres today at ah@mpag.com, or call him at +41 44 500 4555.

Andres Hefti is a partner at Multiplicity Partners. He is responsible for the firm's private market secondary business and has more than 17 years of experience in alternative investments, distressed investing and portfolio management. Before joining Multiplicity in 2012, he held various investment roles with the alternative asset managers Horizon21 and Man/RMF. Andres holds a MSc in Mathematics from the University of Zurich and is a CFA and CAIA Charterholder.

ABOUT MULTIPLICITY PARTNERS

Multiplicity Partners is an investment boutique specialized in providing liquidity to holders of private market funds and distressed assets.

The firm also offers a range of governance and advisory solutions across alternative assets.Since 2010 Multiplicity Partners has been active in the secondary market for illiquid anddistressed assets, as buy-and sell-side advisor, investment manager and principal investor. The team has successfully completed dozens of transactions across a wide range of illiquid and complex financial assets and established a global network of industry contacts. Each partner contributes more than 16 years of relevant experience that give us the collective capabilities to effectively identify, analyse and execute attractive investment opportunities in hard-to-value assets.

Multiplicity Partners was founded in 2010 and is based in Zurich, Switzerland.

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