

THE TRIAGO QUARTERLY

Dear Reader,

Change is the theme of this issue, whether in fundraising, venture capital, the secondary market, or investing strategies. It happens with surprising speed in a PE industry that's often considered static.

Topics include 2015's rapid growth of shadow capital - equal to a record third of classic fundraising - and the rise of Europe as an attractive destination for venture capital. With prices in Silicon Valley looking frothy, Accel Partners' Fred Destin, a roundtable participant, says returns of three times investment are a likely prospect in Europe for the first time. Other trends, quantified qualitatively or numerically, include the popularity of alternative secondary strategies, loan fund growth, asset expansion at big general partners and sovereign wealth funds' pronounced taste for private equity.

As always, we hope the information found here will help you make informed decisions.

Sincerely,



Antoine Dréan • Triago Founder and Chairman
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ANALYSIS: RECORD AMOUNTS POUR INTO PE

Investors are attracted to classic funds and shadow capital

ROUNDTABLE: NO DOT-COM BUBBLE REDUX

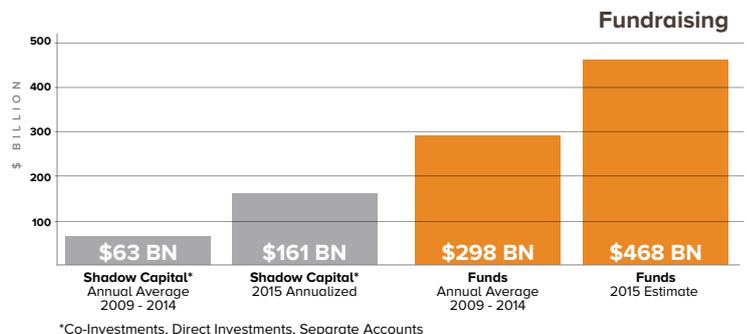
We're far from the dangerous heights of 2000

PRIVATE EQUITY BLOG

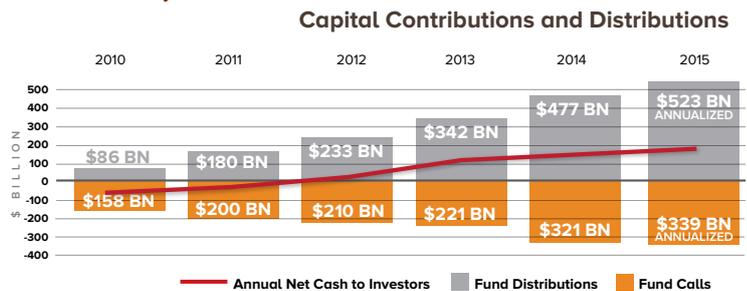
Private equity's move into credit, Record dry powder leads to co-investment, Big GPs get bigger, SWFs grow in importance, The rise of alternative secondaries

SNAPSHOT

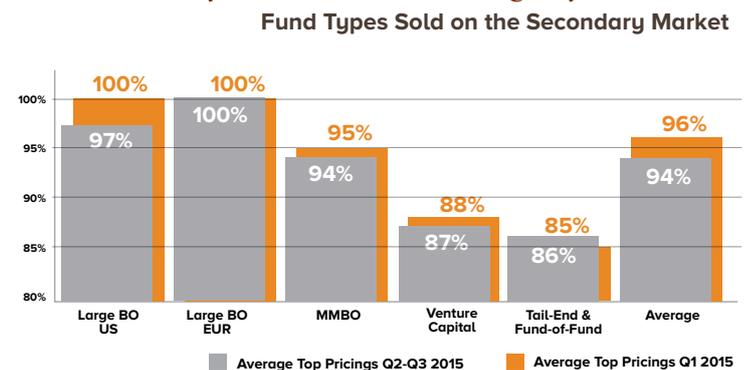
'Shadow' and classic fundraising are at highs...



...driven by net distributions...



...as secondary discounts widen slightly...



...and the NAVs they're priced against cool.

Private Equity Fund Net Asset Value Evolution

STRATEGY	FY 2011	FY 2012	FY 2013	FY 2014	Q1 2015	Q2 2015
Large BO	+2.5%	+18.0%	+24.2%	+15.8%	+1.6%	+0.5%
MM BO	+4.4%	+9.2%	+11.9%	+16.1%	+1.8%	+0.7%
VC	+8.1%	+2.9%	+18.7%	+16.3%	+5.8%	+3.3%
Special Sit.	+0.5%	+5.8%	+11.1%	+5.1%	+1.6%	+3.3%
Energy	-4.3%	+1.0%	+6.4%	-0.8%	-18.7%	-2.4%
Average	+4.1%	+9.7%	+16.4%	+14.1%	+1.4%	+1.0%

Record Amounts Pour into Private Equity

Investors are attracted to classic funds and shadow capital.

Measured by the sheer volume of capital earmarked for private equity investment this year, the asset class has never been healthier, or more competitive. In the first three quarters of 2015 some \$364 billion was raised by classic PE funds, while Triago estimates another \$121 billion was committed through co-investment, direct investment and separate accounts - non-fund structures commonly grouped together under the heading 'shadow capital.' These commitments provide managers with lower fees than those on classic funds, or in the instance of direct investment, where investors bypass managers altogether, no fees.

This quarter across all strategies and regions, funds raised \$40 billion by November 4, representing a slowdown from Q1 through Q3 when respectively \$110 billion, \$123 billion and \$131 billion were committed to classic structures. If the tempo holds - it often picks up as year-end approaches - some \$468 billion will be gathered by traditional vehicles in 2015, which would be the highest annual amount since 2008's record of \$557 billion. Considering this, 2015 is likely to qualify as the third best year ever for classic fundraising. In 2007 - the second best year - \$508 billion was raised by PE funds.

But when sums earmarked for shadow capital are taken into account, 2015 is well on its way to ranking as the biggest year ever for monies raised. Annualizing the estimated shadow capital committed to PE through the third quarter, and assuming the current classic fundraising rhythm continues, a record \$629 billion will be raised in 2015, with shadow capital accounting for 26 percent, or \$161 billion, of it. That's an unprecedented amount and market share.

Shadow commitments have been rising at a faster clip than classic fundraising. The current post-financial crisis high for classic fundraising - 2014's \$438 billion - is still a fifth below 2008's high water mark, but shadow capital commitments last year were up 90 percent over a parallel 2008 peak, hitting a \$127 billion record.

Driving fundraising and the growth of shadow capital are distributions from record private equity

realizations. Through the third quarter, managers distributed \$392 billion to their investors from realized investments and dividend recapitalizations, eclipsing 2014's \$359 billion Q1-through-Q3 high. Net cash returned to investors in the first 9 months of 2015 stands at \$138 billion, only some 12 percent below 2014's annual record of \$156 billion.

A \$629 billion high should be raised in 2015, counting 'shadow' and classic fundraising.

Private equity funds across all categories and geographies lost an estimated 3 percent of their value in the third quarter, holding up better than major stock indexes like the S&P 500 and the MSCI World Index, down 6.4 percent and 8.3 percent respectively. Overall, PE fund value fell 0.7 percent in 2015's first nine months, after eking out a 2.4 percent gain in the first half. The silver lining in a year when the average PE fund may register its first negative return in six years is an increasingly attractive market for PE-backed purchases, at least in some sectors. Average purchase price multiples remain high, but mask much greater diversity than has been seen in years, particularly with reeling energy and commodity prices, a depressed euro, volatile stock markets and investor expectations of higher U.S. interest rates.

Despite no need to unload funds in today's highly liquid environment, investors remain receptive to selling stakes on the secondary market. Supported by the emergence of mega funds as buyers, secondary prices have proved exceptionally stable, with growing numbers of investors using the market to calibrate exposure to managers, strategies and regions. The current average discount for secondaries is 6 percent below net asset value in a market on pace for some \$40 billion in volume, bettering 2014's \$36 billion record. With \$62 billion in dry powder targeting secondaries, discounts should hold in a tight range even if PE funds post modest declines.

No Dot-Com Bubble Redux

Closing in on a 15-year VC investment high, we're far from the dangerous heights of 2000.

There's considerable worry over whether, as in 2000, we're on the verge of a collapse in the venture capital market. Will the world's growing herd of unicorns - at last count there were 151 of these privately held companies valued at \$1 billion or more - plunge from the proverbial cliff? Venture capitalists are on pace to invest some \$60 billion this year, which would be the second highest annual amount ever. But that's far from the all-time record of \$105 billion in 2000, when the market ran amok so spectacularly. Though more money is being invested than in recent years - much of it into unicorns - it's going to a relatively small number of companies. As Triago's roundtable participants explain, attractive long-term investing opportunities exist, at least for the best venture capitalists.



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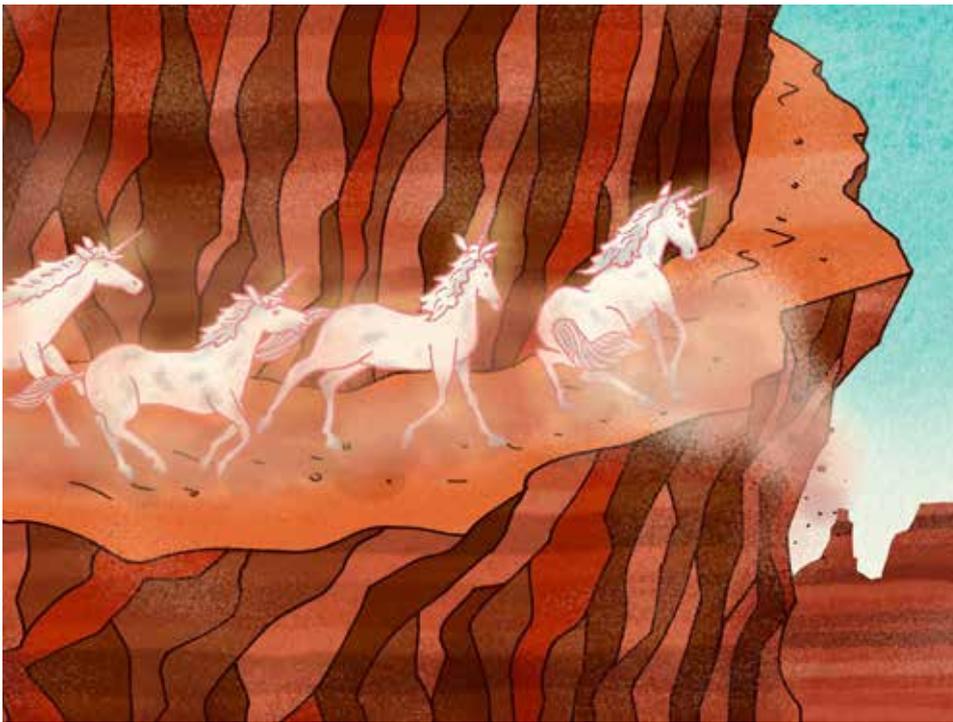
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SILICON VALLEY

How does the state of the market recall (or not) venture capital investing during the height of the Dot-Com Bubble?

FD: When exuberance over the earnings potential of internet companies came to a head in 2000, it was driven by euphoria surrounding the Internet's power to utterly transform lives. The bubble burst when people realized there was a yawning gap between medium -

even long-term - earnings expectations and the timeline for that transformation. The Internet has worked its way into everything now and the fabulous earnings growth of many web-based companies is fact. But people are getting ahead of themselves. They're underpricing risk and overestimating chances of success. That most likely means company values will fall in the near-term. But there won't be a repeat of the shocking industry collapse of 2000.

DP: Importantly, customer acquisition cost is reasonable considering today's much longer client-lifespans. Nonetheless, there's a stream of start-ups telling us 'we're the next Uber of our sector' - there's always a tendency to try to replicate success on a very large scale. While these would-be Ubers spend as if their market were as big as the global taxi sector, mostly it's much smaller, without the volume of repeat customers. Which brings me to one of the keys to investing



success: only take stakes in start-ups in markets that really are as big as the entrepreneurs' vision. That keeps business plans and investment burn rates in line with the opportunity.

GL: There are some striking similarities between the dot-com bubble and the market now - all predictable this late in the cycle. Money typically flows into the venture industry following outsized venture returns caused by companies exiting at high valuations. LPs increase their allocations to venture. Companies start corporate venture arms. Leveraged buyout and hedge funds dip into venture. And in this past wave, public mutual funds have participated in many of the late rounds. All of this money

Fintech and digital health services are overheated; less costs more.

Gary Little, Canvas Venture Fund

bids up valuations, balloons round sizes, and results in higher company burn rates. Fund managers are once again raising bigger and bigger funds, with the more pessimistic doing it to weather the expected downturn. Price inflation that started in late-stage funding is now rippling down to earlier rounds. The logical response is to slow investment as

valuations increase and to be extremely selective when you do buy. If not, your returns will revert towards a not very pretty mean.

Does venture capital call for fundamentally different talents today than it did 15 years ago?

GL: Well, as always, you've got to be bold, beating the bushes and finding value in sectors or geographies that are attracting relatively few investors - inevitably in areas that are perceived as risky or new. Venture capitalists equally need to be disciplined and discerning enough to stay away from the hottest sectors. That's tough since invariably overheated sectors were

yesterday's best investment areas. For example, we were finding great value a few years ago in fintech and digital health services. Now both are overheated, with venture capitalists in these sectors investing more money for smaller stakes, frequently in late-comer competitors with high burn rates.

FD: The human qualities behind successful venture capitalists are eternal. VCs with a nose for talent, who act with conviction and stick with their start-ups through thick and thin have an inside track. But those qualities take you just so far in a marketplace of unprecedented transparency, where proprietary networks no longer protect you from competition. All VCs are aware in real-time now when start-ups get founded and everyone knows the schedules for product launches. Entrepreneurs have fairly complete information regarding the reputations of VCs. The catalyst for all this was the creation of cloud computing and the consequent explosion of online information. The seminal event was Amazon Web Services' launch in 2006. Now investors have to work much harder, make decisions more rapidly, and cover a much broader marketplace.

DP: One illustration of venture capitalists effectively getting an edge in today's more competitive marketplace is our development of Insight Onsite, our captive management consultancy. Today it accounts for a 30 percent share of our professional staff, more than twice the level of five years ago. It employs information technology, sales and marketing executives whose talents help accelerate the development of our portfolio companies. In a period when lofty deal pricing makes it harder to reach return objectives, Insight Onsite allows us to drive capital gains higher over the long-term.

Are prospects for venture capitalists outside of Silicon Valley brighter today than in the past?

FD: I'll return to the point about price inflation in early stage rounds - it's mostly happening in Silicon Valley, with early valuations

reasonable in Boston, New York and Europe. Globally, one of the most interesting developments of recent years is the collapse of European barriers to successful venture capital investing. Half a decade ago it was impossible to get decent exits for sellers in Europe because the likes of Google and Facebook - the industry's U.S.-based acquisition giants - weren't buying here. Now they are - joined by local and Asian competitors. That's led to a dozen venture capital-backed companies with billion dollar-plus valuations, while a dozen valued at

GL: It's fascinating - although the investment flow to Silicon Valley is higher by several orders of magnitude than flows going to other regions, the average returns in the Valley have been the greatest. In almost every conceivable new category pioneered over the past thirty years, the global leaders have emerged here. For early-stage venture capital investment, that means there's no better place to be. Having said that, innovation can occur anywhere, and for later-stage investments, it makes sense to look globally.

For the first time, European VC offers the prospect of 3x returns on investment.

Fred Destin, Accel Partners

\$3-\$4 billion are likely. Europe's now got great venture capitalists and serial entrepreneurs. Yet while Europe offers the prospect of 3x returns for fund investors for the first time, no region can match - or looks set to in my lifetime - Silicon Valley's lightning ability to create world-beaters.

DP: That's right - the Valley has the broadest breadth and depth of any venture ecosystem in the world. But even though it represents our most important region in terms of investment value, interestingly, it's where we have the fewest investments. The bar is higher in the Valley and price inflation is greater there precisely because everyone understands it will produce the biggest winners. Given the competition and current state of pricing in the Valley, we think the most attractive opportunities on a risk-adjusted basis are in Europe. India and China have extremely robust venture capital ecosystems, but current valuations are so high that they make Silicon Valley look cheap. We've made a dozen Latin American investments over time, but we're pulling back there because of uncertainties tied to politics, the economy and currency strength.

Where are VC investment returns headed?

GL: For more mature funds that are finished investing and that have been exiting for the past year or longer, returns should be exceptional, with the top quartile returning 3 times investment or more. For funds currently in the middle of their investing period, I expect an exceptionally wide divide between the best - where returns should be very good - and the worst.

DP: Assets, including the tech companies that account for the lion's share of venture capital, are going through a period of volatility. Whether that volatility leads to sustained falls in prices or whether we'll have another couple of years of up cycle in our business is something I can't predict. A more important question than whether we're on the verge of cyclical downturn, is how persistent top-quartile returns will be. Much more so than private equity in general, the best venture returns have been highly concentrated - fund after fund and throughout the economic cycle - among a relatively small group of managers. Will that trend

continue in today's more competitive marketplace? My prediction is that it will. As venture has evolved the best have raised their game and I suspect that will continue.

FD: I agree that a significant concentration of the best investments will continue to be found in a small number of funds and that most of them will be run by teams that have produced excellent returns year in and year out. As Deven says, that's because they've raised their game. Even among top investors that appear not to have altered the way they do business, there has been a very deliberate reinforcing of brand that insures that they remain among entrepreneurs' first choices for funding - an example that comes to mind is Benchmark Capital. And while today's unmatched information transparency means new opportunity to join this select group, the small number of world-beating investments that are out there and the momentum a manager picks up by successfully identifying a world-beater, means venture is a bit of a winner-take-all game. I believe we're at the cusp of a market downturn, and while the very best managers will produce 5x to 10x returns, most will find themselves producing mediocre returns, and very possibly underperforming public markets.

DP: I'll just add a thought. The recent stock market volatility means it's been possible to buy publicly quoted internet and software companies at a significant discount to private market valuations. Of course, what cushions higher private valuations is significantly higher growth rates than public market averages. But private venture-backed companies spend a lot of capital on growth. If there's a significant pull back from funding in coming months and venture-backed companies are forced to rein in spending, I think we'll see exactly where in our industry growth rates, and hence venture capital returns, are the most sustainable.

PRIVATE EQUITY

BLOG

A round-up of issues and challenges for general partners and limited partners.

Private Equity's Move into Credit

Regulatory pressure in the U.S., the slow pruning of balance sheets in Europe and credit retrenchment in emerging markets is rapidly changing the complexion of leveraged finance. An increasing share of leveraged loans is being supplied by private equity direct lending funds. Seen as low-risk investment vehicles, generating returns in the low double-digits and returning investor capital much more rapidly than leveraged buyout vehicles, they account for some 18 percent of leveraged lending in Europe and the U.S. this year, up from only about 10 percent in 2012. The industry's leading specialists have seen loan fund assets increase by nearly three fourths over that period. Watch for even bigger sums to be raised by the likes of Apollo and KKR, while a range of smaller general partners with sector and regional knowledge complement existing buyout and growth funds with specialist lending vehicles.

SWFs now rank as the third most important investors in private equity.

Record Dry Powder Leads to Co-Investment and...Record Dry Powder

High average purchase price multiples that have made PE firms reluctant to pursue acquisitions, coming in a period of robust fundraising, have translated into an unprecedented accumulation of committed, uninvested private equity capital. Dry powder has risen 23 percent since the beginning of 2015 and stands

at a record of \$1.3 trillion. What's ironic is that competition to invest the pile keeps prices high, preventing much, if any, dry powder erosion. One investor response to this slow deployment is to inject ever-larger co-investment slugs into manager deals. But co-investment's explosive growth means more money held in funds is squeezed out of deals, staying - you guessed it - dry powder.

Big GPs are Getting Bigger, Faster

The U.S. Securities and Exchange Commission published its first "Private Funds Statistics" report a month ago, after initiating oversight of private equity in 2012. Designed as "a summary of recent private fund industry statistics and trends," it reveals aggregate capital, not including fund liabilities, grew a healthy 18 percent between the end of the first quarter of 2013 and the end of the fourth quarter of 2014 for private equity funds managed by general partners with less than \$2 billion. But growth for GPs with \$2 billion or more in assets under management was an even more impressive 24 percent. The implication is that diversified, one-stop shops pose a competitive challenge for smaller PE managers - though given overall growth levels, one that's not insurmountable.

The Rising Importance of SWFs in Private Equity

The above-mentioned SEC report also provides evidence of the growing share of PE held by sovereign wealth funds. From Q1 2013 through Q4 2014, the dollar value of SWF commitments to PE managers with assets under management of \$2 billion or more, the only type of manager required to report this information, rose 38 percent - the

biggest percentage increase for any investor type. The result: SWF share of private equity assets rose 100 basis points to 9.7 percent, making SWFs the third most important investor type behind a second-place catch-all category, 'private funds', at roughly a fifth of assets, and first-place public pension funds, at an unchanged 23.6 percent. Private pension plans edged down just 30 basis points, but still fell a spot, displaced by the rapidly rising PE investments of SWFs.

Early Secondaries, Late Primaries and Mid-Life Co-Investment

Buyers in the secondary market are turning to 'off the beaten path' transactions to capture greater upside while still delivering attractive pricing to sellers. In a market where pricing largely determines volume, secondary buyers are having their greatest success in distressed sectors like energy by buying early secondaries where only about 10 percent on average has been invested. While committed but unused capital is transferred at par, investments can be sold at double-digit discounts without a significant overall loss of value for sellers. Meanwhile, late primaries are finding increasing favor with secondary buyers. Though late primaries are in fundraising mode, they've held first closes and typically deployed 15 percent or more of targeted fund size. Buyers evaluate them like an early secondary, getting a similar benefit - plenty of upside. There's also more mid-life co-investment. In these deals a large slug of capital is invested in a significant minority position in a manager's not-fully-mature investment, crystalizing value that can help in fundraising, while providing investors with liquidity.

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