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US PE Breakdown

Q1 2020

PitchBook

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Introduction

US PE dealmaking activity in Q1 2020 rose YoY as the COVID-19-induced slowdown is likely to be felt in the coming quarters. Global economic uncertainty is at its highest level since the global financial crisis (GFC), and most GPs have been forced to pause dealmaking activity and cancel some deals that had already been announced. PE firms are in triage mode, running through the numbers to determine which portfolio companies to save and which to let fail. Announced deal activity has slowed markedly, and the few new investments that GPs pursue are likely to be minority deals or smaller transactions that can secure financing. Overall, deal activity in the coming quarters appears to be on pace to plunge to levels not seen since the years directly following the GFC.

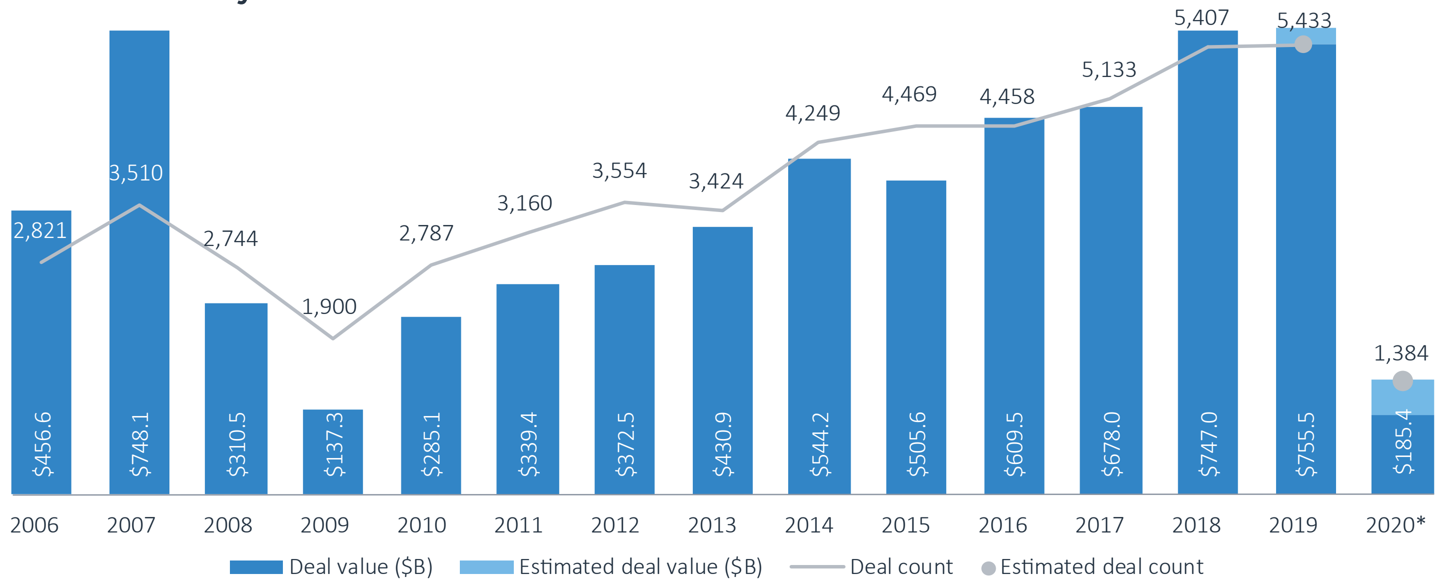
Exit value in the quarter recorded a steep decline, with GPs choosing to forgo sales until we enter a more stable pricing environment. GPs are hunkering down and choosing to hold onto portfolio companies even longer instead of exiting at a significant discount to where the company was valued just a couple months prior. This will lengthen the median holding time, as we saw following the GFC. PE firms are unable to sell to other GPs or strategics because business travel—a necessity for due diligence—has been canceled. Exiting via the public markets is also untenable because of the historic levels of volatility seen in recent weeks.

US PE fundraising experienced declines in Q1 as well, though to a lesser extent than exits. Two mega-funds ($5 billion+) closed in January, boosting the quarter's figures. Mega-fund managers are in the best position heading into 2020 because their established LP base can support their fundraising efforts. However, even the largest GPs may struggle in this time as LPs focus on funding current capital calls and portfolio rebalancing. Meanwhile, smaller and nascent managers are likely to struggle the most in the coming quarters and may see fundraising efforts pushed back by several quarters. Median PE fund size is already up compared to 2019's record and ought to rise further with a dearth of small fund closes.

Wylie Fernyhough
Senior Analyst, PE

Overview

PE deal activity



Source: PitchBook | **Geography**: US
*As of March 31, 2020

1,384 PE deals closed in Q1 2020 for a combined $186.4 billion—YoY gains of 7.3% and 6.0%, respectively. These figures were boosted by deals that had been negotiated before COVID-19's effects on the US economy were felt. For example, the largest deal to close in the quarter was announced in May 2019; this was EQT and Digital Colony's $14.3 billion take-private of fiber optic infrastructure owner Zayo Group. As we head into Q2 and Q3, the current dearth of announced deals and the ramifications of the pandemic will start to appear in the deal data. Even deals that had been in the negotiation phase, such as Apollo's $4.4 billion takeover offer for TEGNA, have been called off, citing coronavirus impacts. Furthermore, as US officials attempt to flatten the curve and enforce social distancing, in-person due diligence—an absolute must for most deals—is now almost impossible. Some of the more sizable deals announced before several states issued stay at home orders are now in flux, such as Stone Point Capital and Further Global Capital Management's $4.2 billion buyout of Duff & Phelps and Apollo's $6.0 billion take-private of TechData. HGGC's CEO, Rich Lawson, explains how PE's mindset has shifted heading into the remainder of 2020: "Valuation multiples, revenue growth and business expansion have given way to optimizing debt capital structures, ensuring liquidity and building capital reserves to weather this new normal."

Due to all the uncertainty, we foresee deal flow slowing to a trickle in the coming quarters, perhaps diminishing to levels last seen during the financial crisis. While the pandemic is already wreaking havoc on the economy, we do not yet know how long the crisis will last or how quickly we will recover. Leveraged loan default rates are currently forecasted to approach 7% in 2020 and 10% in 2021, according to Fitch. This compares to the less than the 2% default rate seen in recent years and the peak of less than 7% during 2009, the worst year for leveraged loan defaults in the GFC. Jobless claims clocked in at 3.3 million for the week ending March 21, 2020, and 6.6 million for the week ending March 28.[2] These figures are orders of magnitude greater than the previous record of 695,000 in October 1982, and those two weeks combined are already greater than the 8.7 million jobs that were lost in the GFC. Goldman Sachs forecasts GDP to contract at a 34.0% rate in Q2 2020,[3] and James Bullard of the St. Louis Fed projected that unemployment may peak around 30%, with GDP dropping by half.[4] At one point in March, public indices had plummeted by more than 30% from the peak.

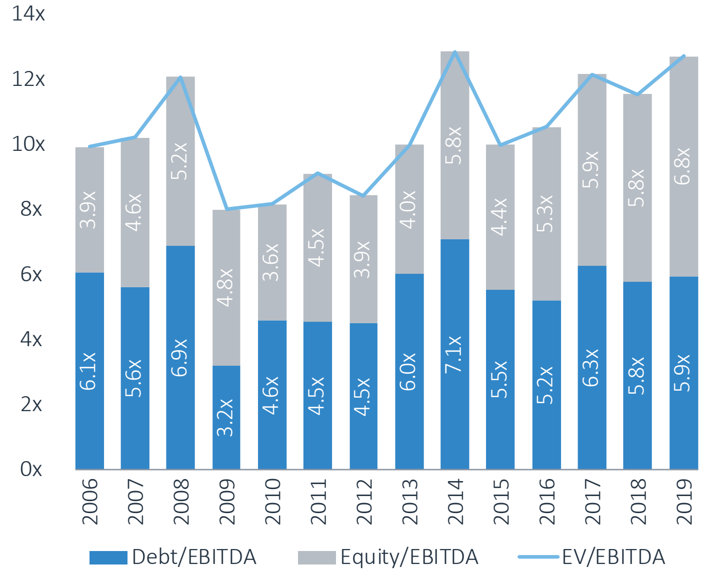
1: Interview with Milana Vinn of PE Hub
2: Office of Unemployment Insurance Weekly Claims Report, U.S. Department of Labor, April 2, 2020
3: Goldman Sachs, Jan Hatzius, March 31, 2020
4: "Expected US Macroeconomic Performance During the Pandemic Adjusted Period," On the Economy Blog, Federal Reserve Bank of St. Louis, James Bullard, March 23, 2020

Though we've seen a slowdown in deal activity, the higher leverage in many deals over the last few years has created opportunity for value-oriented investors. In February, an Oaktree portfolio manager stated that despite a booming economy (at the time) and highly priced deals closing daily, their distressed opportunities team was finding success because many buyouts underwritten at 7x debt/EBITDA with significant addbacks already baked in were hitting pockets of stress and needed to be rescued. Average buyout debt/EBITDA reached heights in 2019 that surpassed what we saw in 2007. This sentiment was echoed by others in the industry. KPMG recently performed a PE portfolio review for New York Life investments, which revealed that EBITDA addbacks have doubled during this cycle—accounting for around 30% of EBITDA now from roughly 15% a decade ago.[5] Beyond further inflating EBITDA addbacks, GPs have had to be optimistic in their forward-looking projections to ensure deals met pro forma performance expectations, meaning that the base case in 2019 was as aggressive as the "bull case" five years earlier in many scenarios.

Adjusted EBITDA figures and bullish base cases will have to be rerated, and future multiples will come under pressure. Brent Beshore, CEO of Permanent Equity, predicts that "EBITDA is going to drop precipitously across virtually every business," later saying that EBITDA leverage will shoot through the roof.[6] This will put significant pressure on GPs when their margin for error is so slim with elevated levels. Beshore believes that "many PE firms are going through the calculus of which of their portfolio companies to save and which not to save." For the cases in which it is better to walk away from portfolio companies than save them, distressed funds will be waiting with open arms.

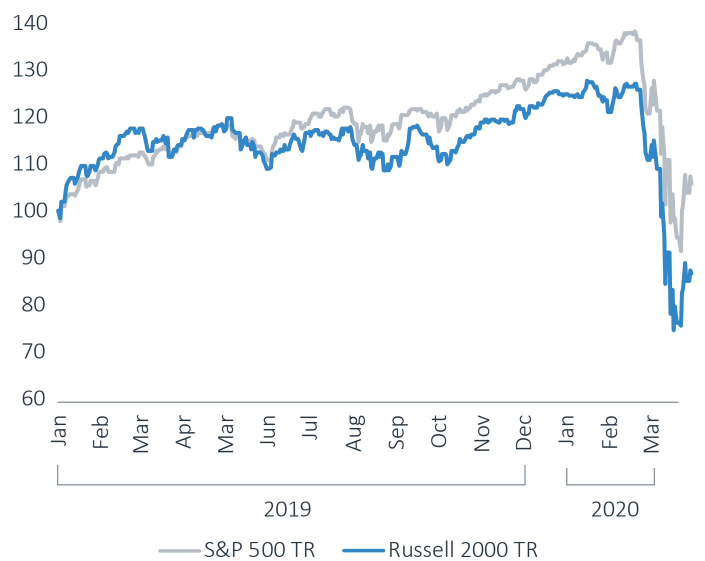
In the coming quarters, a shift in the deal composition is expected. Beyond a proliferation in distressed buyouts, we also expect a rise in private investment in public equities (PIPEs), minority investments and carveouts. PIPEs are attractive to PE firms because valuations in public markets can be more volatile than private markets. This means that when prices drop in the former, these companies may offer a better value than comparable private companies. Their public status also allows GPs to buy into any company they choose. Take-privates may be difficult because shareholders are more likely to see the offer as too cheap.

Median PE buyout EV/EBITDA multiples



Source: PitchBook | **Geography**: US
*As of March 31, 2020

Select stock index performance rebased to 100 on January 2, 2019

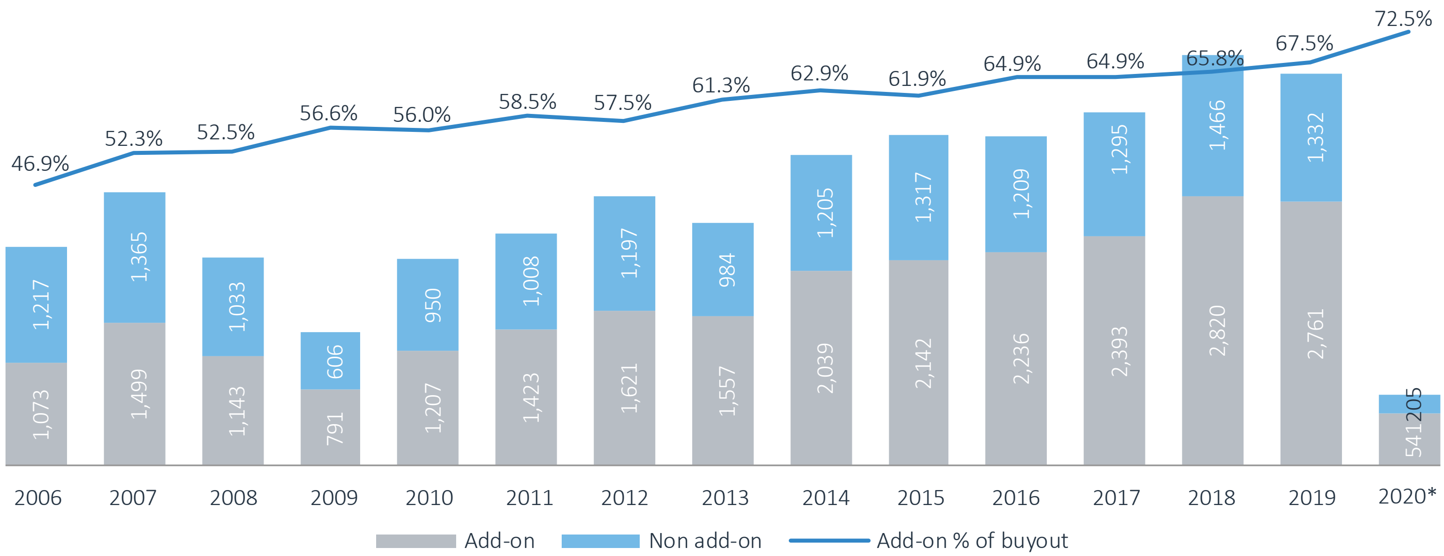


Source: PitchBook | **Geography**: US
*As of March 31, 2020

Smaller deals and add-ons will also become more in vogue in the coming quarters. In Q1, add-ons already ticked upward and set a new record for the proportion of deal count at 72.5%. In an environment where massive platform deals could become prohibitively expensive to finance, add-ons offer an attractive way

5: "The New World Order: Steering the Private Equity Ship in Today's Uncharted Waters," SuperReturn US West presentation, February 11, 2020
6: "Update on Small Business & Private Equity with Brent Beshore: Episode 164" Invest Like the Best, Patrick O'Shaughnessy, March 20, 2020

PE add-on activity



Source: PitchBook | **Geography**: US
*As of March 31, 2020

for GPs to spend down capital at depressed prices. Smaller deals in general are likely to be outsized contributors to deal activity in 2020. Not only do buyouts of smaller companies typically receive financing from private lending funds—compared with larger buyouts which rely on bank syndicated loan packages—but they are also more apt to undergo financial distress, necessitating a sale. Additionally, private lending funds, which tend to cater to the middle market, have mountains of dry powder and are willing to spend in a crisis. Overall, larger corporations have a better shot at riding out the crisis, whereas smaller companies may be forced to close their doors or sell at a steep discount. Increased buying activity on the lower middle market should also help GPs garner healthy performance. In recent quarters, the S&P 500 has matched median PE returns for the first time ever, meaning manager selection is as important as ever. Smaller deals tend to have more upside potential, so this may present another positive note for PE.

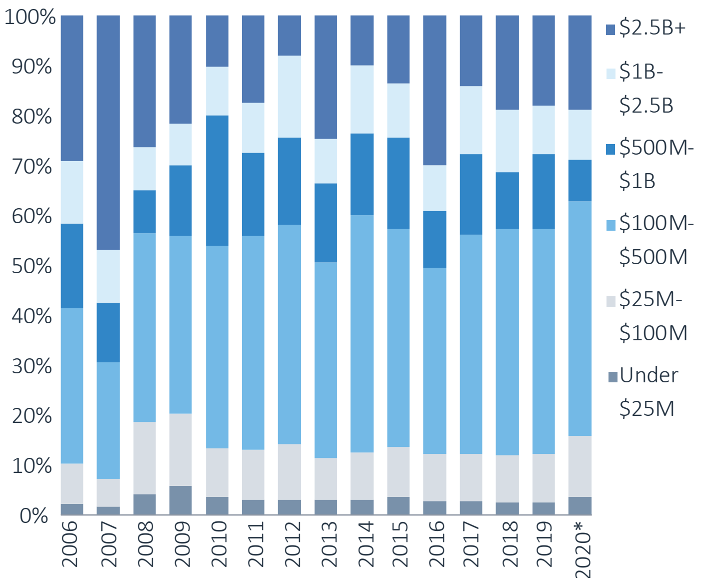
This crisis will likely further pique GPs' interest in areas that had already proven to be attractive long-term investments. B2B companies, especially on the software side, have proven somewhat resilient because of their long contracts. Additionally, many of these companies have been fairly insulated from the dramatic decline in consumer spending. Healthcare spending is also likely to be a long-term winner because of this crisis. It is perhaps the most recession proof because many companies operating in the sector must continue providing services regardless of the source of economic turmoil. Although Q1 2020 saw healthcare account for just 6.8% of deal value—around half of its average over the past decade—we expect that proportion to pick up throughout the year.

These treacherous times also shine a light on how important data has become to the PE landscape, both in due diligence and operational improvements. As many datasets become commoditized, PE firms are placing increased focus on alternative data—such as geospacial, transaction or web engagement—and are often utilizing these datasets with their portfolio companies before less capitalized competitors. An example of this is overlaying geolocation data with population density information to better plan a dental office rollup, maximizing locations in a given area while minimizing client cannibalization. Although around two-thirds of a PE firm's alternative data spending budget goes to the due diligence process, a mounting proportion is allocated to operational improvement.[7] In many cases, GPs are now incorporating alternative datasets into their operational improvement process, creating information asymmetries against smaller, non-PE-backed companies. As competition within PE remains fierce, we expect the usage of alternative data, both in due diligence and in continuous operational improvements, to proliferate as GPs constantly search for an edge.

7: Personal communication with UBS Evidence Labs, March 25, 2020

Deals by size and sector

PE deals ($) by size



Source: PitchBook | **Geography**: US
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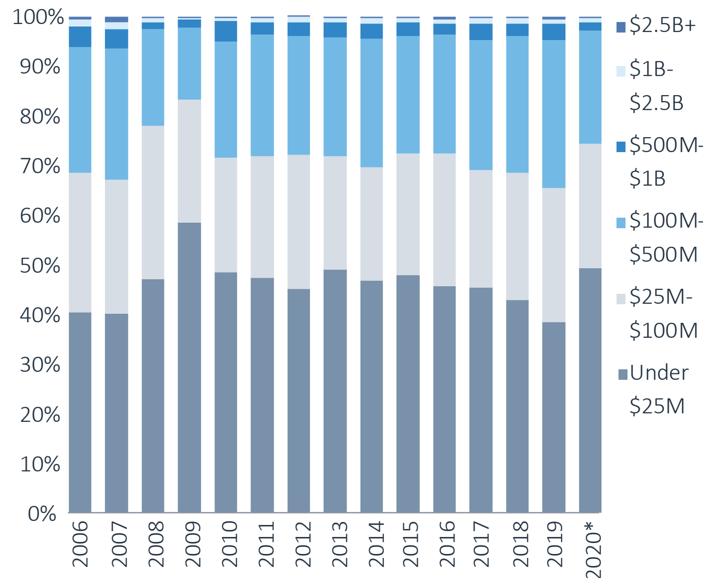
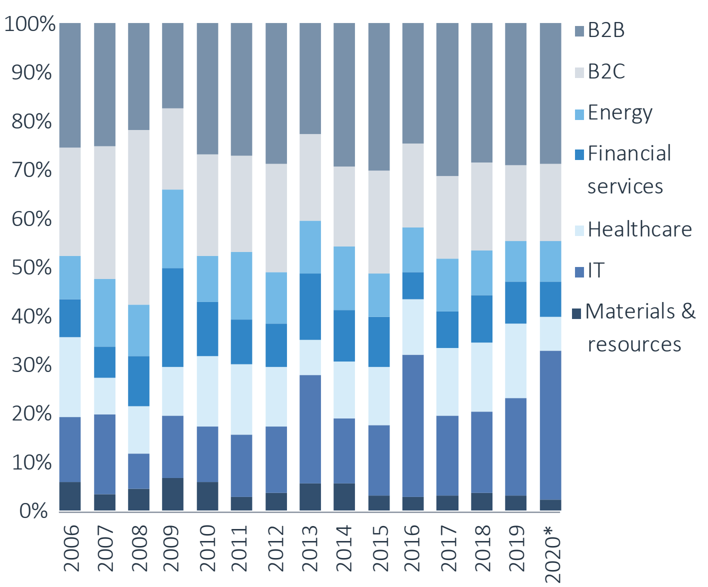
PE deals (#) by size



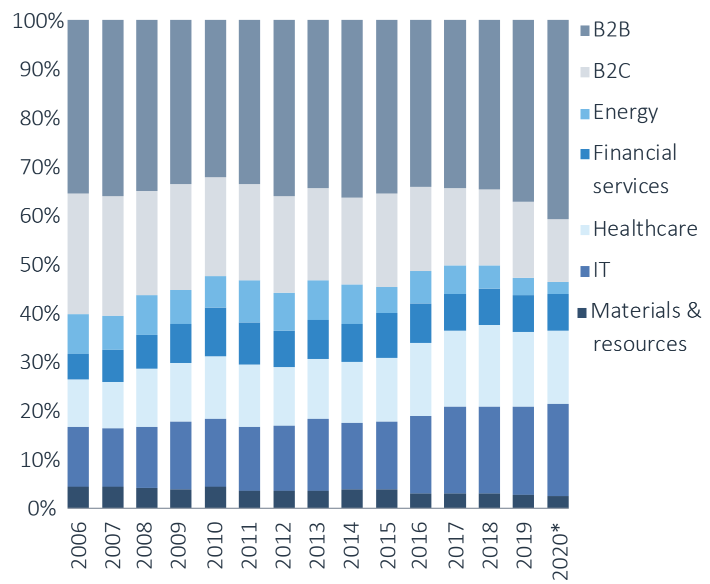
Source: PitchBook | **Geography**: US
*As of March 31, 2020

PE deals ($) by sector



Source: PitchBook | **Geography**: US
*As of March 31, 2020

PE deals (#) by sector



Source: PitchBook | **Geography**: US
*As of March 31, 2020

A Q&A with FIS: Are PE and credit fund managers braced for the impact of COVID-19?

Are PE and credit fund managers well positioned to weather today's new environment of volatility and uncertainty?

Read this Q&A with FIS' Tony Chung for insight on how PE managers can adapt and succeed with credit through the turmoil of this pandemic.

Tony Chung

General Manager, Head of Private Equity, FIS

Tony Chung is head of our Private Equity business at FIS where he is responsible for meeting the diverse needs of our general partners, limited partners and service providers globally. With more than 20 years of strategy, product management and sales leadership experience, Tony is an innovative leader focused on delivering transformative technologies and services to help our clients achieve greater efficiency and drive growth.

COVID-19 is causing significant turmoil across public and private financial markets, albeit to varying degrees. Given the macro background, what are the primary economic, financial and political events happening now that could have the most significant impact on credit markets, especially private?

From an economic perspective, the reduction of interest rates to record lows has created opportunities for all market segments seeking credit, whether it be in the form of new loans or refinancing existing debt.

From the financial and political lens, the volatile market conditions and economic slowdown have generated highly distressed situations for some markets as well as transformative business opportunities for others. The combination of these factors is driving strategic investment prospects for many market participants.

Given the broader PE landscape prior to the impact of the pandemic, how do you foresee those events affecting PE fund managers and their private credit counterparts?

Current market conditions have caught the attention of traditional PE fund managers due to the dislocation in credit markets and the investment returns they

About FIS

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could provide. With dry powder still on the sidelines, PE fund managers are looking closely at how to invest in distressed assets to enhance returns. For fund managers who already have a credit strategy, markdowns of current portfolios are likely; however, these managers are well positioned to identify, execute and operationalize new investment decisions to enhance portfolio returns.

How can private credit managers most readily adapt in this environment? What are their best actions to take?

All investment managers have been challenged during COVID-19, not only in their investment strategy performance, but in how they are able to manage their portfolio operations given the shift to a work-from-home environment.

Credit strategies are notorious for their heavy operational overhead, so at minimum, managers should reflect on business operations that have displayed weaknesses. Weaknesses lead to errors or delay in data management and operational workflow. The reliance on accurate, consistent and near real-time data is required to ensure the best investment decisions and performance reporting.

Therefore, managers need to ask key questions to guide operational decisions in this environment:

- Are middle- and back-office staff prepared to work remotely?
- Is there any key person reliance that is a cause for concern?
- Do infrastructure and core systems meet expectations for all staff?
- Are there any delays in processing and closing month/quarter end?
- What in-flight projects were delayed, and are they still a priority?

In turn, what should PE fund managers prioritize, especially given the volatile conditions that credit fund strategies are experiencing?

Whether a PE fund manager is new to credit or is an established credit fund manager, the priority should be to identify operational risks and evaluate costs associated with an operationally intense portfolio. Once key items have been identified, managers should connect with proven service providers and industry peers to explore opportunities to mitigate operational risks.

A proven service provider will have expertise in a wide variety of credit strategies and complex fund structures, as well as a large, experienced team with an operational model that is able to withstand systemic events. At the same time, a credit fund service provider should be able to offer a high degree of flexibility, including full or partial outsourcing, especially as fund managers are forced to think creatively about their operations during today's environment.

Last but not least, what is currently not being discussed or noted by practitioners in this space of which they should be apprised?

The advent of the coronavirus pandemic has made significant challenges for the PE market outlook in 2020. However, the same truisms will hold. The ones to navigate the challenges effectively in this market will be those PE managers who can couple their skills with robust risk management techniques. These firms will have the ability to leverage the new and significant alpha-generating opportunities that these volatile markets will present.

Wondering if you have the right operational plan to launch a credit fund?

Our solutions, managed services and expertise have credit covered. Learn more about Virtus from FIS.

Spotlight: Pandemic effect on allocations

The following is an abridged analysis of how allocators are reacting to this crisis. For a more detailed understanding of how COVID-19 is influencing LPs and private market strategies, please read our analyst note discussing the subject in full.

While we'll discuss some opportunistic ideas for LPs in the various strategy sections throughout this note, we wanted to explicitly discuss what the allocators are thinking and experiencing in this time of market upheaval.
One principle of which people took serious note in the last crisis was the "denominator effect." Nearly every LP operates within a target allocation framework for their selected asset classes. If the investor was at or above the 20% allocation target before the stock market drop, then the LP now finds itself overallocated.

This is a known phenomenon, of course. After the last crisis, some LPs made their investment policy statements more flexible. Instead of a hard 20% target with a tight allowable band of drift, ranges were widened. In some cases, a time element was added to allow for the portfolio to be outside of the targeted zone for two consecutive quarters before the investment staff must consider options for how to bring the portfolio back to the desired allocation. In addition to this new leeway, LPs as a group are better positioned to combat the denominator effect today because many entered the 2020 underallocated or at their targets to private markets.

LPs are, of course, not homogenous in their governance or objectives—both of which can have a significant impact on the reaction an investor may have to a crisis. An endowment or sovereign wealth fund (SWF) investing for perpetuity might be willing to take longer-term risks by doubling down on risky assets when they seem inexpensive, but a pension that was underfunded with a growing base of retirees going into the crisis is now in an even worse position. In the latter case, the company or public entity responsible for funding the pension may be extremely wary of assets perceived to be riskier when they are already being required to increase their contributions to the pool at a time when revenues may also be suffering.

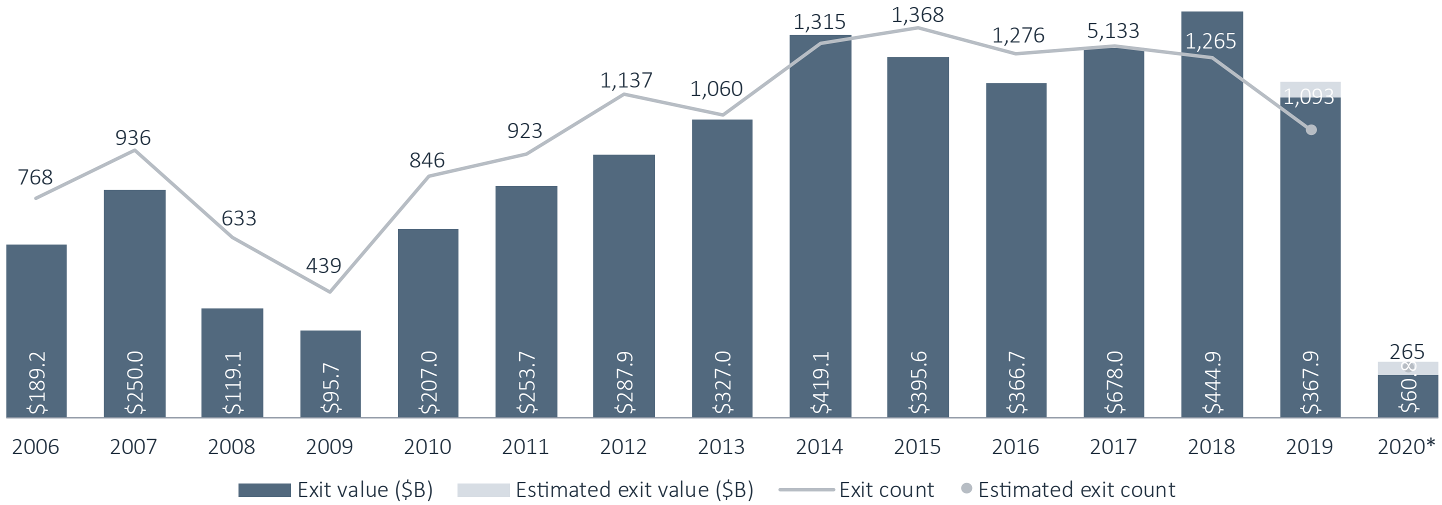
Even when an investment committee is made up of savvy investors, they typically meet only quarterly. They are undoubtedly having ad hoc update calls, but scheduling conflicts and the need, at least for public pensions, to hold meetings in a public forum make it difficult to have off-cycle meetings where decisions can be made. It is highly likely that the agenda for the meeting scheduled in April or May is going to be focused on triage: What does the meltdown mean for funding ratios or spending/granting programs? What can they do to be opportunistic right now? What areas of the portfolio are most exposed to the worst part of the current crisis? New commitment recommendations are unlikely to make the next agenda unless the investment staff was far along in the diligence process and a final close was imminent. It will be another quarter or two before the committee is ready to consider changes or additions to the portfolio's asset managers.

In terms of partnership commitments already signed, some LPs seeing the dramatic decline in their portfolio may wonder what would happen should they find themselves unwilling or unable to meet capital call demands from GPs. Whether it be a cash crunch or a loss of confidence in the GP or the strategy, most LP agreements have severe penalties designed to deter defaults. Despite the potential consequences, some LPs still chose to default during the GFC because it was early in a fund's life and because some found allocating limited liquidity to a strategy that no longer seemed advisable to be anathematic.

One of the more specific impacts of the current crisis is the fact that working from home bars LPs from performing what for some is mandatory in-person due diligence.
This will have a number of follow-on consequences. First, beyond the logistical issues stated previously about packed agendas and distracted investment committees, the pace of commitments will slow from the record levels seen in 2019 if in-person due diligence requirements must be upheld. Second, funds for which the LP had already completed due diligence prior to the crisis may still be approved. Third, GPs coming back to market with strategies in which the LP has invested previously may require a lesser level of due diligence, so these "re-ups" may have a better chance of garnering commitments than strategies new to an LP. Finally, GPs with poor performance histories or ones hoping to start a new fund or broaden their investor base will be disadvantaged, as their targeted LPs will be unable to get comfortable with them during this time.

Exits

PE exit activity



Source: PitchBook | **Geography**: US
*As of March 31, 2020

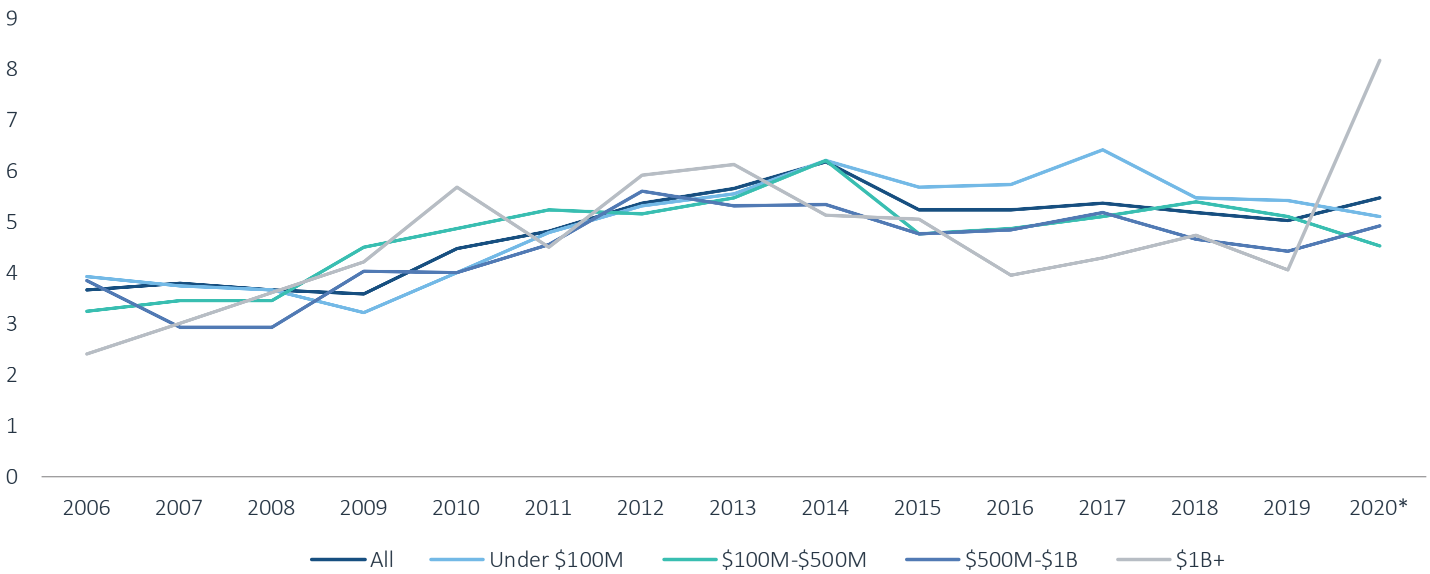
In Q1 2020, PE firms closed 265 exits totaling $60.8 billion. This left the number of exits flat but value down 37.3% YoY as GPs liquidated smaller companies. Although exit activity was already on the downswing, we believe it will diminish dramatically as GPs choose to hold portfolio investments rather than sell at discounted prices.

This is especially relevant in the energy space, which accounted for a healthy proportion of exit value in the quarter. The sector registered several billion-dollar-plus sales in the first quarter, such as People's Natural Gas, Felix Energy II and Jagged Peak Energy, which combined for over $7 billion. However, we expect the sector to represent a far lower proportion of value going forward. In March, a price war, accompanied by a COVID-19-induced drop in global demand, caused oil prices to plunge to levels not seen in 20 years. WTI was trading at about $20 per barrel by the end of March, compared to more than $60 at the beginning of 2020. As a proxy, prices of publicly traded energy companies have plummeted more than market averages, implying that prices of private assets in the energy space will see massive declines as well—especially E&P companies and landholders.

While energy companies inked more billion-dollar-plus exits than any other sector, the largest exit of the quarter came from healthcare. Pharmaceutical Product Development (PPD), which was backed by Hellman & Friedman, The Carlyle Group and a pair of SWFs, went public on February 6 at a $7.5 billion pre-money valuation. This exit speaks to how engrained SWFs are becoming in PE dealmaking but also how quickly financial markets move. PPD's IPO would have been untenable just a couple weeks later because of the recent dive in stock prices and valuations and the extreme volatility in public markets. Amid such uncertainty, IPOs appear to be off the table entirely, and the few exits that will occur are more likely to go to a strategic or financial sponsor than under normal circumstances.

More broadly, PE firms are postponing exits until pricing equalizes. GPs are placing most transactions that are not near the finish line—meaning due diligence has been completed and buyer financing secured—on the back burner because they loathe to sell assets at a discount of 20% or more compared to where the asset was priced a few months before. Thoma Bravo had been collecting buyer interest for its portfolio company Imprivata, which was reportedly valued north of $2 billion, but decided to pull the plug on the process and suspend the deal indefinitely. The lofty price tag would have been approximately four times more than what Thoma Bravo paid for Imprivata just three-and-a-half years prior.

Median PE holding time (years) by size

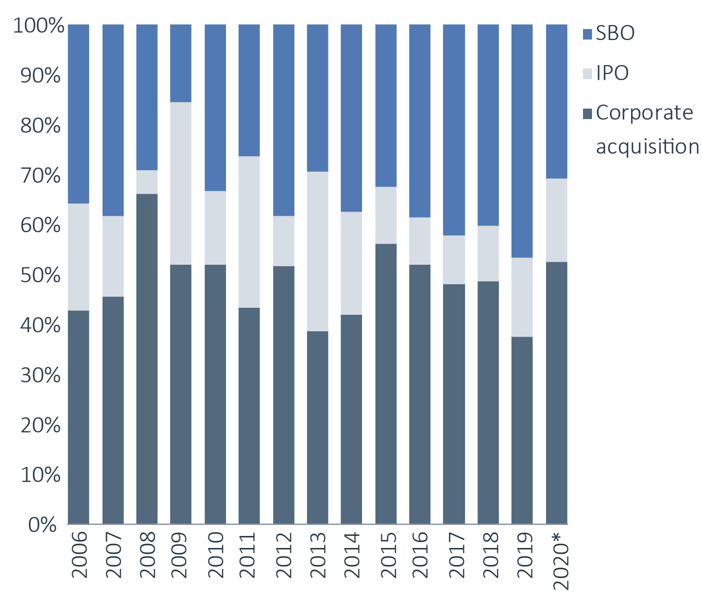


Source: PitchBook | **Geography**: US
*As of March 31, 2020

GPs similarly continued to hold assets when pricing collapsed during the GFC, and median holding times became progressively longer over the ensuing five years. This is not a problem for young funds, but those near the end of their lives may be forced to utilize GP-led secondaries transactions in order to continue holding portfolio companies because of a lifetime predefined in the LPA. We see this already showing up in the data, as GPs in Q1 chose to hold their largest investments longer than they would normally. These $1 billion companies typically mark to market more quickly than smaller ones, meaning GPs saw prices drop the fastest with larger exits, and only sold portfolio companies that had been held much longer than average and had to be sold.

Lower-middle-market GPs are likely to have more success exiting investments than their larger counterparts because their portfolio companies are often valued below a couple hundred million dollars. Larger GPs still appear willing and able to buy small, middle-market companies in the current climate for add-on purposes or in distressed transactions. Small companies also have a higher likelihood of being sold because buyers can utilize private lending funds—which tend to cater to the middle market—to finance the transaction. However, GPs are unlikely to execute larger deals that rely on bank-syndicated lending facilities because of the credit crunch. Smaller managers' portfolio companies may represent some of the few tenable deal flow opportunities to other GPs, making their exit prospects better than most.

PE exits ($) by type



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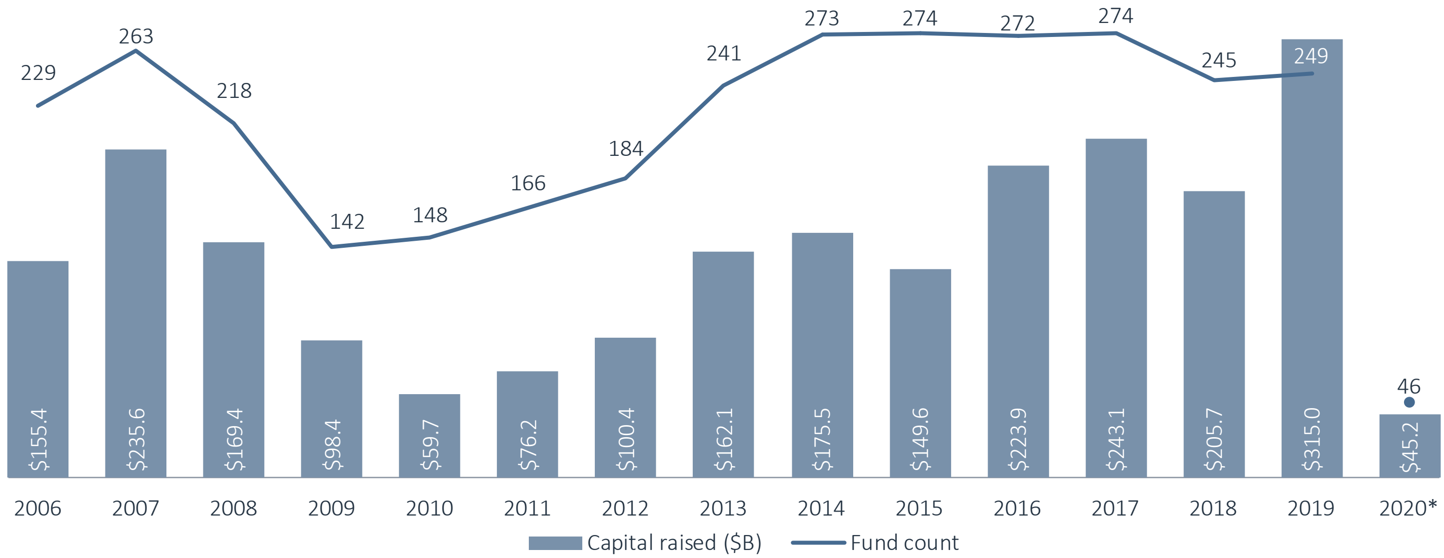
Fundraising

PE fundraising activity



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PE fundraising activity recorded a mild slowdown in Q1 2020 because GPs could still collect new commitments despite the volatile pricing market. 46 funds closed on $45.2 billion in the quarter, putting 2020 figures on pace to fall YoY. These figures are likely to weaken further throughout the year.

In recent years, mega-funds have comprised a rising fraction of total capital raised. These vehicles closed on $161.9 billion in 2019, accounting for more than half the year's total. In Q1 2020, two funds alone constituted more than a third of the quarter's results. Stonepoint Capital Partners' Trident VIII contributed $7.0 billion to the total, while Platinum Equity Capital Partners V furnished $10.0 billion. We expect any manager that closed a multibillion-dollar fund before the crisis—or that came tantalizingly close—will struggle less than other GPs seeking to come to market in 2020. We anticipate the fundraising efforts of smaller GPs, those planning on launching a new fund, and those currently seeking commitments to stall a few quarters.

Mega-fund managers are likeliest to find success in this difficult environment because they are usually established entities, and their existing LP base could prove sufficient to raise new funds should the GP choose. Many mega-funds that were lucky enough to begin fundraising in 2019 have continued to secure capital because LPs were still able to discuss new commitments in their Q1 meetings, whereas they'll focus on triage in the coming quarters. For example, Ares secured a $50.0 million commitment from Kansas Public Employees Retirement System for its Corporate Opportunities Fund VI—the firm's flagship fund targeting $9.25 billion—in late March 2020.[8] Similarly, New Mountain landed a $175.0 million commitment from Pennsylvania state Employees' Retirement System for its fifth flagship fund—which is seeking $8.0 billion—on March 6, 2020.[9] In both cases, the commitments were reups from LPs that had invested in the GPs' previous flagship PE funds.

Mega-fund managers do not appear to be altering their fundraising plans despite the current environment. Silver Lake is launching its next flagship fund—targeting between $16.0 and $18.0 billion—and KKR is expected to launch its next flagship offering in the next couple quarters. Thoma Bravo also recently brought a mega-fund to market, and the GP is concurrently raising capital for a $14.0 billion flagship fund and a $4.0 billion buyout fund. This strategy of simultaneously raising flagship funds and smaller, middle-market funds is newer but catching on. In December 2019, Leonard Green closed on $12.0 billion for its Green Equity Investors VIII and $2.75 billion for its inaugural Jade Equity. Concurrent

8: "Kansas Public Employees Slates $300 Million for Real Estate, Private Equity," Pensions & Investments, Rob Kozlowski, March 25, 2020
9: "Pennsylvania Public School Employees Earmarks $390 Million for 3 Buyout Funds," Pensions & Investments, James Comtois, March 9, 2020

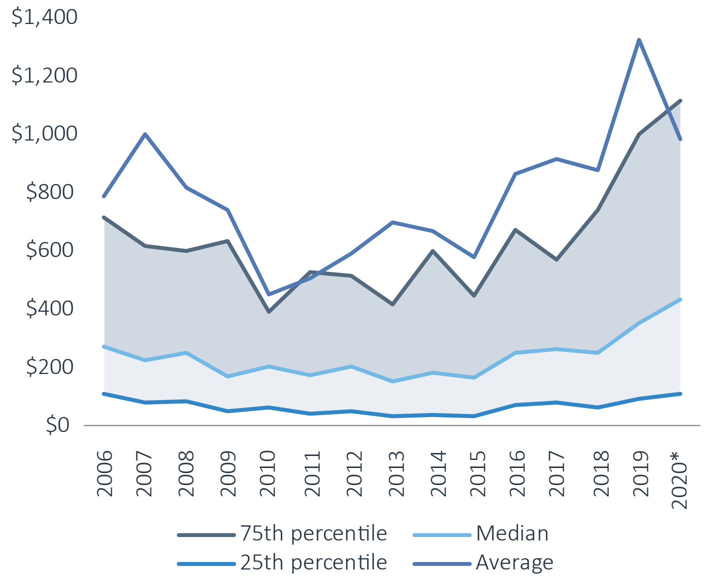
fundraising efforts allow for fewer meetings from the IR team and permits the GP to concentrate on the fundraising aspect across several teams before shifting focus to investment. The heavy overlap in LPs that committed to both Leonard Green funds, including Alaska Permanent fund, Washington State Investment Board, and several others, appears to support this. We will be watching to see if the industry continues to adopt this tactic.

Although mega-fund managers could find some success in this environment, we still expect a substantial decline in both fund count and capital raised in 2020. There were already fewer mega-funds expected to close than in 2019, which was bound to lead to a YoY fall in capital raised. The current conditions are apt to exacerbate this as managers could take another three to six months to close a mega-fund and even longer to close smaller funds. Nascent managers, which we define as having raised three funds or fewer, will be hit particularly hard by this crisis. These GPs are trying to establish themselves and secure a stable LP base. Those attempting to come to market in early to mid-2020 will find an extremely tenuous market.

Though plenty of LPs remain willing to allocate to smaller funds, vehicles sized under $200 million have become rarer over the years as the median fund size has steadily risen. In 2015, funds below this threshold constituted over half of all US PE funds, but by 2019, they comprised just over a third. We believe LP commitment preferences will hamper the efforts of funds targeting less than $200 million; many larger LPs and funds of funds prefer not to commit less than $20 million to a single fund or account for more than 10% of its total capital raised. Additionally, smaller funds are especially vulnerable to the impacts of the crisis, so we expect to see even fewer close in 2020.

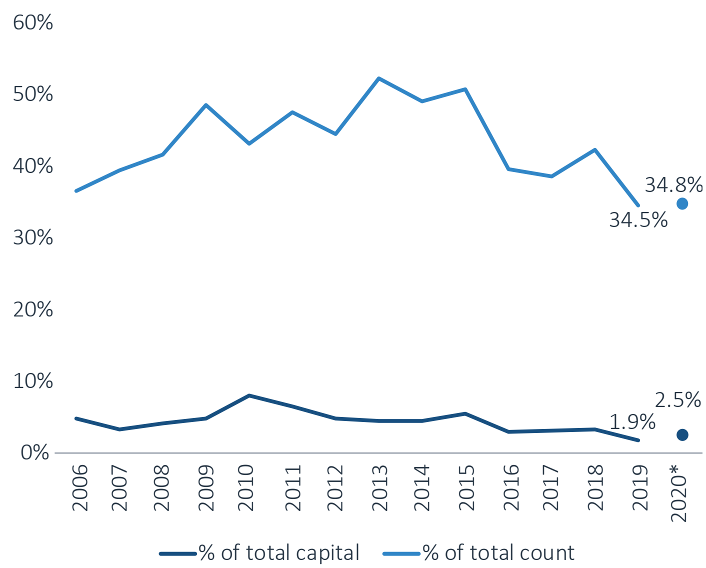
The denominator effect could also temporarily hinder fundraising, though to a lesser extent than in past crises. With public market performance falling more quickly than that of private funds in recent weeks, alternative strategies such as PE may temporarily account for a more sizable percentage of an LP's portfolio. This happened during the GFC, and many LPs were forced to cut exposure to alternatives and sell on the secondaries market at steep discounts. Most learned from that and now have an allocation range and can even delay rebalancing. Furthermore, numerous LPs are already underweight alternatives, muting the denominator effect. However, we still expect it to have an impact on fundraising. Despite LPs being able to forgo rebalancing or allocating to a wider range, tumbling public equities

Quartile distribution of PE fund sizes ($M)



Source: PitchBook | **Geography:** US
*As of March 31, 2020

Sub-$200 million funds as proportion of total PE fund count and capital raised



Source: PitchBook | **Geography:** US
*As of March 31, 2020

still indicate that PE will account for a greater share in the portfolio than it otherwise would. We have already heard reports of LPs forgoing new commitments for the time being because of the denominator effect. These LPs are likely to delay their commitments for a couple of quarters or until the crisis diminishes.