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HEDGENORDIC

SPECIAL REPORT

PRIVATE MARKETS

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INTRODUCTION

HedgeNordic is the leading media covering the Nordic alternative investment and hedge fund universe. The website brings daily news, research, analysis and background that is relevant to Nordic hedge fund professionals from the sell and buy side from all tiers.

HedgeNordic publishes monthly, quarterly and annual reports on recent developments in her core market as well as special, indepth reports on "hot topics".

HedgeNordic also calculates and publishes the Nordic Hedge Index (NHX) and is host to the Nordic Hedge Award and organizes round tables and seminars.

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Editor´s Note …

… Perks and Plain Vanilla

One of the perks my profession is the opportunity to talk to different people in various corners and positions of our industry. I find that the most insightful perspectives on what is really going on often come from marketing and especially sales professionals (who sometimes have much more flamboyant job titles).

It gets all the more interesting if you have sales people from very large organizations that have everything, literally everything in their offering, reaching from the plain vanilla, long-only products to extremely niched boutique offerings. Simple questions as "what are investors buying, or where are you seeing redemptions?" give an immediate insight and feel into trends and shifts in the behaviour of allocators.

In the years leading up to 2022, the most frequent response to that question, more often than not, was something relating to private markets. The significant rise in interest rates and return expectations for fixed-income instruments potentially reduced the relative attractiveness of alternative investments. So, coming towards the end of the first half of 2023, we at HedgeNordic wanted to dive in and see how the different segments of private markets navigated the new year and look closer at some of the offerings that are getting investors excited.

In this special report on Private Markets, we want to take a closer look at various strategies and instruments traded in the private asset space. Olivier Keller of PineBridge Investment starts off by highlighting "What Investors Should Consider" when doing due diligence on emerging or first-time managers in the private markets universe. Shaniel Ramjee, Senior Investment Manager of Multi Asset at Pictet Asset Management, then discusses "Private Assets' Role in a Diversified Portfolio."

In "Mitigating the J-Curve," Susanne Forsingdal, Head of Americas for Allianz Capital Partners shares her thoughts on the benefits of co-investments in the private equity space. Benjamin Alt and Johan Strömberg then discuss Schroders' semi-liquid range in private equity, venture capital and infrastructure in "Innovation and Impact Investing with Potential Liquidity." In "PartCo Performance: Finding Gold in Ore," Patrick Carlevato from SEI Novus explores best practices to help LPs extract meaningful insights from the mass of private equity portfolio company data.

The due of Jyri Hietala and Kari Kangas from United Bankers "Unveils Evergreen Fund for Timberland Investments," as well as discuss attractive characteristics of timberland investments. The new fund will expand its geographical reach to new markets in Europe beyond the Nordic and Baltic Rim markets. In "VC and Growth Deals: High Level of Activity Continued in 2022," Espen Langeland and his team at Argentum summarize the level of activity in the Nordic start-up and growth universe.

In "Private Debt: An Asset Class that Benefits from Volatility," Matias Hauru and Jussi Tanninen from Mandatum Asset Management explain how underlying private debt strategies perform differently based on underlying market conditions, as do existing and new investments. Moving on, Miguel Zurita and Jörg Höller from AltamarCAM discuss "The Private Market's Role in ESG Transformation," highlighting their desire to push beyond merely playing a participatory role in the progressive adaptation to this new "green" reality. The publication concludes with a summary of how alternatives and private markets investments helped offset losses for the first four AP Funds in the challenging market conditions of 2022.

Kamran Ghalitschi

PUBLISHER, HEDGENORDIC

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First-time funds can be a make-or-break proposition.

What Investors Should Consider

By Olivier Keller, CAIA, FRM – PineBridge Investments


Olivier Keller, CAIA, FRM, Portfolio Manager, Private Funds Group – PineBridge Investments

> "Despite these fundraising challenges, there are many potential motivations for seasoned yet hungry investment professionals to start their own endeavours."

The private capital universe has matured significantly over the past two decades. According to PitchBook, private market funds raised US$1.2 trillion globally in 2022. While down somewhat from a record year in 2021, it nonetheless marks an increase of nearly 130% from 2012 levels and nearly 50% over pre-global financial crisis years (2007)[1]. The average fund size grew substantially over the past decade as many existing managers raised significantly larger pools on the back of institutional investors' increasing allocations to illiquid alternative markets. New groups emerged to cover the lower market segments abandoned by those firms, while the number of sub-strategies and specialization areas grew. Areas such as emerging market private equity (PE), growth capital, and private debt or infrastructure grew more prominent, allowing investors ever more nuanced ways to fine-tune their alternatives allocations.

This maturity process has influenced today's market for emerging managers in several ways. On the one hand, a whole generation of investment professionals have built up significant experience across market cycles and now feel ready to branch out on their own. On the other, the growing number of seasoned general partners makes it easier for investors to stick to their existing managers rather than adding new names to their rosters. If limited partners choose to enter new relationships, it is still easier to do that with established managers than with newly formed general partners. In 2021, capital collected by private capital first-time managers accounted for a mere 6% of the total fundraising volume. This share has declined steadily for much of the past decade.

In absolute terms, some segments of the first-time fund markets still seem to be expanding. Developed market private equity managers (in North America and Western Europe) collected a total of US$27 billion across 131 first-time funds in 2022.[2] However, these numbers include new fund lines raised by existing platforms. These tend to enjoy significant advantages over newly formed firms, such as the ability to leverage existing infrastructure and cross-sell to the LP base of their other products.

For investors, emerging managers can present a challenge. Due diligence is often more demanding than with established firms in areas such as historical performance, team cohesion and firm culture, or deal sourcing capabilities. The majority of spin-out teams do not receive track record attribution from their prior firms, requiring a significant amount of work by LPs to confirm the principals' track records. In many cases, the partners of a new firm have a limited history of working together, which can raise concerns about team chemistry and personality fit. On the execution side, questions may arise as to whether company owners are willing to transact with new outfits without a demonstrable independent history. These considerations may cause many institutional investors to shy away from emerging managers entirely, particularly in a market where an increasing number of limited partners are looking to reduce their overall number of general partner relationships.[3]

One potential path to overcoming these fundraising obstacles involves the sale of a minority stake in the new GP to an anchor investor in exchange for a significant commitment to the initial (and often following) fund generation. Such a transaction can serve as a catalyst to accelerate fundraising, and the prospect of bringing on board a strong financial partner may be compelling. At the same time, many new groups are reluctant to sacrifice a portion of their independence and future economics out of the gate. However, emerging managers are becoming increasingly creative with ways to attract high-profile investors to their funds.

Despite these fundraising challenges, there are many potential motivations for seasoned yet hungry investment professionals to start their own endeavours. While lucrative financial prospects and the hope of one day taking over the reins may incentivize many junior partners to stay with established players, professionals with a strong entrepreneurial spirit may feel compelled to take full control of their fate. From a strategic perspective, many professionals spinning out of rapidly growing GPs cite a wish to return to a lower segment of the market, allowing for more direct sourcing and interaction with founders and managers. Others see opportunities in specific market segments, sectors, or transaction types. A further source of motivation is the prospect of working with a group of like-minded peers, either from the same employer or leveraging relationships fostered through interactions across firms over the years. In many cases, these new teams seek to replicate success factors from their prior employers while implementing lessons learned in softer areas, such as decision-making processes, communication, or ensuring equitable economics among team members.

The entrepreneurial risk that founders of a new GP assume is often considerable. Significant upfront investments are required before there is any visibility on revenues. Infrastructure must be built up, and service providers such as law firms, administrators, auditors, and often placement agents need to be retained to establish the GP and the fund. While teams will typically enhance staffing after an inaugural fund's first close, some initial hires on the investment and administration side are a requirement for successful marketing. Beyond these outlays, investors often expect emerging managers to tie up a significant portion of their net wealth via a GP commitment to their initial funds.

This implies a make-or-break proposition for the outcome of a first-time fund. To raise the initial capital, partners tend to rely on track records generated at their prior firms. However, if a Fund I portfolio does not perform well, investors are unlikely to rate the manager on their broader history again. While dealing with this added pressure may be a challenge, emerging managers typically do not have a legacy portfolio to manage, allowing them to fully focus on the fund at hand while simultaneously developing the team.

For many ambitious private equity professionals, launching their own firm will remain an attractive proposition. However, they will need to prepare for significant headwinds in the current fundraising market – and achieving a meaningful first close presents a particularly daunting hurdle. Skill, creativity and resilience will determine how many new GPs will further enrich the universe of addressable opportunities for private equity fund investors over the coming years.

1 Source: Preqin, First Time Funds Struggle For Survival, November 10, 2022
2 Source: Preqin; Strategy: Buyout & Growth; First Time Fund: Yes; Primary Region Focus: North America & Europe. As of 18 November 2022.
3 Source: Private Equity International, PEI LP Perspectives 2023 Study, December 2022.

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Shaniel Ramjee, Senior Investment Manager of Multi Asset
Pictet Asset Management

Private Assets' Role in a Diversified Portfolio

Private assets are an increasingly important source of returns and diversification. The Q&A with Shaniel Ramjee, Senior Investment Manager of Multi Asset at Pictet Asset Management (Pictet AM), takes us through the opportunities private markets offer, as well as the risks they pose.

Q: WHAT DO YOU SEE AS THE DEFINING FEATURES OF PRIVATE EQUITY – BOTH AS COMPANIES AND AS INVESTMENTS?

A: There are many reasons why companies might choose to remain private. They might be family owned, or not want to be subject to the administrative burden of public listing, or to the short-termism imposed by quarterly reporting. Typically they are in a different part of their lifecycle – usually at an earlier stage – from publicly-traded firms. They might have just found their niche in the world of business and are starting to grow. It's at a stage where a lot of exciting things happen to some of these companies. And where a bulk of their returns is often generated. So for investors to be able to access investments at this stage is particularly interesting.

Q: DOES IT MAKE ANY DIFFERENCE BEING A EUROPE-BASED PRIVATE EQUITY INVESTOR?

A: Europe has a long history of private companies, many of which have been in existence for decades and controlled by a founding family. These companies are extreme specialists in what they do. And there are lots of them – there are 23 million small and medium-sized enterprises (SMEs) in Europe, employing two-thirds of the region's workforce. But we see with increasing frequency in these companies that younger generations are less involved in the business, or indeed, a first round of professional managers have stepped into the business hoping to expand or grow it.

Private equity can be one of the ways in which they do that without relinquishing family control. So they're able to get financing through the private markets but still retain that ability to have that long term management style, long term vision in terms of where the company is going and how to grow it. They don't need to go to the public market. They can align themselves with private equity capital, which has a similar mindset to that long term investment style.

Private debt becomes important here too – historically, these companies were much more dependent on bank loans, but these can be relatively inflexible compared to contracts that can be struck with private lenders. But for the most part private lenders have focused on larger companies, so it's a wide open field for new entrants focused on SMEs.

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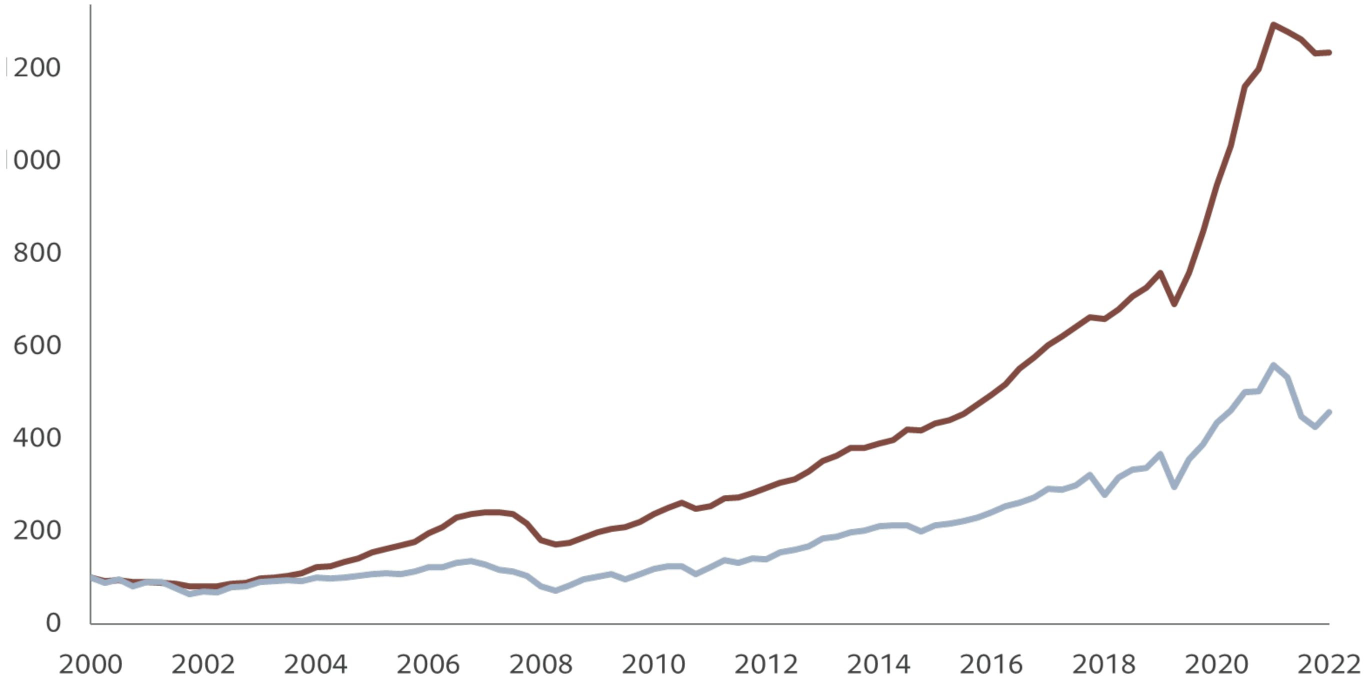
Figure 1: Private trumps public

Performance of Private Equity Buyouts vs S&P 500, rebased Dec 2000 = 100



Source: Prequin Pro, Pictet Asset Management. Data covering period 01.12.2000-31.12 2022

Q: ULTIMATELY, IS WHAT MAKES PRIVATE ASSETS SPECIAL THE FACT THAT THEY ARE ILLIQUID AND THAT INVESTORS EXPECT TO BE PAID A PREMIUM FOR HOLDING ILLIQUID ASSETS?

A: The illiquidity premium in and of itself doesn't garner extra return. It's what you do with that illiquidity that matters. So, for example, private companies are able to set longer term objectives, longer term goals, which management can work hard to achieve without having to focus on the market's quarterly reporting demands. We believe that illiquidity in itself doesn't generate the return, it's the value creation it allows that does.

It's also important for investors to really understand how much illiquidity they can manage in their portfolios. They need to realise the degree to which leverage was employed in private equity and to have a very clear understanding of what the value creation proposition was in private equity deals, especially now that interest rates have gone up.

Q: RISING INTEREST RATES HAVE CLEARLY BEEN A WIDER RISK FOR THE MARKETS, BUT ARE THERE ANY RISKS THAT ARE SPECIFIC TO PRIVATE ASSETS?

A: Due diligence is crucial. We know that, on the face of it, these companies are slightly less transparent than those in the public markets. So what investors in private equity partnerships need to understand is how these due diligence processes are undertaken and the guiding philosophy of each private equity transaction that is undertaken. Meanwhile, private equity teams need to be able to source deals in a competitive landscape.

Vintage diversification – holding a spread of investments in private equity companies, coming due in different years – therefore, is extremely important because we know once we're invested, we are invested for quite a long time, we might be able to choose when we start investing, but when we start after that, there's very little we can do about the economic environment. So understanding how the thinking behind investments that are being made in various economic environments is extremely important in that risk management.

Exits are also important. When conditions for initial public offerings (IPOs) are robust, taking private companies public becomes more likely. But in some market environments this is more difficult. In those circumstances, expertise in trade sales becomes necessary, that's to say selling companies to other parts of the value chain – mergers and acquisitions that build conglomerates that become worth more than the sum of their parts.

Q: WHAT DOES THAT SORT OF CONCENTRATION IMPLY ABOUT THE RELATIONSHIP BETWEEN INVESTORS IN PRIVATE MARKETS AND THE ASSETS THEY HOLD?

A: In all private markets, the investor or the manager is very close to the companies in which they invest. It really is an active approach.

They're close to the boards. They often have seats and they are able to draw on not just their capital to fund the growth of these companies, but also their know-how, their expertise, their operational excellence to build these companies over time.

That's not just private equity, but private debt and private real estate.

For example, in private debt, investors can write specific needs or objectives into the contracts they make with borrowers, in other words the terms and conditions of the of the loans.

These can be around key points of company performance or even something broader – think about sustainability of a company in terms of its environmental impact and goals around that. For example, if the company has a target of, let's say, reducing its carbon footprint over time, the contract could be written such that the coupon on its borrowings drops once the target is hit. Its borrowing costs drop. But the investor benefits because in hitting its targets, the company becomes more secure and its credit rating rises. Everyone wins. In a way, private markets offer a much more active role to investors.

In many cases, this develops into a very strong symbiotic relationship between the private equity or debt managers and the companies in which they invest. That is true active investing.

Q: AS AN ASSET MANAGER, DOES IT MAKE A DIFFERENCE TO YOU THAT THE FIRM YOU WORK FOR IS ALSO PRIVATELY HELD?

A: Absolutely. I think at Pictet AM we understand uniquely what strength private structure gives us: the ability to think long term; to invest long term; to be able to be contrarian at times; and to think about what truly matters in terms of growth. It is always about the quality of that growth, not just the quantity or the speed. And we appreciate that.

For more information, please scan the QR code or visit am.pictet

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Susanne Forsingdal, Head of Americas - Allianz Capital Partners

Private Equity Co-Investments
Mitigating the J-Curve

By Hamlin Lovell – HedgeNordic

HedgeNordic had the opportunity to interview Susanne Forsingdal, Head of Americas for Allianz Capital Partners (part of Allianz Global Investors), who is based in New York City and hear her thoughts on the benefits of co-investments in the Private Equity space. Prior to joining Allianz Capital Partners, Forsingdal was part of the team that set up another highly successful Private Equity program for Denmark's largest pension fund, ATP. This followed her career in banking including equity analysis, strategy and investor relations for Nordea, Codan Bank and Danske Bank.

Private equity has not been immune from interest rate and inflation shocks, and valuation multiples have generally come down – but in some cases growth of revenues and cashflows, advancing even faster than inflation, has been enough to keep valuations and fund NAVs fairly steady. Going forward, there are now opportunities to make additional investments in existing or new portfolio companies, at lower valuations, helping portfolios to "average down" and reduce weighted average valuations. Historically, these sorts of downturns have later turned out to be some of the more lucrative vintages in which to invest, as private equity managers are creative in finding ways to build value in companies.

> "We only make co-investments with existing managers carefully picked for our program and with whom we have built up relationships of trust and respect."

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This does not necessarily involve buying a deep drawdown in performance, rather getting more revenues and EBITDA growth for the same sort of NAV entry level. Some Private Equity programs have proved to be resilient through both the Covid crisis and the more recent inflation and interest rate shocks.

This partly reflects the segments that Allianz Capital Partners has allocated to. "We are not invested in venture in Europe or the US and are not in the ultra-growth segment of the market. We are invested with some more conservative growth managers who mainly own profitable or breakeven companies, but we have an overall tilt towards buyouts, evenly split between large to mega and small to mid-market buyouts," explains Forsingdal.

The outperformance of Allianz Capital Partners' Private Equity program predates both Covid and the rate hikes. "In the early years since we started investing in 1996, performance was closer to market averages. But over the past 15 years it has been continually improving," she points out.

Allianz Capital Partners, as part of Allianz Global Investors, is one of the leading private equity investors with over 25 years of expertise in private markets and a strong international network to leverage. Their co-investments build on the success of the rest of the program.

"We only make co-investments with existing managers carefully picked for our program and with whom we have built up relationships of trust and respect. We have not been tempted to commit to new funds in return for co-investments," says Forsingdal.

Allianz Capital Partners has EUR 29 billion AuM in over 100 Private Equity funds and relies on its strong relationships with Private Equity managers to access healthy co-investments. Allianz Capital Partners is invested with many "blue chip" PE managers in the US and Europe and generally selects funds running at least USD 500 million.

Their funds of Private Equity funds can allocate up to 20% to co-investments, and Allianz Capital Partners is planning a standalone strategy focused solely on co-investments.

THE J CURVE

The existing co-investment program is performing well. But even if investors assume neither an adverse selection bias, nor any skill in picking co-investments, there are two reasons why they may outperform. Since co-investments hit the ground running an asset is closer to a monetization event, whereas the IRR of a brand new Private Equity funds will suffer from sitting on idle capital, as it may need to wait 5 or 6 years to invest some of the capital in a new investment.

The second benefit is that most of the co-investors pay no management fees nor carry to the underlying managers (though in a few cases there can be carry above a very high return threshold).

Allianz are considering opening up their co-investment program to new clients and Forsingdal estimates that a new co-investment strategy in the pipeline could benefit from significant fee discounts, while matching the level of gross returns of the other Allianz Private Equity funds.

A DIVERSIFIED PORTFOLIO

This new co-investment strategy should be well diversified over 20 or more different managers, regions, strategies, and maturities, ranging from mid-market to late growth to mega buyouts. This results in a portfolio with a higher level of diversification than a single typical Private Equity fund.

Allianz research shows that private equity has a lower technology weighting than publicly listed US equities. In addition to the technology, media, and telecom (TMT) sector, the co-investment strategy should invest in healthcare, industrials, consumer and retail and business services. Financials are excluded because they could be too correlated with Allianz's own business.

Other exclusions are based on an extensive ESG list which goes beyond some other ESG policies: criteria rule out clinical trials and animal testing, mining, and human rights violators, amongst others.

Deal types could focus on both operational improvements and financial engineering. They could

Allianz Capital Partners is invested withmany "blue chip" PE managers in the US and Europe.

include rationalizations, buy and builds, carve outs, mergers of equals and take privates. Deal sizes could range from below $250 million to above $1 billion but will tend to be on the larger side because Private Equity managers need more capital from co-investments to fund larger deals.

Case studies include a home products group, a residential services group and a software company acquired by one Private Equity company and sold to another one for multiples of between 2 and 4 times and IRRs above 30%. Another deal involved an information provider acquired by a Private Equity group and later sold to a credit ratings agency, generating a comparable return.

MONITORING AND ESG

Allianz Capital Partners receives financial and ESG KPI reporting on investments between 2 and 4 times per year and has never exited a co-investment before the underlying manager wanted to do so. Allianz Capital Partners defines ESG conditions and KPIs at the time of the investment. "If Allianz Capital Partners' ESG policy evolves in different directions to that of the managers over 10 years, that is not necessarily a reason to divest as it is reasonable for GPs to expect Allianz Capital Partners to stay aligned with the fund through the life of the co-investment, though hypothetically Allianz Capital Partners might then seek to sell an investment back to the manager or another third party," says Forsingdal.

TARGET INVESTOR BASE

In contrast to the underlying managers, Allianz Capital Partners do not insist on any previous relationship as a condition for participation in the new co-investment strategy.

"The target market is not the very largest pension funds such as ATP, which will generally have their own Private Equity programs, but rather smaller and medium sized pension funds, insurance companies, endowments, family offices, and possibly also Private Equity funds of funds, high net worth individuals and private banks," says Carl Winnberg, Head of Wholesale Nordics for Allianz Global Investors, who sits in Stockholm.

Investors in such a Private Equity co-investment strategy would need to meet the minimum ticket of USD 5 million and commit to the 10-year holding period.

OUTLOOK

Careful deal selection will be important in a climate of potentially slowing economic growth as rate rises filter through to the economy, and higher costs of leverage and inflationary cost pressures could create challenges for some companies, and may reduce exit valuation multiples for deals including leveraged buyouts (LBOs). Seasoned Private Equity managers with experience of workouts and restructurings should be well placed to weather these headwinds for any portfolio companies that do find they are overleveraged when the time comes to refinance debt. Equally, Private Equity managers have been adept at selecting secular growth stories where companies can continue growing with limited sensitivity to overall economic growth. Notwithstanding the denominator effect increasing weightings in 2022, many of the world's largest institutional investors are maintaining or increasing their target portfolio allocations to a range of illiquid alternatives, including private equity, private debt, real estate, other real assets, and infrastructure.

ALLIANZ GLOBAL INVESTORS

Allianz Capital Partners is one of the Allianz Group's asset managers for alternative equity investments and are part of Allianz Global Investors (AllianzGI). As a leading active asset manager with over 2700 employees including 750 investment professionals in 25 offices worldwide, we manage €647 billion in assets for individuals, families and institutions. Allianz Global Investors has an expertise across equities, interest rates, multi asset and alternatives asset classes.

AllianzGI is part of Allianz Group, which is one of the leading financial services providers worldwide. Founded in 1890, Allianz has more than 125 years of asset management expertise to its name. Back in 1998, Allianz saw the opportunity to create a unique asset management business by integrating all of its major asset management units under one roof.

For professional investors only. Private Equity investments are highly illiquid and designed for professional investors pursuing a long-term investment strategy only.

Target return assumptions may be based on the investment team's experience with predecessor funds, market participants and other stakeholders of the industry. Actual returns from an investment in the portfolio over any given time horizon may vary significantly from the target return assumptions. To the extent we express any prognoses or expectations in this document or make any forward-looking statements, these statements may involve known and unknown risks and uncertainties. Actual results and developments may therefore differ materially from the expectations and assumptions made.

Investing involves risk. The value of an investment and the income from it may fall as well as rise and investors might not get back the full amount invested. Past performance does not predict future returns. If the currency in which the past performance is displayed differs from the currency of the country in which the investor resides, then the investor should be aware that due to the exchange rate fluctuations the performance shown may be higher or lower if converted into the investor's local currency. The views and opinion s expressed herein, which are subject to change without notice, are those of the issuer companies at the time of publication. The data used is derived from various sources and assumed to be correct a nd reliable at the time of publication. Allianz Global Investors may terminate arrangements made for marketing, including by way of de notification. The Summary of Investor Rights is available in English at https://regulatory.allianzgi.com/en/investorsrights

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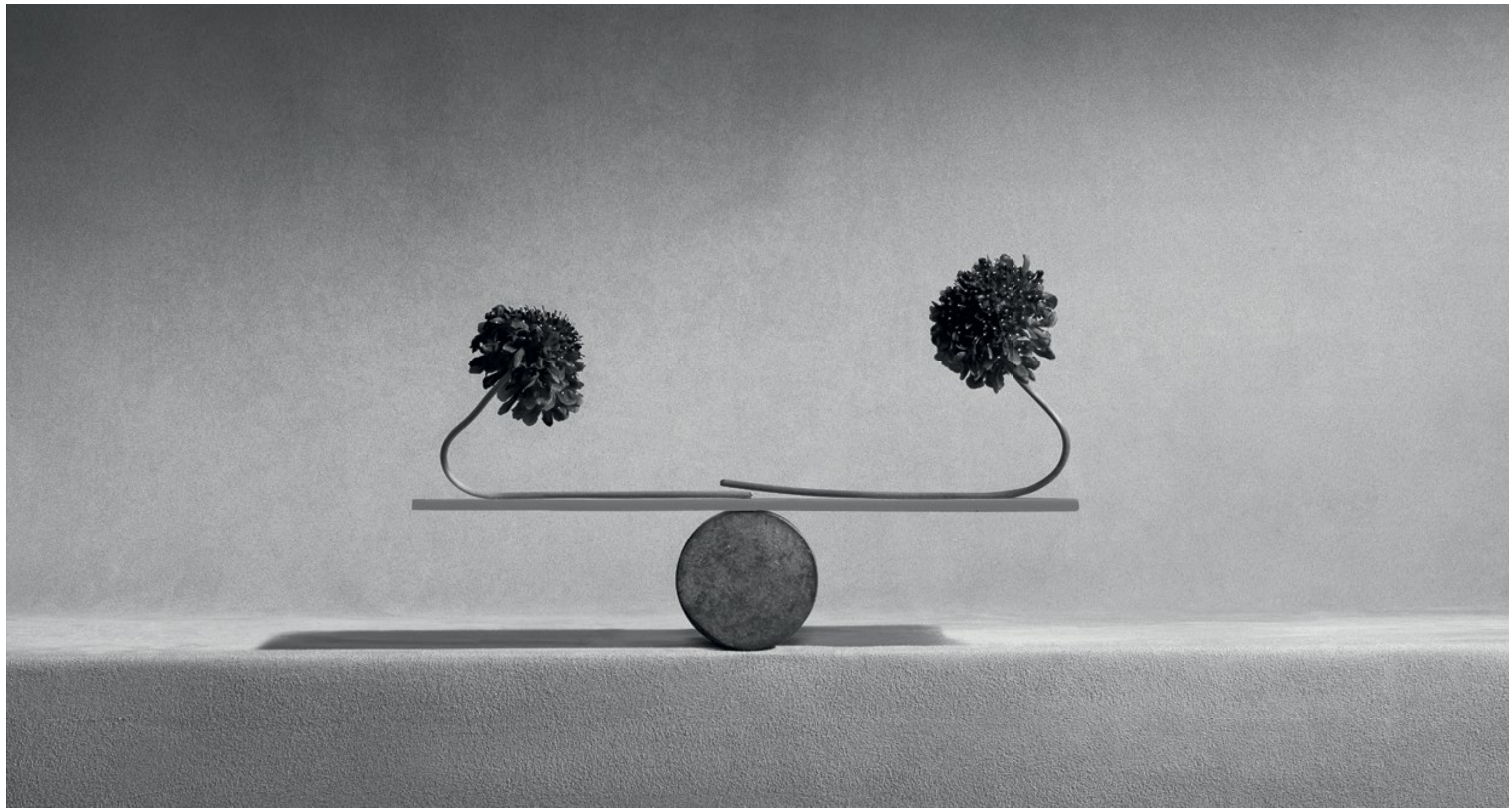
"The target market is smaller and medium sized pension funds, insurance companies, endowments, family offices, and possibly also Private Equity funds of funds, high net worth individuals and private banks."



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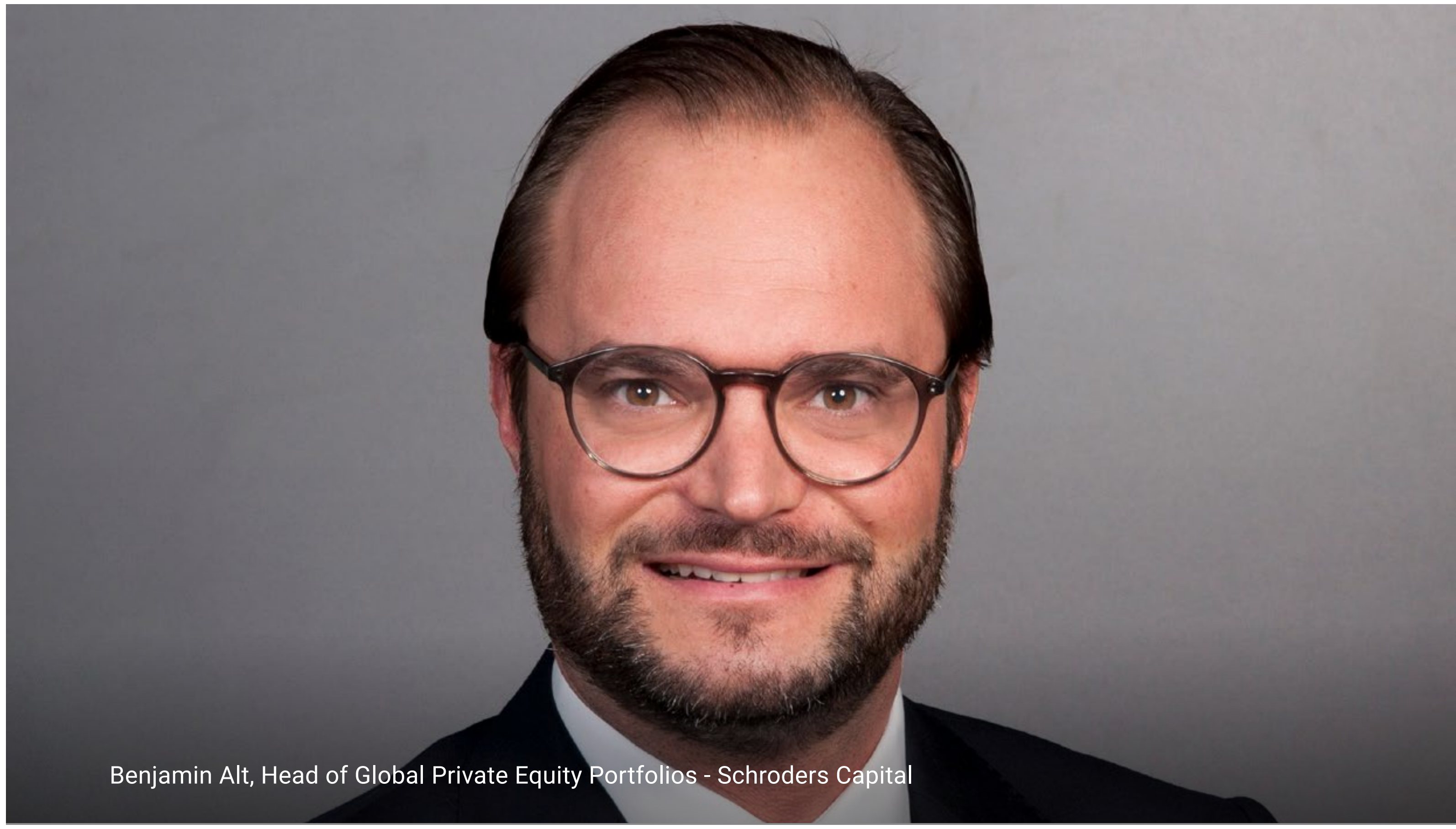
Innovation and Impact Investing with Potential Liquidity

Schroders' Semi Liquid Private Equity, Venture Capital, and Infrastructure

By Hamlin Lovell - HedgeNordic



Benjamin Alt, Head of Global Private Equity Portfolios - Schroders Capital

> "If there are still redemption pressures, the secondary market, which has grown enormously over the past decade, could also be used to create liquidity."

Schroders' semi-liquid range, which allows for quarterly redemptions up to certain limits, now has three strategies: Global Private Equity (GPE), Global Innovation Private Plus (GIPP) and a new Circular Economy (CE) strategy, with an infrastructure fund launch slated for early 2024.

Though the three private equity vehicles have distinct mandates, there is also scope for them to have overlapping investments. One example is Sweden's online used goods platform, Tradera, which is a good fit for all three. Its reporting KPIs include emission savings to meet the impact criteria of CE and it also fits into some buckets for the other two funds.

INNOVATIVE THEMES

GIPP is focused on 8 themes in healthcare and technology: AI; Cybersecurity; Fintech/Payments processing; Consumer; Infra software; Vertical SaaS; Oncology, and Biotech discovery. These are expected to be present for several years:"every 1-2 years we look to refresh them and see if any major changes are needed. I don't see major changes coming in the next few years. In the past we had 6 themes, and decided to expand to 8 as we got deeper in our domain expertise by sub-sector," says portfolio manager Michael McLean.

The two broad sectors of healthcare and technology also make up roughly half of GPE. "However, only 10% of GPE is likely to be invested in the sorts of growth stage venture capital that populate GIPP, which limits the overlaps. For example, select cybersecurity firms could be found in both of them in the future," says Johan Stromberg, Director of Private Asset Sales, who is based in Stockholm. Investors seeking a mix of larger cap and smaller cap investments may allocate to both GPE and GIPP, while some invest in all three. There is also significant standalone impact investing interest in CE.

WHY PRIVATE?

The attraction of private equity for growth investing includes the growing longevity and size of private companies. "There are fewer listed companies and private companies stay private for longer: now for 7-8 years compared with 4-6 years historically. They can grow more steadily with stable owners and without a focus on quarterly results, which can result in firms switching between public and private hands several times," says Stromberg.

LIQUIDITY MANAGEMENT

This corresponds well with the normal life cycle for a private equity fund, which is about ten to twelve years allowing for buying, developing and selling companies within an average holding period of approximately five years.

The three semi-liquid funds offer potential for calendar quarterly redemptions up to 5% of the net asset value, dealing with the fund itself and at NAV. Redemptions are not guaranteed, but there are several features that reduce the risk of the fund being unable to meet either capital calls or redemptions or both, even under a 2008 scenario stress test. "They typically hold cash and/or publicly listed equity of 10-20%, which could cover one to two calendar quarters of redemptions. On top there is a credit facility of

Johan Strömberg, Director, Private Asset Sales - Schroders

around 20% of NAV provided by Schroders, which is available to fund underlying capital calls through a period of low distributions. The funds can suspend redemptions for four consecutive quarters. If there are still redemption pressures, the secondary market, which has grown enormously over the past decade, could also be used to create liquidity," says portfolio manager, Benjamin Alt. The liquidity management framework has not really been tested so far because the vehicles have had net inflows.

In 2021, liquidity management for GPE involved holding 10-20% cash. Now this has been revised to blend 5—10% cash with 5-10% public equity for GIPP and CE (but not GPE).However, since early 2022 the manager has been quite cautious and slow in allocating capital and is sitting on some cash, and has refrained from investing in some more volatile publicly listed equity funds.

COINVESTMENTS AND GP LED SECONDARIES

Liquidity management also influences the choice of vehicles. Longer term investments often become GP-led secondary deals or coinvestments. "only 10% of GPE is in primary funds because they can create an open ended liability since we cannot predict the timing of capital calls. We would rather keep as much as possible in GP led secondaries and coinvestments," explains Stromberg.

These vehicles are also attractive for their fee savings: GP-led secondaries typically charge half of regular fees while co-investments usually have no management or carry fees.

THE DENOMINATOR EFFECT

The minimum ticket of EUR 50,000 and the liquidity feature can appeal to some retail investors, who can invest in at least Sweden. Equally some institutional investors welcome some more flexibility since the "denominator effect" has resulted in their unlisted allocations over-shooting target levels. "We have seen interest from pension funds in Iceland," says Stromberg. With publicly listed equities and bonds down 20% or more in 2022, while some private equity and infrastructure has held steady or made small gains, the unlisted weights may have risen by 25% or more.

VALUATIONS

The denominator effect has arisen because, while some older PE funds (and publicly listed PE funds) do change hands at discounted valuations, many private equity strategies have proved to be more resilient than public equity in 2022.

In some cases, less leverage and lower starting valuations have been helpful. For mid market private equity, leverage multiples, typically a maximum of 3-5 times are lower than at the large end, which can reach 7-8 times. Valuations are lower in smaller PE deals, though they have come down across all sizes. GPE performance held steady in 2022, partly because growth offset valuation multiple compression, but also due to inflows and "averaging down" through follow on investments at lower valuations.

Portfolio manager, Benjamin Alt, illustrates the strong growth dynamics in the portfolio: "Fundamentals across our portfolio have been strong in 2022. In fact, the average revenue growth across our portfolio companies in 2022 was more than 20%. The EBITDA Margin across the portfolio was at c. 25% in 2022, reflecting our focus on robust sectors such as Healthcare and Technology. Most of the positive performance in the portfolio over recent months was driven by company specific events such as a significant overperformance to their organic growth plans as well as accretive M&A add-on acquisitions. The average EBITDA growth across the portfolio in 2022 was +20%"

Meanwhile, the selected cases of lower valuations have had only marginal effect: "Negative valuation changes are mostly driven by adjustments because of public comparable companies' trading multiples and to a lesser extent by some companies underperformance versus their plans. This had a minor impact thanks to the EBITDA growth of portfolio companies as well as the amount of inflows in the fund and new investments made at prices reflecting current market environment effectively diluting the negative impacts," Alt explains.

Valuations are received from underlying managers, but Schroders' valuation team of six people, also make their own adjustments, based on mark to market comparisons with listed peers, and other considerations. The final valuations are signed off by PWC.

ESG, IMPACT AND SFDR

GPE and GIPP report under SFDR 6, partly for legacy reasons. "Article 8 requires KPIs which we negotiate via side letter when investing. As the portfolio is approaching 4 years old, we cannot retrospectively change side letters, and realistically some small investee firms in places like Silicon Valley do not have the time to provide the KPIs," says Stromberg.

In fact, 81% of direct and co-investments support at least one SDG, but that would not necessarily be enough for SFDR 8 or 9.

CE reports under SFDR article 9. "This also requires clear intentions for the company to make a positive impact at the time of investment, as well as KPI reporting," explains Stromberg.

Schroders' impact investments, in CE and elsewhere, have the same investment criteria as any other investment, but must also pass a separate independent impact assessment to qualify. A carve out of previous investments that could have met impact criteria generated returns equivalent to, or better, than the broader private equity platform thereby reflecting the opportunity to deliver "impact with returns".. The myth that positive impact is a trade off against returns is simply not true.

The investment and ESG analysis are integrated as part of a process that has been informed by templates developed alongside microfinance specialist Blue Orchard, which Schroders acquired. "We received a 5 star rating from UNPRI for the Indirect – Private Equity module in the latest reporting cycle. The 5 star rating is a summary score for the module based on outcomes from the assessment of 7 indicators included in this module. Across these 7 indicators, we achieved 96% of the available points, resulting in the 5 star module score," says Edson Fonseca, Sustainabilty Specialist, who is also a board member of SWESIF, Sweden's Sustainable Investment Forum.

"The infrastructure fund will also have a strong impact flavour, with a green focus, including energy transition, energy storage, and hydropower," adds Stromberg.

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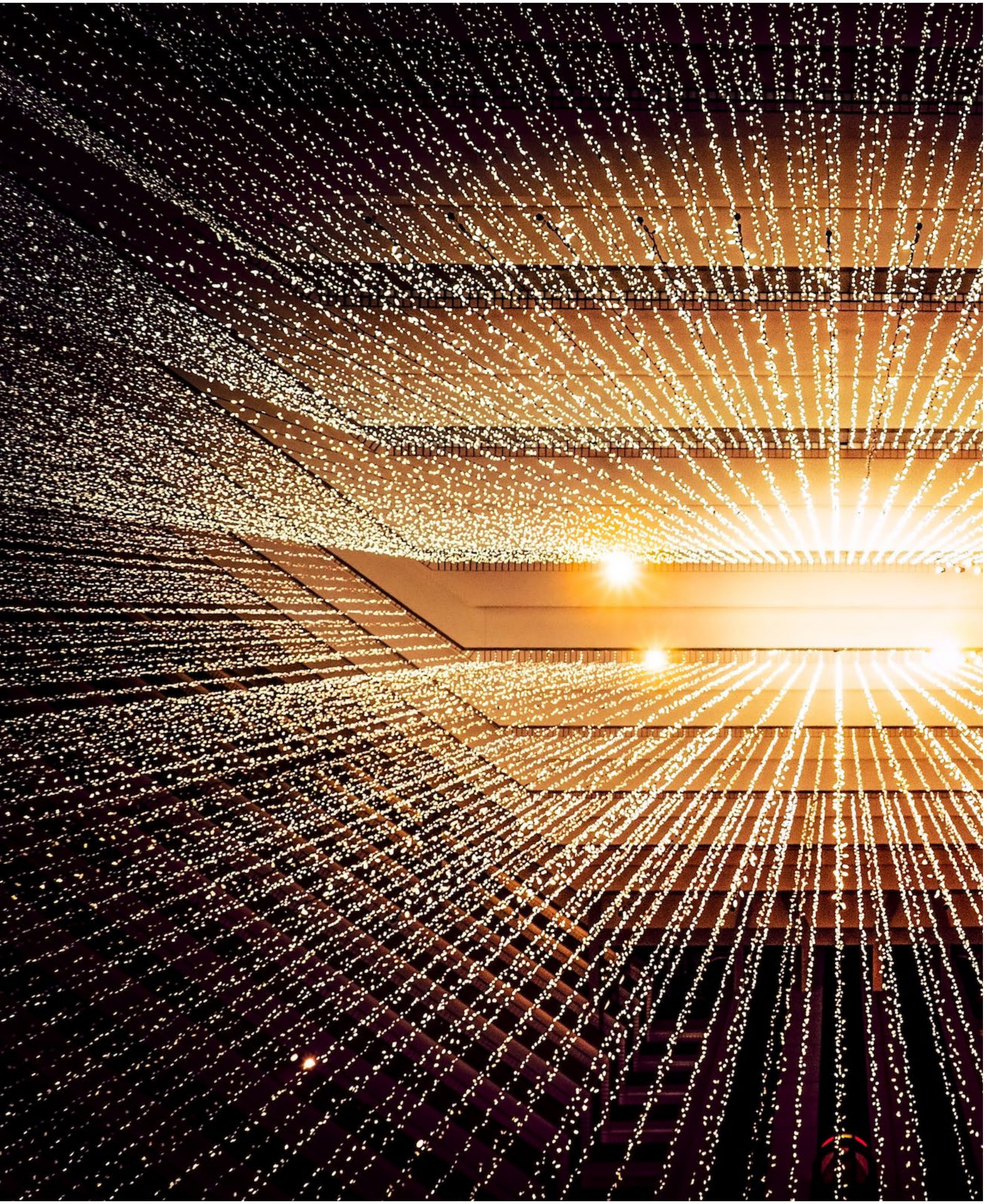


PortCo Performance: Finding Gold in Ore

By Patrick Carlevato, CFA – SEI

Explore best practices to help LPs extract meaningful insights from the mass of private equity portfolio company data.

When a well-known tech-focused hedge fund shared that it marked down the value of its investments in private companies by about 33% across its VC funds in 2022, it delivered a treasure trove of information to its LPs—at least to the LPs positioned to utilize this information. The announcement of such a large markdown presents an opportunity for us to examine how LPs can extract the most accurate and actionable insights from manager data.

PORTFOLIO COMPANY DATA

Private equity performance metrics have their drawbacks, but private fund managers do share tremendous transparency with their managers in quarterly updates—providing details on each portfolio company. The increasing number of private investment lines in the portfolio is a challenge for LPs, as it requires sifting through PDFs to extract the most meaningful information. When applied across a portfolio of private investments, it is onerous to structure data on each portfolio company to answer purposeful questions about the portfolio.

Let's look at a fictitious portfolio with 100 private investments. This portfolio has more than 1000

Figure 1. Deluge of data

underlying portfolio companies. Each quarterly financial update includes data points on sector, geography, valuation, revenue, EBITDA, employees, and additional nuanced details for each portfolio company. Please introduce me to the LP that has the time to key these thousands of data fields into an Excel spreadsheet.

Without that data in a structured format, it is tedious for LPs to isolate true exposure to specific sectors or geographies. However, when that data is structured and part of a robust analytics system, the LP can begin to apply in mass the insights from valuations when a manager shares its quarterly update to similarly categorized portfolio companies across all of its managers. Instead of applying a blanket 33% haircut to its entire venture book, the LP can look at the size of the haircut for specific sectors within the manager's portfolio and apply that haircut to its exposure to that sector in the rest of its venture portfolio. Whoa—a manager might be able to make a reasonable estimate for the markdown across its venture portfolio and better understand current exposures.

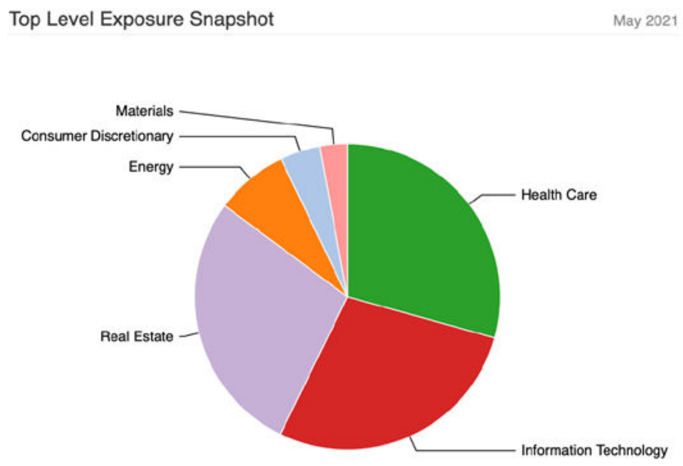
LOOK-THROUGH TRANSPARENCY

For an LP with heavy alternatives exposure to both private equity and hedge funds, it is particularly tricky to understand exposures by sector or geography. There is heavy data work involved and each manager may provide varying depths of transparency or may use any of a number of industry classifications. For example, a hedge fund manager may share exposures by sector and industry plus its top 10 positions—all the while, masking the names of its short positions. Meanwhile, a health care focused private equity manager will provide narrow industry definitions that make it hard to roll up exposures across all managers.

Through a harmonization process, any exposure that acts like Health Care will be categorized as Health Care, so that exposure can be rolled up across all managers to determine the total portfolio's exposure to Health Care. This process solves the challenge created when some managers use proprietary industry classifications while others use S&P GICS or Bloomberg.

The idea of Look-Through Transparency allows an LP to roll up the portfolio to meaningful categories

Figure 2. Top Level Exposure and Company Lookthrough Exposures. Data shown in the above charts is from a paper portfolio created by SEI Novus for demonstration purposes only. Past Performance is not a reliable indicator of future results.



Company Lookthrough Exposures May 2021

Fund	Exposure (%)	Contribution (bps)
Health Care (12)	29.33	1,813.91
Information Technology (12)	27.92	9,431.57
Real Estate (12)	27.90	3,098.75
Energy (6)	7.69	1,219.14
Consumer Discretionary (4)	4.25	580.61
Materials (4)	2.90	186.96
Communication Services (2)	-	627.21
Industrials (2)	-	514.43

like Asset Class, Strategy, Sector, Geography, Size, etc., and then drill into any of those categories to see the underlying fund(s), positions, or portfolio companies. To do this efficiently, managers need to deliberately structure essential meta-data for each portfolio company and the exposure data from every hedge fund fact sheet as well as systematically apply multiple tags to every investment in its portfolio. A reliable service provider, such as SEI Novus, can efficiently and methodically manage this process for you, so that your team can focus on gleaning insights from the data to make better investment decisions.

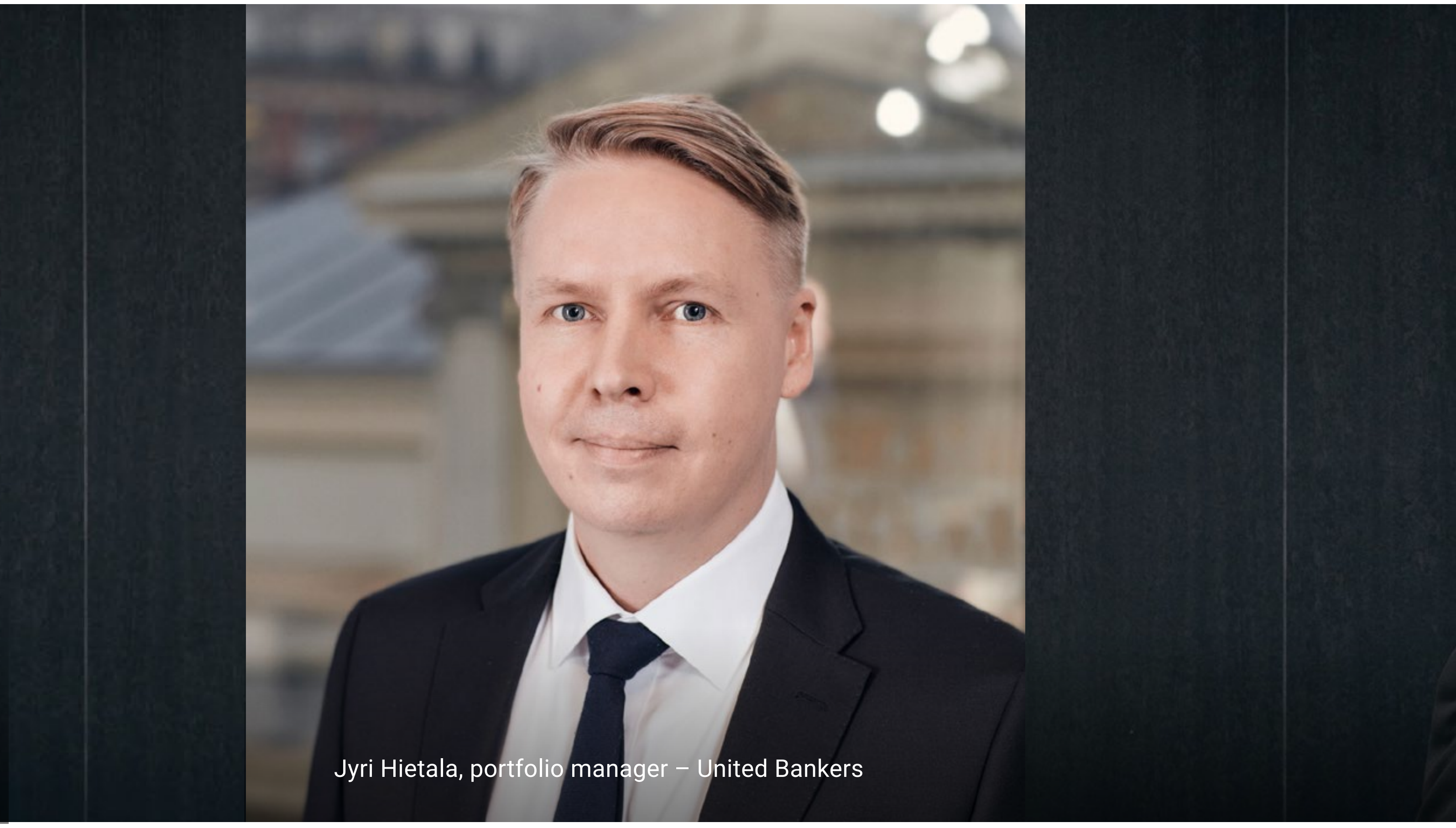
PORTCO PERFORMANCE WITH SEI NOVUS

Here at SEI Novus, we provide investment offices with a structured, aggregated, and accessible viewport into their private investment program. Manage exposures, explore portfolio company details, construct valuation bridges, and more. Watch a product tour now, or connect with a member of our team.

Kari Kangas, portfolio manager – United Bankers

Diversify and Hedge: United Bankers Unveils Evergreen Fund for Timberland Investments

By Eugeniu Guzun – HedgeNordic



Jyri Hietala, portfolio manager – United Bankers

The World Bank has projected a fourfold increase in global timber demand by 2050, driven by anticipated worldwide economic and population growth. The surge in demand for timber is expected to result from various factors, such as increased construction activities, infrastructure development, and the growing need for wood products in industries such as furniture, paper, and packaging. With the launch of its fifth forest fund, structured as an evergreen fund, Finnish asset manager United Bankers aims to provide investors with an opportunity to tap into the growing demand for timber products while offering access to the attractive characteristics of timberland investments.

CHARACTERISTICS OF TIMBERLAND INVESTMENTS

Diversification and Inflation Hedge. "Diversification is one of the main reasons for adding exposure to timberland investments," states Kari Kangas, forestry-focused fund manager at United Bankers. Timberland investments offer unique diversification benefits derived from the biological growth of trees,

> "Diversification is one of the main reasons for adding exposure to timberland investments."
>
> Kari Kangas

which adds a 'natural' element of diversification to investment portfolios. "Forests and trees grow every year, so the value of your assets in terms of biological growth increases every year," explains Kangas.

Another key advantage of timberland investments is their potential to serve as a hedge against inflation. The inflation-hedging properties of forestry investments arise from the many uses of wood in the real economy, including fuel, building materials, furniture, paper, tool, and more.

Carbon Sink. Timberland investments are often considered 'impact' investments due to their positive environmental attributes, emphasizes United Bankers fund manager Jyri Hietala, who also focuses on forestry. Investing in sustainably managed forests contributes to the preservation and conservation of forests, promoting biodiversity and mitigating climate change.

As forests act as carbon sinks – absorbing more carbon from the atmosphere than releasing – institutional investors aiming to reduce portfolio emissions to net zero must consider forestry investments in their portfolios. "Forestry investments are a necessary component in a portfolio as most, if not all, other asset classes generate some emissions," explains Hietala. "You can neutralize emissions in the portfolio by investing in forestry investments; all our funds are carbon sinks."

Similar to the three previous vintages, the new fund – UB Nordic Forest Fund IV – will also be classified as an Article 9 fund under SFDR. "Our aim is to mitigate climate change, that's our objective," says Hietala. "Our forests, first of all, act as carbon sinks, but we are trying to do something additional compared to an average forest owner," he elaborates. "We also manage our forests sustainably, with most of our forests being double-certified with PEFC and FSC," both of which have the same goal of creating and implementing sustainable forestry policy.

Steady Cash Flows. Forestry investments provide access to a steady stream of returns and predictable cash flows derived from carefully planned and sustainably managed timber harvesting. "We typically create a budget for harvesting for the whole year based on an assessment of harvesting possibilities, the type of forest we own, and the expected market development for the next year or two," explains Hietala. "If the prices are high, we can increase the amount of harvesting depending on the harvesting possibilities. We don't want to deplete our yield or the future value growth by cutting too early."

Buy and Build Premium. In addition to the direct cash flow return generated from forestry activities, the return on forestry investments consists of an additional component: asset value growth determined by supply and demand for forestry assets, changes in the growing stock, and its composition, among other factors. The forestry team at United Bankers has employed the strategy of buying individual properties or small pools of properties to drive asset value growth through the 'buy and build' premium created when acquiring nearby properties to achieve operational synergies.

"Whereas many of our competitors are buying very large packages through a few transactions annually, we conduct 200 or 300 transactions annually, almost one transaction per day," explains Hietala. "This is a fairly different strategy, but we see that this buy and build strategy adds value in this acquisition process and we have been quite successful following this strategy with our previous funds." he elaborates.

> "You can neutralize emissions in the portfolio by investing in forestry investments; all our funds are carbon sinks."
>
> Jyri Hietala

NEW FUND, SIMILAR STRATEGY, WIDER FOCUS, AND DIFFERENT STRUCTURE

United Bankers manages approximately 150,000 hectares of timberland in the Nordic and Baltic Rim countries, with around 131,100 hectares in Finland, approximately 6,500 hectares in Estonia, 10,600 hectares in Latvia, and about 1,800 hectares in Lithuania. While its first two forest funds fully focused on the Finnish market, its third fund began broadening its geographical exposure into the Baltic countries. With the upcoming fourth launch, United Bankers will place more emphasis on the Baltic Rim countries and expand its geographical reach to new markets in Europe.

"One of the main differences between the new fund and the previous vintages is the broadening of the geographical scope in this new fund," says Hietala. "This fund will operate and focus on the Nordics and Baltics in addition to seeking new markets elsewhere in Europe such as Spain, Portugal, UK, and Ireland, among others," he explains. The expansion of focus is driven by the desire to allocate capital more efficiently in a significantly larger timberland market.

"The size of our investable universe in the timberland market will be much larger, allowing us to invest capital more efficiently and achieve higher diversification due to different markets and species," elaborates Kari Kangas. This diversity in markets and species serves as an additional risk management tool, according to Kangas. "Expanding the geographical focus enhances diversification across natural risks, which we consider the most severe risk in our line of work due to climate change," he elaborates. "When you go south to the Mediterranean, you encounter different natural risks, especially fires, and insects, so you must be prepared for these kinds of issues."

The forestry team at United Bankers does not blindly seek to expand its geographical reach. Instead, the team has a range of criteria that the new markets must meet before venturing into them. All of the forestry funds at United Bankers aim to generate an investment return of minimum four percent after all costs, considering that the expected timberland returns are between 4-5 percent in Finland and slightly higher in the Baltics. The new markets United Bankers plans to invest in need to meet the minimum return targets set by the UB team.

"We have conducted a preliminary screening of new markets and have already identified a few areas that seem quite attractive and meet our targets and criteria," says Hietala. First and foremost, every new market must meet the minimum yield target of four percent after all costs. But there are other criteria as well. "The roundwood markets need to be well-developed to ensure stable demand, and the forest market and the timberland market should be fairly liquid," he continues. "We also want to see other institutional investors investing in timberland in these markets, which indicates an actual market for timberland if we ever decide to realize some returns by selling properties."

EVERGREEN STRUCTURE

Unlike the previous vintages of UB's forest funds, which utilize a closed-ended fund structure with a predetermined lifespan, the upcoming UB Nordic Forest Fund IV will be an evergreen fund with an open-ended structure and no termination date, similar to UB Timberland Fund (AIF). This different structure will also lead to minor changes in the team's investment approach, particularly regarding the sale of properties. "Since we don't have a pre-defined term for exiting our investments to realize the 'buy and build' premium, we will opportunistically buy and sell properties to capture the premium," explains Hietala.

While the team can rely on the return stream from timber harvesting on a frequent basis, the return stream from the appreciation of forest properties can be captured only by periodically selling some properties and acquiring new ones. "The 'buy and build' premium and the appreciation of land value appreciation are not factors incorporated into the net asset value calculation for our investors," says Hietala. "If the land value increases, we will occasionally sell properties to realize the appreciation." This evergreen structure allows for a more opportunistic approach to capturing land value and 'buy and build' appreciation.

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VC and Growth Deals: High Level of Activity Continued in 2022

By Argentum

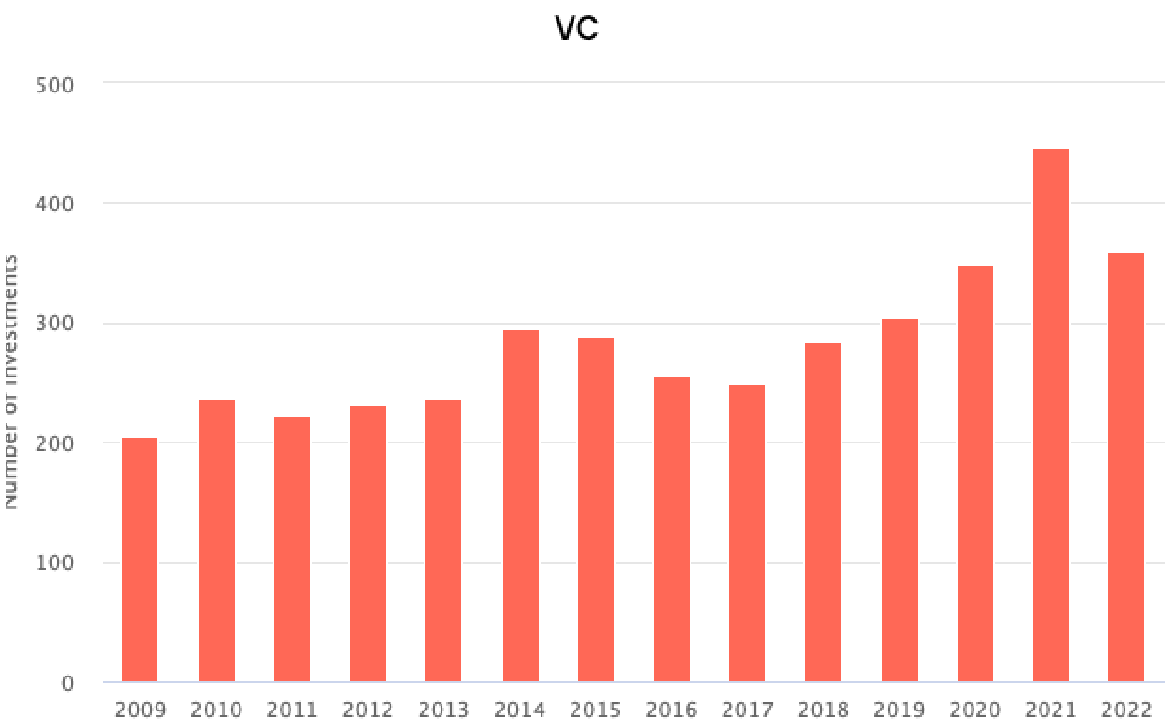
In 2022, 359 transactions were completed by venture funds in Nordic start-ups and growth companies. The amount invested in the segment remained high, with €2.2 billion in total. Compared to the average for 2017-2021, the invested amount was up 52 percent, but down 25 percent compared to 2021. The high activity level of 2021 continued in the first half of 2022, before slowing down in the second half of 2022.

"The Nordic venture and growth market has made impressive progress, with the number of deals exceeding 300 for the first time in 2019, and continuing to do so for four years in a row. Overall, we have seen an acceleration within the professionalisation of the venture sphere, driven by more venture firms and greater competition among them," says Espen Langeland, CEO of Argentum.

The number of venture deals remained high in 2022, after a record-breaking number of deals in 2021. The high activity level from 2021 was maintained in the first half of 2022. However, activity was reduced

Espen Langeland, CEO – Argentum

Figure 1: High activity: 2022 was a good year for investments in unlisted Nordic early phase companies, regarding the number of transactions and the invested amount.



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in the second half of the year. The activity did not experience a hard stop in the wake of uncertainty, even though activity slowed down somewhat in the second half of 2022. The number of venture and growth deals surpassed 300 for the first time in 2019, and for the fourth straight year, the number of deals was well above 300. The number of deals fell from 447 in 2021 to 359 in 2022, but the activity remained high. Compared to the previous five years, the number of investments is up 10 percent.

"Although there was a decrease in investment activity in the latter half of 2022, the Nordic venture and growth market continues to attract significant investment. The record-breaking amount of capital raised in 2022 has put many funds in a strong position to make promising investments in the coming years," says Espen Langeland, CEO of Argentum.

SEVEN OF THE TEN LARGEST DEALS INVOLVE TECH COMPANIES

Seven of the ten most significant transactions during the year were in the ICT sector, two were within the consumer sector and one was within cleantech. Eight of the ten largest deals were completed in the first half of 2022.

The ICT sector is still attracting the most investments from venture and growth investors. The sector attracted 55 percent of investments in the segment, which is about the same share of investments as in the previous two years. The share has stabilised at around 50-55 percent, after the five-year period of 2014-2018 in which the sector attracted around 60 percent. Compared to the number of deals in the previous five years, investments increased by 4 percent, but decreased by 10 percent compared to 2021.

GROWTH IN INDUSTRIALS

Industrials was the only major sector that experienced an increase in investments compared to 2021, with a record-breaking 39 deals. Industrials attracted 11 percent of venture and growth investments, compared to 8 percent in 2021. Compared to the average for the previous five years, this was an increase of 52 percent, and an increase of 11 percent compared to 2021.

Closely behind we find health care and life science and the consumer sector, each with 10 percent of investments. Both sectors attracted fewer investments than in 2021. Health care and life science investments fell by 23 percent compared to the average for the previous five years, and fell by 47 percent compared to 2021. Although investments in the consumer sector fell by 20 percent compared to 2021, investments in the sector are high compared to historical levels. Compared to the period 2017-2021, the average number of investments in the sector is up by 25 percent.

Financials is another sector that attracted a significant number of investments, attracting 7 percent of investments. This is a reduction of 42 percent from 2021, but the sector is still an important one for venture and growth deals.

UNCERTAINTY SPREAD IN THE SECOND HALF OF THE YEAR

Many of the GPs we have talked to referred to greater uncertainty in the market last year. Ingrid Teigland Akay, Founding Partner of Hadean Ventures, describes this as a turbulent year:

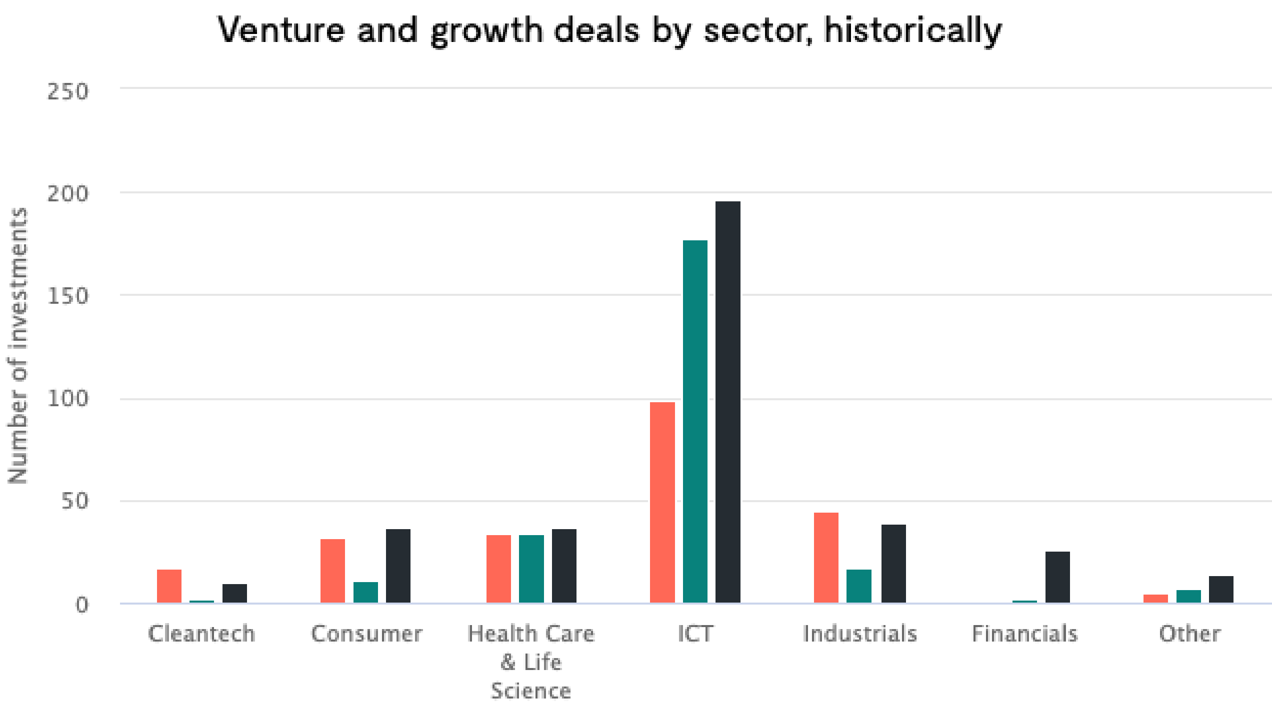
"It was a very turbulent year. A lot happened that created uncertainty in the market. We saw many of our peers slow down and become more cautious. When it came to investments, people sat on the fence to assess the situation. We were also a little cautious. Our investments last year were made at the beginning of the year, and were a result of long and thorough processes. We had a very strong deal-flow and worked on a number of processes throughout the year, but we saw that, in particular, syndication with other investors took longer than before," says Teigland Akay.

THE NORWEGIAN MARKET EXPERIENCES GROWTH

All Nordic countries experienced a decrease in the number of venture and growth deals except for the Norwegian market, which experienced a significant increase in the number of investments:

- **Norwegian** companies attracted 28 percent of the deals in the region, compared to an average of 17 percent in the previous five years. The number of transactions was 12 percent higher in 2022 than in the record year of 2021, and 82 percent higher than the average for the period 2017-2021.

Figure 2. New sector: Financials has only been counted as a separate sector in Argentum's tracking for the last couple of years, and the sector already has a significant market share.



- **Swedish** companies still attracted the most investments, with 125 investments in 2022. Sweden accounted for 35 percent of the market, with a decrease of 25 percent compared to 2021, but an increase of 2 percent compared to the previous five years.

- In **Denmark**, the number of investments fell by 46 percent in 2022, from an extraordinarily high level in 2021. Compared to the average for the previous five years, the reduction was 9 percent. Danish companies attracted only 16 percent of the venture transactions, which is lower than usual.

- Activity in **Finnish** VC experienced a moderate decrease of 10 percent in 2022 compared to 2021, and a 6 percent decrease compared to the average for the previous five years. The Finnish market did not experience particularly high activity in 2021, and the activity had remained quite stable for the previous five years.

If we look at the share of the invested amount, the distribution across the Nordic countries differs from the number of deals. Finland attracted the largest amount of investments, but Finland had the second lowest number of investments among the four Nordic countries. In other words, the average investment in Finnish companies was a lot larger than in the other countries. Norway is second in terms of the amount invested with 29 percent, which compares to the 28 percent when we look at Norway's share in terms of number of investments. Sweden attracted the highest number of investments but only 21 percent of the amount invested (see graph above). Denmark only attracted 14 percent of the amount invested.

FEWER NON-NORDIC GPS, BUT MORE DEALS BY NORWEGIAN GPS

Investments from Nordic GPs remained relatively stable, falling from 268 to 243 deals. Compared to 2021, the share of non-Nordic15 GPs fell considerably, from 40 percent in 2021 to 32 percent in 2022. However, the share of non-Nordic managers remained at levels seen in the years before 2021, and was high compared to historical levels. The number of US and UK investors fell considerably from 2021.

Figure 3. Norwegian growth: Activity in Nordic venture fell in 2022, but the Norwegian market experienced increased activity despite the overall fall in the Nordics. Activity in Denmark fell sharply, while the decrease was moderate in Sweden and Finland.

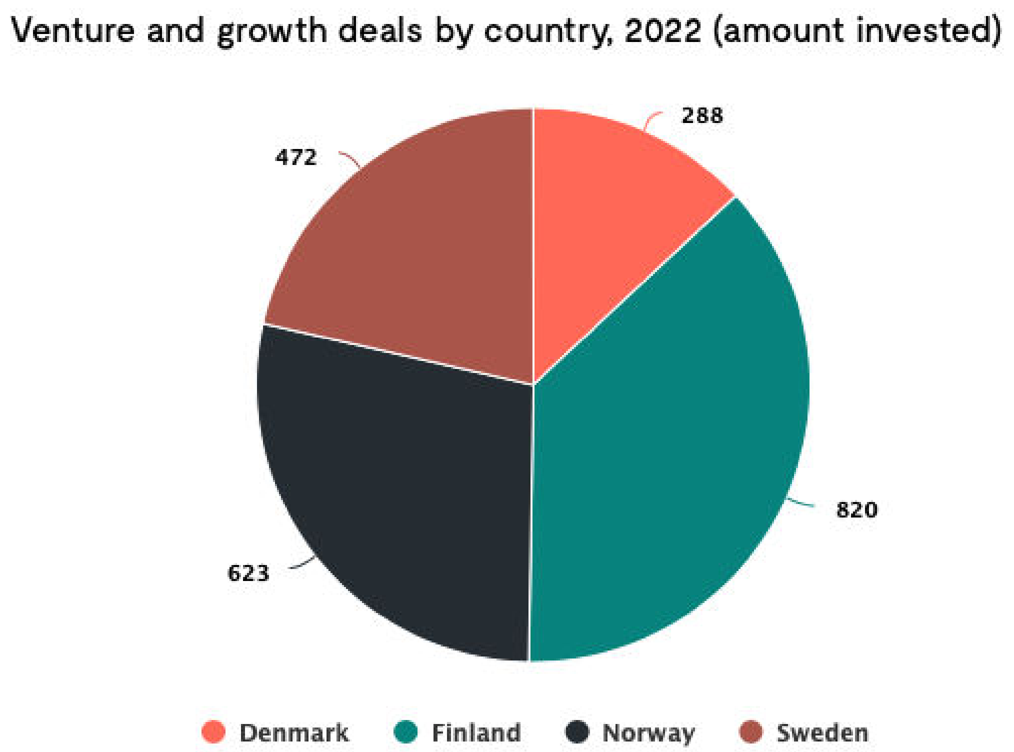
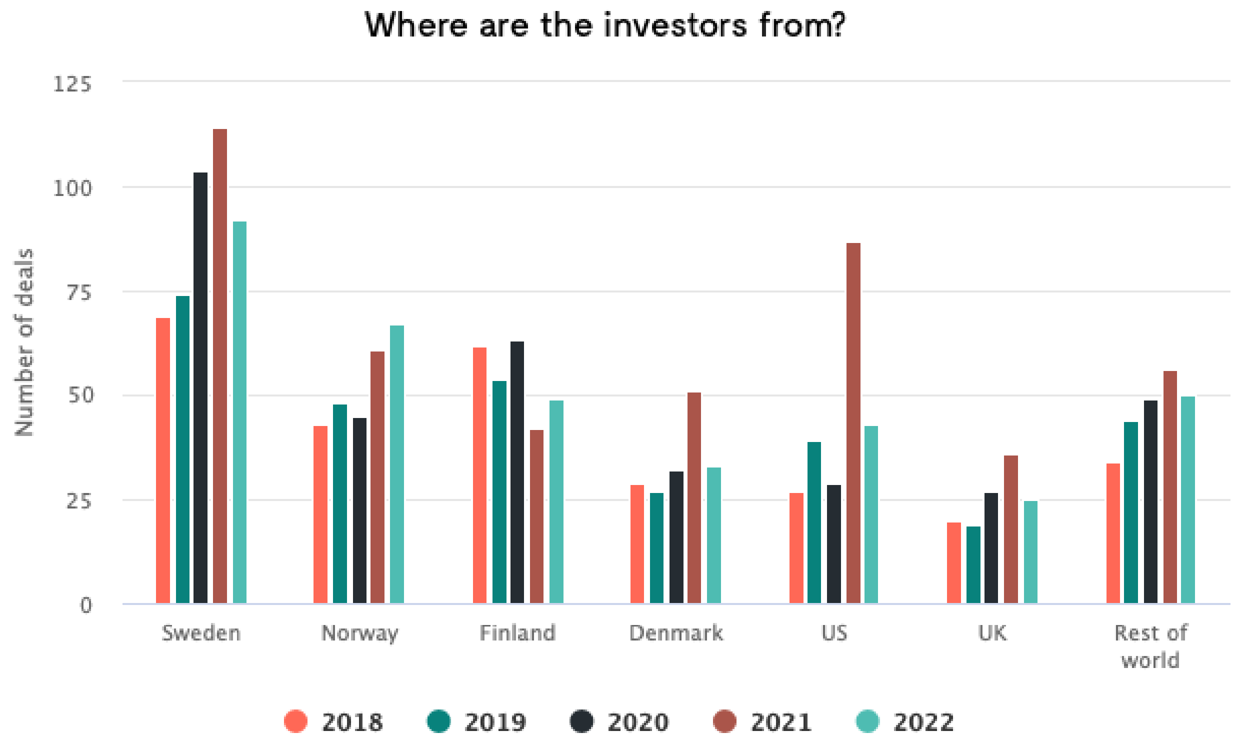


Figure 4. Active Norwegian fund managers: Norwegian fund managers made the most investments in Nordic venture and growth in 2022, with 19 percent of the Nordic market. The number of investments by US fund managers fell sharply by 51 percent, compared to 2021.



Investments from US GPs fell by 51 percent from 2021, and by 31 percent for UK GPs. Investments from GPs from the rest of the world experienced a more moderate decline of 11 percent.

Swedish fund managers were, as usual, the most active in 2022, making up 26 percent of venture investments. The number of investments remained stable, decreasing from 114 in 2021 to 92 in 2022. Compared to the average for the previous five years, the number of investments from Swedish GPs was up 5 percent.

For the first time, the Norwegian GPs were the second most active in the Nordics. Norwegian fund managers accounted for 19 percent of Nordic venture deals. Investments from Norwegian GPs increased by 10 percent from 2021 and, compared to the average for the previous five years, the number of investments was up by 38 percent.

Finnish fund managers also increased their investments in Nordic venture, up by 17 percent compared to 2021, but down by 9 percent when compared to the average for the previous five years. The number of investments from Danish GPs fell by 35 percent compared to 2021, but increased by 1 percent compared to the average for the previous five years.

The article is originally part of Argentum's State of the Nordic Private Equity 2022. The report is based on data from Argentum, as well as publicly available data and media coverage.

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Private Debt: An Asset Class that Benefits from Volatility

By Jussi Tanninen and Matias Hauru – Mandatum Asset Management

Matias Hauru, Senior Portfolio Manager Private Debt – Mandatum Asset Management

Mandatum Asset Management (MAM) takes a diversified approach to its Private Debt programme. With over fifteen years of private debt experience, we believe that diversification is particularly critical as the asset class is so complex. Historically, our Private Debt programme allocation is split almost evenly between direct lending strategies and opportunistic strategies, with further diversification by sub-segments and geographies.

The different risk/return and cash flow profiles of direct lending and opportunistic strategies balance the programme in different market situations. For example, direct lending strategies, including large cap, sponsor-backed and non-sponsor transactions, provide a steady cash flow and return profile from coupons and arrangement fees. On the other hand, opportunistic strategies, including primary short-term loans and secondary loans from banks' balance sheets, can take advantage of downturns and thus provide outsized returns.

We advocate allocating to a programme with both direct lending and opportunistic strategies on a rolling basis. A systematic vintage allocation will ensure a diversified portfolio of existing investments along with a constant level of dry powder. While existing investments behave in different market conditions predominantly like investments in other asset classes, a programme with dry powder benefits from volatility. For example, deploying capital in an active M&A market may not result in as strong performance given increased competition; however, committing capital in a volatile, but not recessionary, environment can lead to attractive investments for the programme. As a result, we believe it is necessary to understand how both existing and new investments perform across strategies and markets.

EXISTING INVESTMENTS BEHAVE PREDOMINANTLY LIKE OTHER ASSET CLASSES IN DIFFERENT MARKET CONDITIONS

Normal Market Conditions

In normal market conditions, as in 2016-2019, both direct lending and opportunistic strategies perform in line with expectations.

- Direct lending strategies – Strategies generate stable and predictable returns with low default rates
- Opportunistic strategies – Similarly, returns for opportunistic strategies are in-line with long-term averages, but return generation is dependent on the underlying company rather than the market

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Figure 1. Private Debt investments across market conditions.

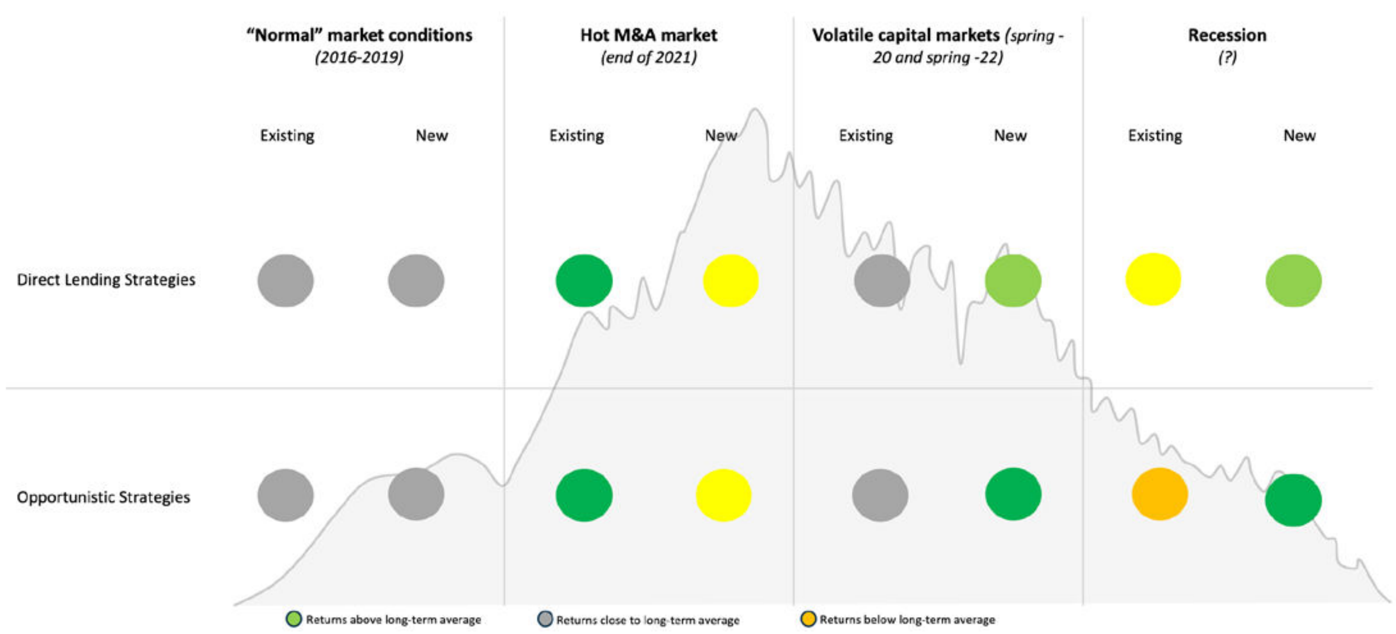
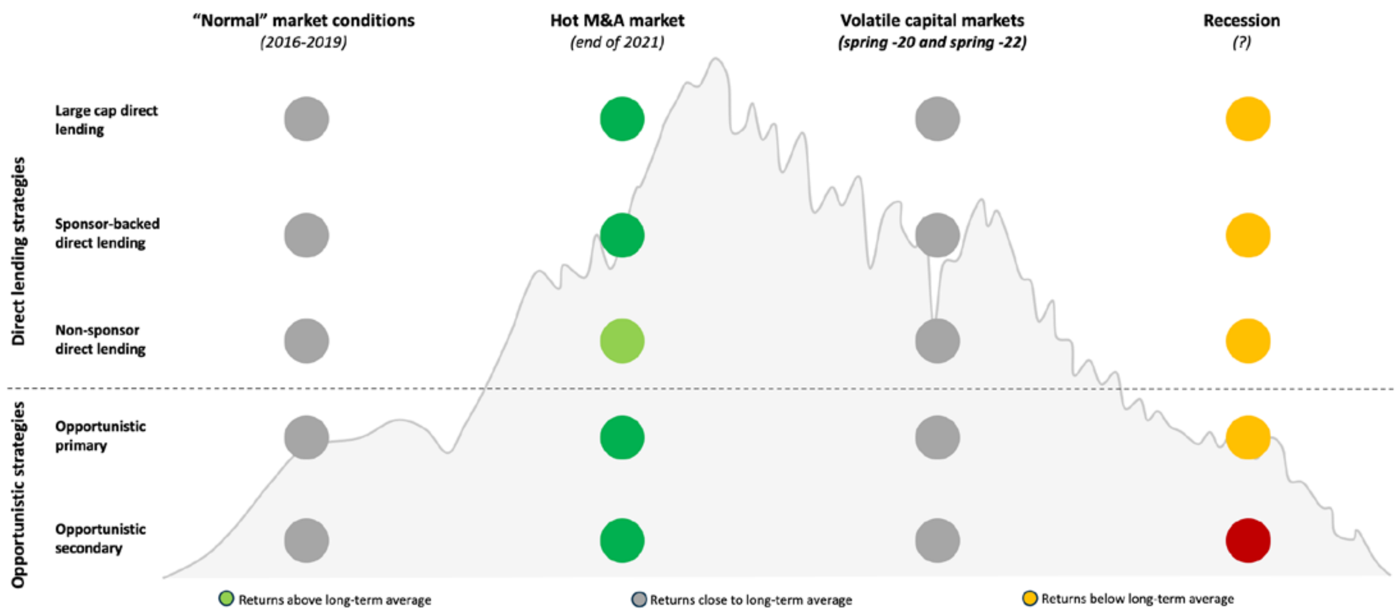


Figure 2. Existing investments across market conditions.




Jussi Tanninen, Head of Private Debt and Real Estate – Mandatum Asset Management

Hot Market

In a hot market, similar to the end of 2021, the M&A market was very active and asset valuations were high. Existing investments generally demonstrate strong outperformance, but due to different underlying reasons.

- Direct lending strategies – In particular, IRR increases in large cap and sponsor-backed transactions due to pre-payment fees and shorter holding periods, while credit losses remain minimal. In non-sponsor direct lending, outperformance remains strong as well, however, not as significant as compared to large cap and sponsor-backed given their higher correlation to the M&A markets

- Opportunistic strategies – Returns in primary transactions tend to increase due to equity upside, for example, and secondaries have a similar uptick due to increased company profitability and the potential for early exits given market dynamics

Volatility

The springs of 2020 and 2022 were characterized by volatile capital markets and lower M&A activity as the markets reacted to COVID-19 and the war in Ukraine, respectively. Existing investments perform in line with averages despite the market volatility.

- Direct lending strategies – Returns may decrease during volatility, as compared to a "hot" market environment, but are still generally in line with long-term averages. IRRs tend to decrease marginally as holding periods increase, and credit losses remain small. Quarterly valuations tend to be affected by capital market movements

- Opportunistic strategies – Credit losses remain small, although the value of equity upside components and early exits are decreasing. The profitability of companies remains strong

Recession

Heading into a potential recession or period of increasing credit risk, existing investments will struggle as expected given the market conditions.

- Direct lending strategies – During a recession, we see that the number of defaults is increasing, particularly in smaller and non-sponsored deals, but recovery rates continue to be higher due to better loan documentation and lower entry leverage. The asset class remains relatively strong (compared to other asset classes) due to the defensive nature of investments, but portfolio construction and selecting strong managers remains crucial to navigating challenging market conditions

- Opportunistic strategies – Similarly, credit losses increase although opportunistic early investments with strong profits provide buffer for potential credit losses. Opportunistic secondaries are most significantly affected as investments are typically made in challenged businesses as a starting point

NEW INVESTMENTS CAN BENEFIT FROM MARKET VOLATILITY

Normal Market Conditions

In normal market conditions, as in 2016-2019, both direct lending and opportunistic strategies perform in line with expectations.

- Direct lending strategies – Strategies generate stable and predictable returns with low default rates

- Opportunistic strategies – Similarly, returns for opportunistic strategies are in-line with long-term averages, but return generation is dependent on the underlying company rather than the market

Hot Market

In a hot market, similar to e.g. the end of 2021, the M&A market was very active and asset valuations were high. New investments are made in line with or below averages given increased competition in the capital markets.

- Direct lending strategies – Deploying capital into large-cap direct lending can lead to muted returns given significant competition and weaker documentation. Sponsor-backed, or mid-cap, transactions may perform slightly better as direct lending funds are more competitive against banks

- Opportunistic strategies – Return expectations for new investments are unchanged but the types of deals are different; generally, there are limited secondary opportunities from liquid markets with the possibility for deal flow from bank balance sheets

Volatility

The springs of 2020 and 2022 were characterized by volatile capital markets and lower M&A activity when the markets reacted to COVID-19 and the war in Ukraine, respectively. Significant opportunities can be found when making new investments in opportunistic strategies.

- Direct lending strategies – Strategies closer to the capital markets, like large cap direct lending, benefit from market volatility, but deployment becomes slower in sponsor-backed and non-sponsor direct lending due to less activity in the M&A market

- Opportunistic strategies – Significant opportunities across primaries to fix problems but also offer capital for offensive plays. Forced sellers and liquid credit markets also provide significant opportunities

Recession

Heading into a potential recession or period of increasing credit risk, the access to dry powder has the potential to lead to significant outperformance.

- Direct lending strategies – Banks decrease their supply of debt financing, leading to more opportunity for strong direct lending funds to invest in large-cap and sponsor-backed direct lending. The best opportunities in a challenging environment come from smaller and non-sponsored businesses where debt financing is even more difficult to get from traditional sources

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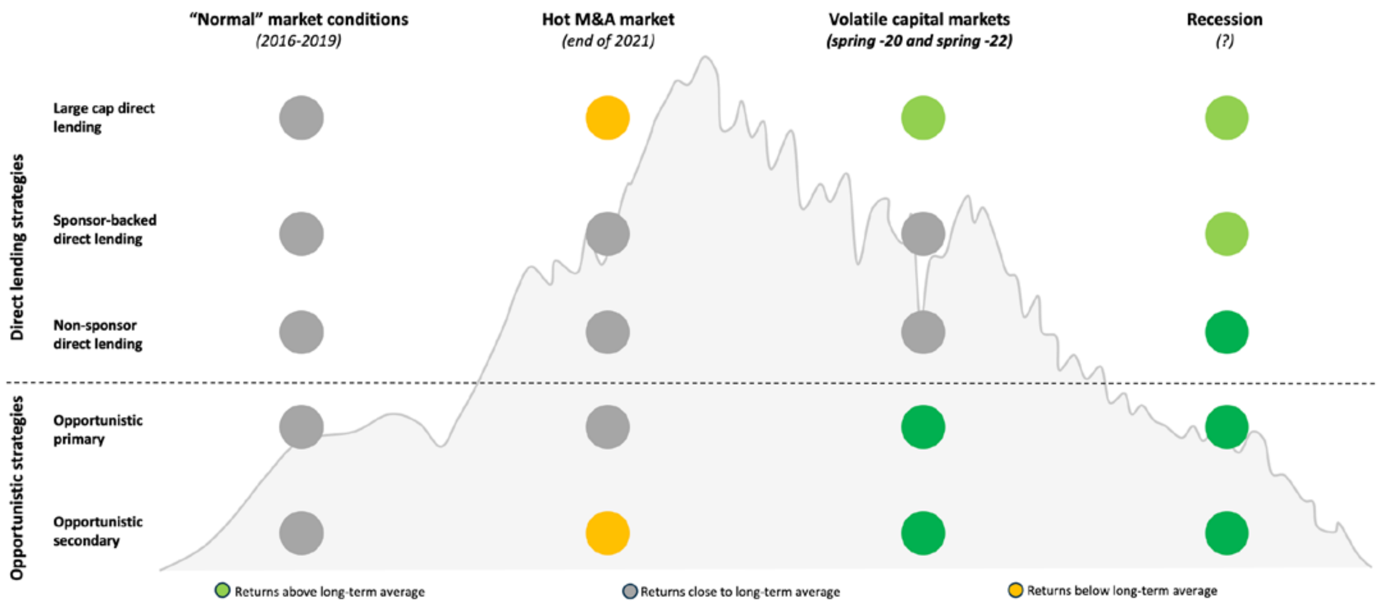
Figure 3. New investments across market conditions.



- Opportunistic strategies – Significant and attractive opportunities across both primaries and secondaries, including senior secured debtor-in-possession financing and debt-for-equity

CONCLUSION

Private debt offers attractive opportunities across markets as existing and new investments, along with underlying private debt strategies, perform differently depending on market conditions. A systematic commitment to a diversified programme allows an investor to essentially put their private debt allocation on "autopilot". Commitments can thus be allocated to and pivoted between direct lending and opportunistic strategies based on market conditions, without further action from the investor, to create a balanced programme that provides attractive risk-adjusted returns across market cycles.

This approach to private debt investing was critical during the pandemic in the spring of 2020. With many forced sellers and limited M&A activity for our direct lending funds, we deployed our clients' commitments into opportunistic strategies. As a result, our programme was meaningfully invested during a period of volatility, generating strong returns, steady cash flows and predictable capital calls.

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Miguel Zurita, Co-Head of Private Equity, chair ESG Committee – AltamarCAM

The Private Market's Role in ESG Transformation

By Eugeniu Guzun – HedgeNordic

> "The private market investor has a lot to say in the sustainable transition."
>
> Miguel Zurita

The field of environmental, social, and governance (ESG) investing has evolved and matured to the point where corporations, politicians, regulators, and investors can greatly accelerate market and business transformation for the better. With the luxury of long-term thinking and commitment, private market investors like AltamarCAM Partners believe they are well-placed to incorporate sustainable investment ideas and steer businesses and industries in the right direction.

"The international and European agenda is currently dominated by challenges such as energy transition and resource scarcity. Very ambitious targets have been set for the next few years, requiring the deployment of billions in additional investments that far exceed the capabilities of the public sector," notes Miguel Zurita, AltamarCAM's Co-Head of Private Equity and chair of the firm's ESG Committee. "In this context, private investors play an increasingly important role, becoming the perfect ally to complement public investment and achieve the necessary goals."

Due to the long-term nature of private market investments and the scope to shape the direction of underlying investments, private market investors can use their influence to accelerate ESG commitments and sustain the momentum behind ESG investing. "The private market investor has a lot to say in the sustainable transition," argues Zurita. "At AltamarCAM we are closely following this moment of inflection in the sector, and we want to push beyond merely playing a participatory role in the progressive adaptation to this new "green" reality. Our aspiration is to position ourselves as a driver of change in the industry," he emphasizes.

As one of Europe's leading asset managers in private markets, AltamarCAM has invested with over 400 GPs, spanning Private Equity, VC, Private Debt, Infrastructure and Real Estate strategies, and with this reach comes influence and, above all, responsibility. "We maintain very close relationships with the managers we work with," says Zurita. "We strive to raise awareness of ESG issues through continuous engagement with both GPs and LPs."

AltamarCAM positions itself as a responsible investor, integrating ESG criteria in its investments across all asset classes, while also seeking to stimulate innovation within specific sectors tackling global challenges such as energy transition or access to healthcare. The asset manager has launched a real assets fund investing in targeted sustainable megatrends, including the growing need for healthcare, smart cities, digital transformation and decarbonization, among others. Separately, Zurita highlights AltamarCAM's activities in the Healthcare space, where they are going to launch a new direct-investment fund focused on impact investment opportunities. "Our holistic approach allows us to align ourselves with best sustainability practices," comments Zurita. "It also allows us to take advantage of commercial opportunities stemming from a growing appetite among our investors for sustainable funds."

ESG AND INVESTMENT PERFORMANCE

One argument often heard in ESG discussions is that "doing the right things" comes at a cost and dampens performance. A growing body of research however suggests that companies may be helping the bottom line by improving their ESG performance. "At AltamarCAM, we understand the impact ESG factors have on an investment over the long term, which is also determined by the environmental, social, and governance performance," explains Zurita. "For this reason, ESG factors are an integral part of our investment process and are always considered when evaluating potential opportunities. We are building ESG analysis into the investment Due Diligence process, while also giving great importance to our dialogues and ongoing engagement with fund managers and underlying companies, which are key to improving their ESG commitment in the long term."

Businesses and investors alike appear to have realized that incorporating ESG factors into their business models and investment processes is not only a necessary cost of satisfying the modern customer, but also brings financial rewards. One consideration does not need to supplant the other when allocating capital. "As stewards of capital, our ESG approach is characterized by our fiduciary duty to our investors, as well as our sense of responsibility as a company to our employees and other stakeholders," emphasizes Zurita. "We believe that generating strong returns in a responsible and sustainable manner that benefit for example pensioners or insurance premium holders that have invested in it, which is in itself a way to contribute to society and give a clear example of good practice."

ESG AS A MEGATREND

The integration of ESG factors into the investment process has gained momentum over the last decade, with ESG emerging as a key investment theme. "We could say that ESG is a megatrend on its own, which, in addition to dominating the global risk map, has created a range of tailwinds," argues Jörg Höller, Chief ESG Officer at AltamarCAM. "These tailwinds present very attractive investment opportunities."

Höller views the fight against climate change as the main environmental, social, or governance challenge faced by investors. "There is no doubt that the fight against climate change is the main challenge. In this regard, more and more initiatives are promoting transparency and regulatory pressure is leading investors to adopt a much more proactive role in emissions management," says Höller.

> "We could say that ESG is a megatrend on its own, which, in addition to dominating the global risk map, has created a range of tailwinds. These tailwinds present very attractive investment opportunities."
>
> Jörg Höller

AltamarCAM has also been intensifying its efforts around measuring and reducing their own CO2 footprint. "Since 2019 we have been carbon neutral at an operational level. At the portfolio level, despite the inherent difficulty we experience as a fund of funds manager, we conduct climate analyses aligned with international benchmark standards," says Höller. To accelerate its efforts associated with combating climate change, AltamarCAM has adhered to the Task Force on Climate-Related Financial Disclosures (TCFD), the Initiative Climat International (iCI), as well as the Institutional Investors Group on Climate Change (IIGCC). "To face this unprecedented challenge we must engage with the leading initiatives in the field

Jörg Höller, Chief ESG Officer – AltamarCAM

and keep up to date with all the new developments affecting our market," argues Höller.

Going beyond the E and G aspects of ESG, an important issue in the asset management industry under the social pillar is the lack of diversity, according to Höller. "Internally, diversity is one of the most important drivers in our industry," says AltamarCAM's Chief ESG Officer. "This sector has traditionally been male-dominated, and while significant progress has been made, there is still a long way to go," he emphasizes. As of June 2023, 42 percent of AltamarCAM's workforce are women. "We continue to work on formalizing processes and career plans that will allow us to continue improving these statistics," says Höller. "We are also very conscious of understanding and managing diversity in the broadest sense of the term, and are developing specific projects that will enable the identification of all the implications that the concept of "diversity" has for us."

Zurita and Höller are proud of the progress AltamarCAM has made so far, and themselves represent two key figures within the wider organisational ESG framework within the business, which counts on a firm-wide ESG committee and steering group in addition to the dedicated ESG team. The results of the latest PRI report on AltamarCAM, which awarded four- and five-star ratings across all reported categories, are a testament to what has been achieved. "ESG is at the core of our corporate culture and investment DNA, and is a fundamental characteristic of our role as a trusted advisor. We are convinced that it offers long-term financial opportunities," affirms Zurita. "We are doing everything we can to ensure we have the resources and strategies in place to best serve our employees, investors and society as a whole."

AltamarCAM Partners

- A leading independent private asset manager and solutions provider
- AUM: €17.5b
- +19 years of experience
- Asset Classes: Private Equity, Venture Capital, Life Sciences, Infrastructure, Real Estate, Private Debt
- Office Locations: Madrid, Cologne, New York, Barcelona, London, Munich, Santiago de Chile

Diversification and Alternatives Pay off for the AP Funds

By Eugeniu Guzun – HedgeNordic

> "AP2's portfolio showed resilience. Our non-listed assets performed better than our listed assets…Over time, we've built our portfolio for situations like the one that arose in 2022."
>
> Eva Halvarsson

Sweden's four buffer funds, the First, Second, Third, and Fourth AP Fund, reported record combined profits of SEK 316 billion in 2021, after earning an average return of 19.3 percent after expenses. However, the following year proved to be challenging for the four AP funds, as both equity and fixed-income investments significantly impacted their performance. Fortunately, their allocations of alternative investments – both listed and unlisted assets – acted as a stabilizing force in their overall portfolios.

The buffer funds, also known as the AP Funds, play an essential role in the Swedish pension system. Their main task is to manage the buffer capital for the state income pension system. Currently, the buffer capital constitutes in and around one-seventh of the pension system's assets and is used when annual contributions to the system fall short of disbursements. Although each fund operates independently with separate management plans, investment, and ownership policies, AP1, AP2, AP3, and AP4 all share the common objective of managing about 15 percent of the pension assets.

Starting from 2019, new investment guidelines were implemented for the AP Funds. The maximum allocation to illiquid assets was raised to 40 percent, removing the previous restriction of a maximum of five percent for unlisted or illiquid assets. This change enabled the funds to choose from a broader spectrum of opportunities in alternative assets, particularly unlisted assets. Their allocation to alternatives, including unlisted assets, proved beneficial in countering losses in equity and fixed-income investments during the challenging market conditions of 2022.

AP1

AP1, which oversees SEK 421 billion in assets under management as of the end of 2022, invests in several classes of assets, mainly equities and fixed-income securities, but also allocates 28.6 percent to alternative investments, such as real estate, infrastructure, and private equity. Despite the positive contribution from its portfolio of alternative investments, negative contributions from fixed-income and equity investments resulted in a negative return of 8.6 percent in 2022.

AP1's allocation to real estate, which stood at SEK 74.4 billion at the end of 2022, returned 7.4 percent in 2022, while infrastructure investments returned 9.8 percent. Real assets, which include unlisted investments in real estate and infrastructure, comprise about 19.6 percent of AP1's total portfolio. Its investments in private equity funds amounting to SEK 33.1 billion, on the other hand, returned 2.1 percent in 2022. All in all, the return contribution from alternative investments reached SEK 7.4 billion, which in addition to the contribution of SEK 19.2 billion from foreign exchange and SEK 3.3 billion from the absolute return mandate, helped offset some of the losses stemming from equity and fixed-income investments.

"Diversification allows improved, risk-adjusted returns and successful diversification requires deep understanding of the forces underlying and driving investments," writes the team at AP1 in its annual report for 2022. "An improved, risk-adjusted return is achieved through diversification within and between assets, risk premiums, risk factors, strategies and investment horizons."

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AP2

Andra AP-fonden (AP2) reported a negative return of 6.7 percent after costs for 2022. While equities and fixed-income assets suffered due to war in Europe, rising inflation and interest rates, AP2's non-listed assets achieved a positive return. Alternative investments, including unlisted real estate (including timberland and farmland real estate), private equity funds, sustainable infrastructure, Chinese A-shares, alternative risk premiums, and private debt, generated a positive return of 11.8 percent (5.1 percent reflecting currency hedging). The contribution to the fund's return for 2022 reached 3.5 percent.

"2022 was a very turbulent year in several respects. However, AP2's portfolio showed resilience. Our non-listed assets performed better than our listed assets, which was also in line with our expectations," says Eva Halvarsson, CEO of Andra AP-fonden. "Over time, we've built our portfolio for situations like the one that arose in 2022. We've placed great value on spreading the risks as far as possible between different types of asset classes and markets, between listed and non-listed assets and between different management models," she continues. "Our assessment is that, over time, this creates a good and stable return, in line with our long-term mission."

AP2 had 36 percent of its SEK 407 billion portfolio allocated to alternative investments at the end of 2022, reflecting an 18.5 percent allocation to real estate, 12 percent to private equity, 2.0 percent to Chinese A-shares, 1.6 percent to alternative risk premiums, 1.8 percent to sustainable infrastructure and 0.4 percent to alternative credits. The fund's real estate portfolio, excluding timberland and farmland real estate, returned 6.5 percent. The portfolio of timberland and farmland, on the other hand, returned 15.4 percent. The private equity portfolio delivered a return of 3.6 percent for the year. Alternative risk premiums booked a loss of 4.6 percent, while the return on sustainable infrastructure assets reached 17.2 percent.

"Over time, long-term, focused efforts have created the ability to generate and pick alternative investment opportunities across the various alternative asset classes," writes AP2 in its annual report. "For example, the sustainable infrastructure asset class, which was only established three years ago, performed very well and the investments made have appreciated much more quickly than the Fund initially expected."

AP3

In 2022, AP3 experienced its first year of negative returns since 2011 with a decline of 5.8 percent after accounting for expenses, following an advance of 20.7 percent in 2021. However, AP3's alternative investments returned 8.9 percent in 2022, mainly due to investments in infrastructure and timberland. These alternative investments, which encompass private equity funds, property, infrastructure assets, forests, and insurance risk, constitute 34.9 percent of AP3's portfolio of SEK 468 billion. Of the 34.9 percent of the AP3 portfolio that is held in alternative investments, 33.3 percentage points relate to unlisted investments.

"The overall characteristics of the portfolio provided resilience during a challenging year," says Staffan Hansén, the CEO of AP3. "The alternative investments in real estate, infrastructure, timberland and private equity funds, which make up 35 percent of the portfolio, generated a total return of 8.9 percent. This offset the negative returns on listed equities and fixed income assets and demonstrates that portfolio diversification is serving its purpose."

AP3's real estate portfolio, valued at SEK 87 billion – equivalent to 18.6 percent of the portfolio, returned 10.1 percent in 2022. Infrastructure investments, which amounted to SEK 25 billion, or 5.4 percent of the broader portfolio, delivered a return of 14.4 percent. Timberland investments, representing 3.1 percent of the portfolio, yielded a return of 15.8 percent last year. However, the allocation to private equity funds, amounting to SEK 34.9 billion or 7.4 percent, returned only 0.8 percent in 2022 following a return of 62.8 percent in 2021.

AP4

The Fourth Swedish National Pension Fund (AP4) experienced a much more difficult 2022 after recording a negative return of 11.9 percent after costs for the entire year. This was the third toughest year for AP4 since the start of the new pension system in 2001. "AP4 needs a relatively high share of equities in its asset allocation to best fulfil its mission over the long term as a buffer fund in the income pension system," says Niklas Ekvall, the CEO of AP4. "This means that we also need to be prepared for the possibility of having comparatively large swings in our result from one year to another, and also to have an acceptance for large, negative results in individual years."

With an investment portfolio valued at approximately SEK 528 billion, AP4 does not have a separate alternative assets portfolio. Instead, AP4 focuses on the underlying drivers behind each asset class and does not differentiate between exposures based on different forms of listing. The AP4 team considers private equity as part of the equity allocation and private debt as part of the fixed-income allocation. However, AP4 recognizes real assets, such as real estate and infrastructure, as a distinct asset class generally associated with long-term and comparatively stable cash flows along with built-in protection against inflation. AP4 had about 18.2 percent of its portfolio allocated to real assets at the end of 2022, primarily consisting of unlisted property companies and infrastructure investments.

In 2022, real assets generated a negative return of 0.6 percent, compared to the 24.1 percent return recorded in 2021. Over a five-year period, the portfolio averaged an annual return of 14 percent. Looking at other unlisted investments beyond the portfolio of real assets, unlisted credits generated a return of 6 percent in 2022 and over a five-year period, the average annual return was 5.8 percent. Unlisted equities, however, experienced a negative return of 0.6 percent in 2022, contrasting with the 45 percent return achieved in 2021. Over the course of five years, the average annual return for unlisted equities was 20.6 percent.

CONCLUSION

The AP Funds implemented new investment guidelines in 2019, lifting the cap that previously limited the amount the state pension funds could invest in unlisted assets. The five percent cap limited their ability to invest in unlisted assets and thereby the ability to diversify their portfolio properties and improve risk-adjusted returns. The lifting of this cap allowed the state pension funds to better navigate the challenging market conditions of 2022.

"The overall characteristics of the portfolio provided resilience during a challenging year. The alternative investments in real estate, infrastructure, timberland and private equity funds, which make up 35 percent of the portfolio, generated a total return of 8.9 percent."

Staffan Hansén

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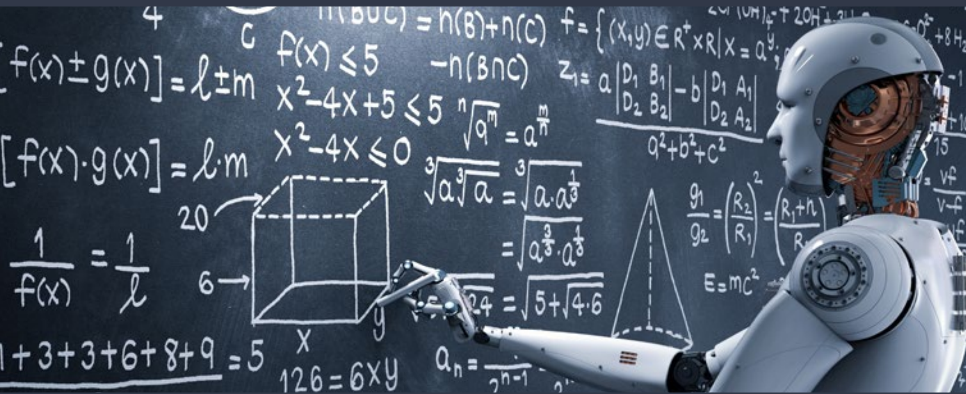

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