# COVID-19:
# Impact on Closed-End Alternative Investing
# Follow-up, Fall 2020

September 30, 2020

PROBITAS RESEARCH™

# The Current Situation

- The COVID-19 pandemic has spread rapidly but its affects are falling or rising in different geographies at different times, affecting institutional investors in different ways depending upon the location of their offices

- There are strong fears that a global second wave is coming this fall in the Northern Hemisphere just as the Southern Hemisphere comes out of its winter

- This presentation is a snapshot of what is happening at this specific point in this evolving crisis, focused on its impact on the closed-end fund alternative investment market – specifically for funds and co-investments targeting private equity, performing debt, distressed debt, real estate, infrastructure and natural resources

- This analysis is based upon the results of a targeted Internet survey of institutional investors that was taken between September 2nd and September 17th, with comparison to the results of a similar survey we did in late April and with additional insight from ongoing conversations with investors by Probitas' professionals over the last five months

# Overview: Investor Focus in April

- In late April, the pandemic was in its early stages, and many investors were heavily focused on the impacts on their current closed-end alternative investments due to the knock-on affects of the dramatic public market declines in March
  - Much more time was spent with their current fund managers reviewing the valuations of the investments and their liquidity needs, their plans to deal with companies under stress, and the potential liquidity needs of the GP's funds themselves

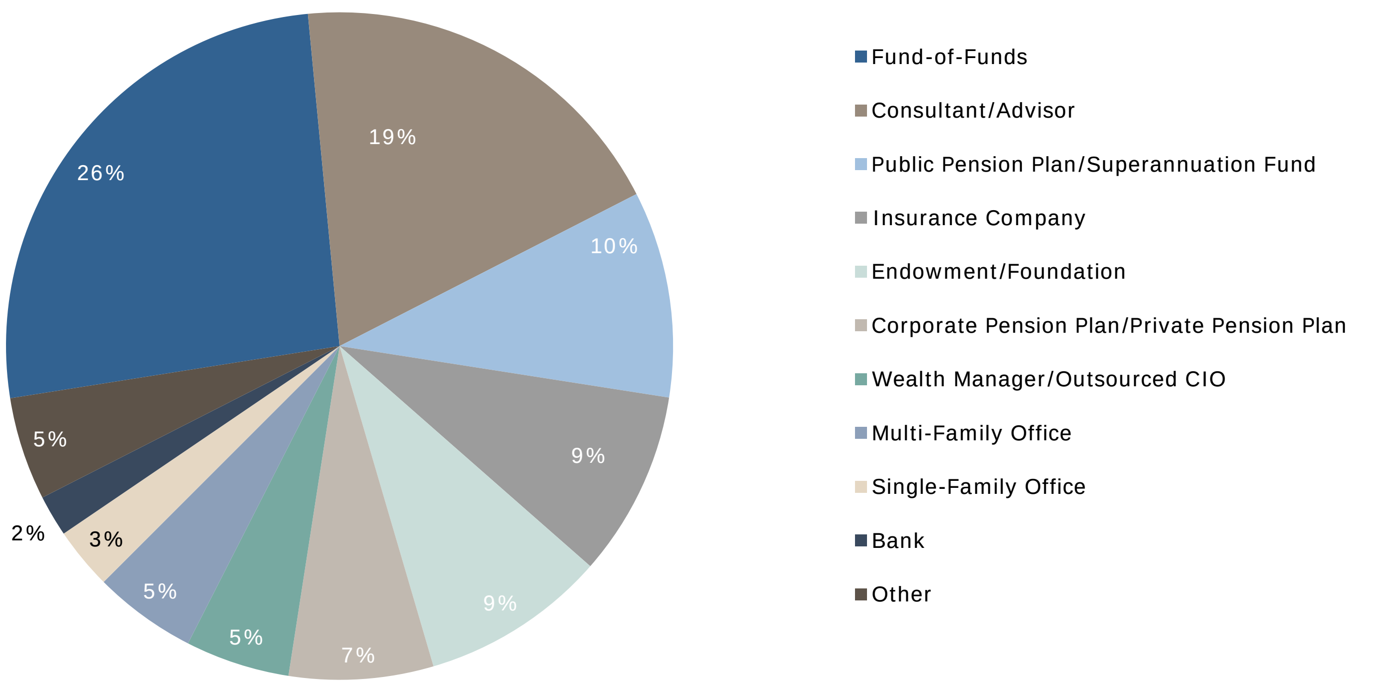
- Even with these concerns, LP's continued to invest, looking to avoid mistakes made during the Great Financial Crisis when many institutions dramatically slowed investing to manage the impacts of the "denominator effect" on their portfolio allocations – resulting in their missing investment opportunities as the market re-bounded

- At this point, as far as new commitments there was a heavy concentration by investors on:
  - Deals already in process where they had met the fund manager
  - Re-ups with fund managers they already knew well
  - And a limited focus on new opportunities in special situations/distressed debt and secondaries

# Survey Respondents by Type of Institution

- For this snapshot survey, we received nearly 60 responses from a varied group of investors including fund-of-funds, pension plans and insurance companies
- Our insights into what was happening behind the numbers are driven by insights gleaned from numerous conversations with investors over the last five months

**Chart I Respondents by Institution**
I represent a:

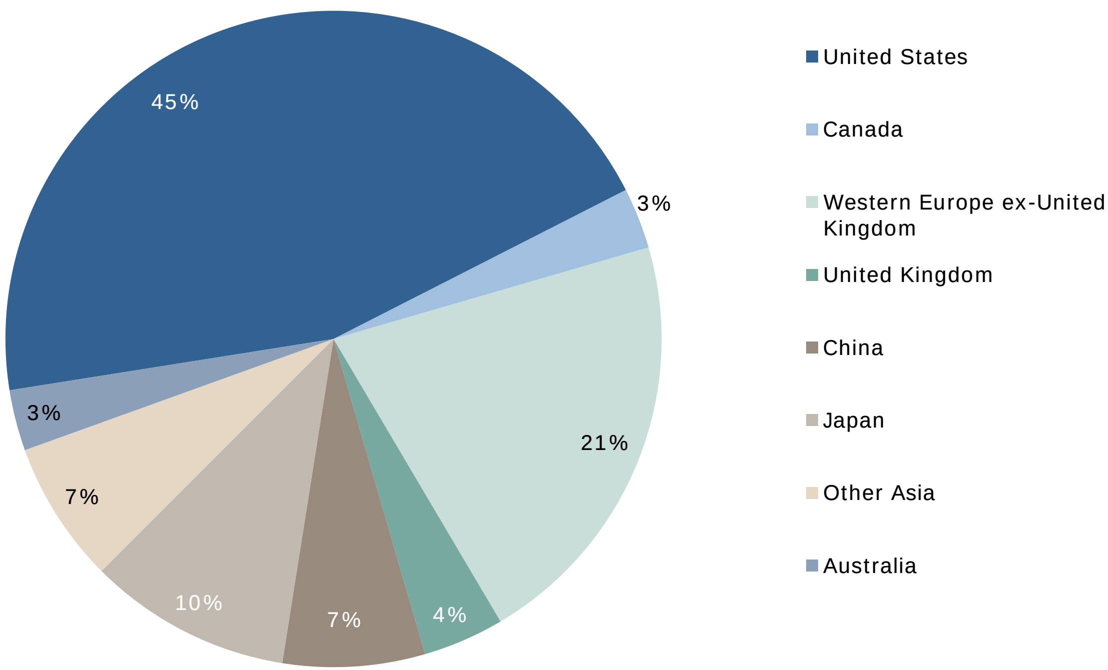



*Source: Probitas Partners' Impact of COVID-19 Survey: Follow-up*

# Survey Respondents by Geography

- Nearly half of the respondents were from North America, the most established closed-end fund alternatives market, with the rest of the responses split between Asia and Western Europe
- There were fewer respondents from China compared to last April's survey

**Chart II  Respondents by Firm Headquarters**
My office is located in:

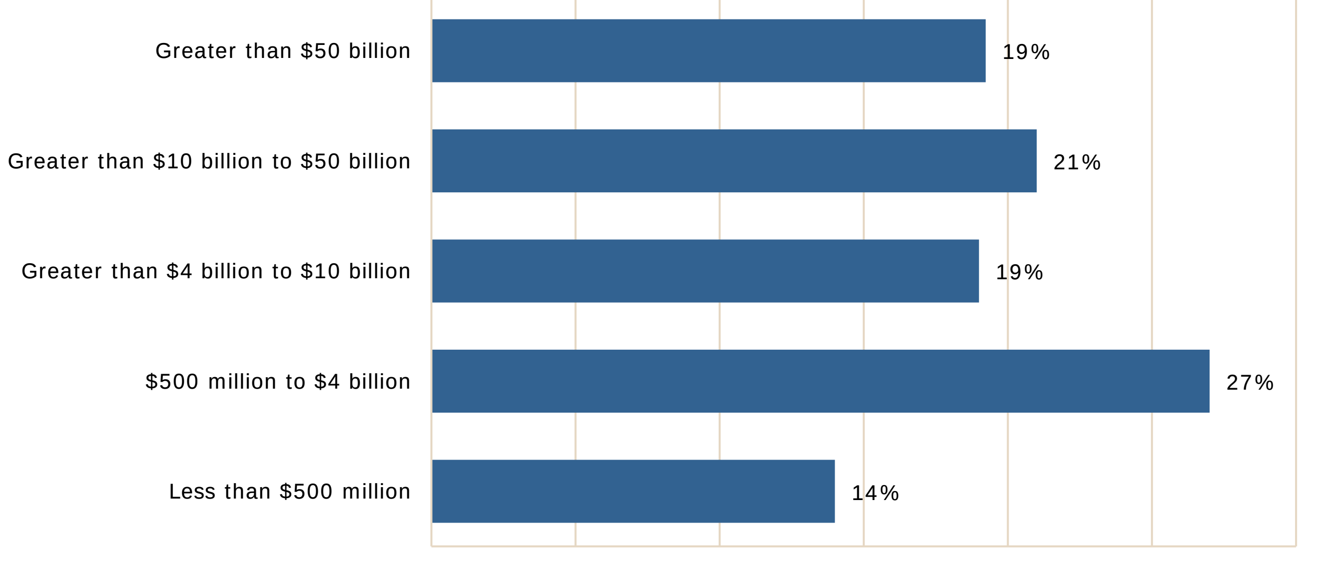



*Source: Probitas Partners' Impact of COVID-19 Survey: Follow-up*

# Survey Respondents by Assets Under Management

- Investors of various sizes responded to the survey, providing a diversity of views
- Larger investors are more likely to be active in such areas as co-investments and real assets, and are more likely to have very diverse portfolios; smaller investors often have more targeted portfolios

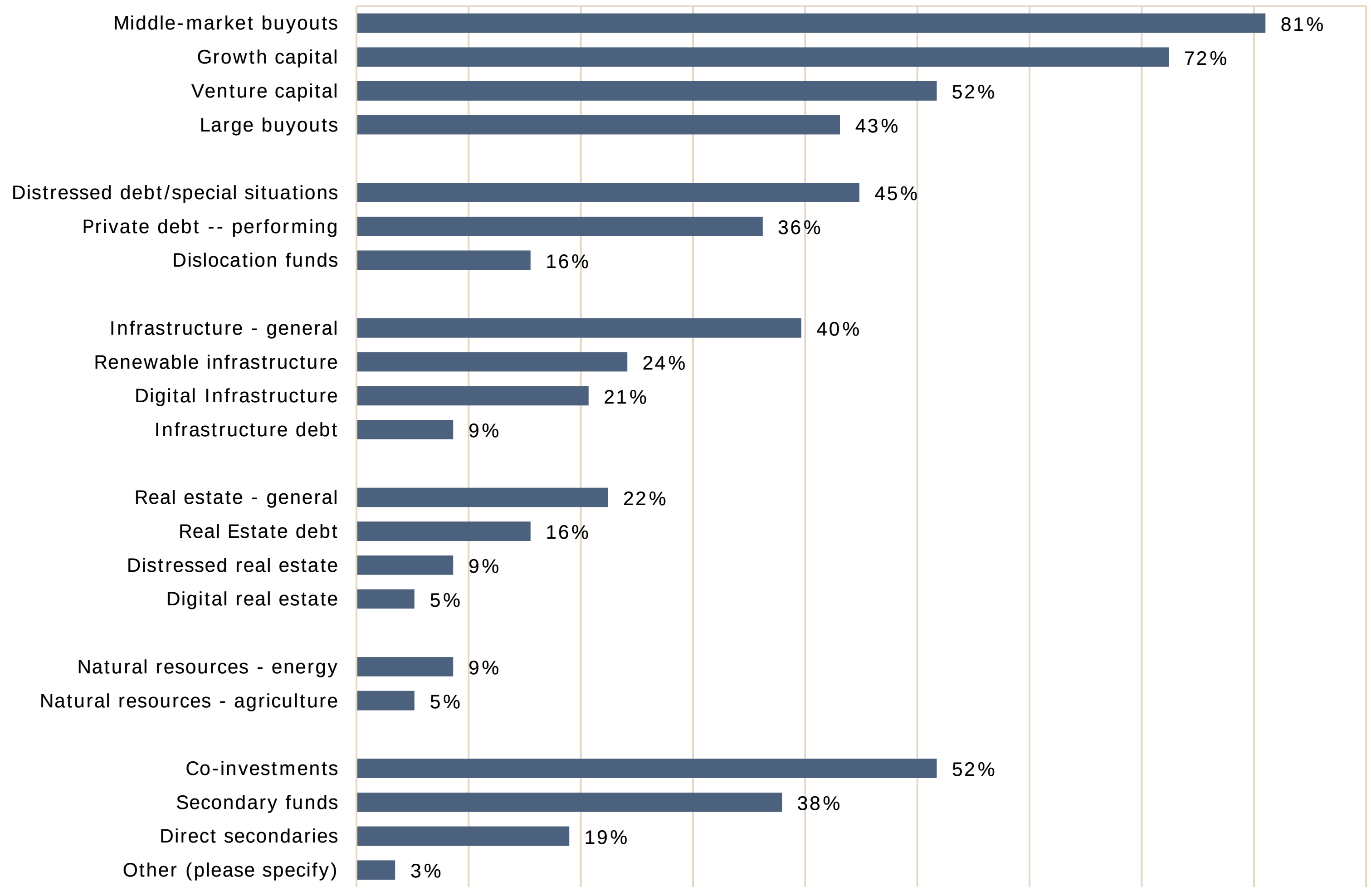
**Chart III Alternative Assets Under Management or Advisement**:




*Source: Probitas Partners' COVID-19 Impact Survey: Follow-up*

# Alternative Sectors of Interest

**Chart IV Alternative Closed-end Fund Sectors of Interest by Percent of Respondents**:




*Source: Probitas Partners' Impact of COVID-19 Survey: Follow-up*

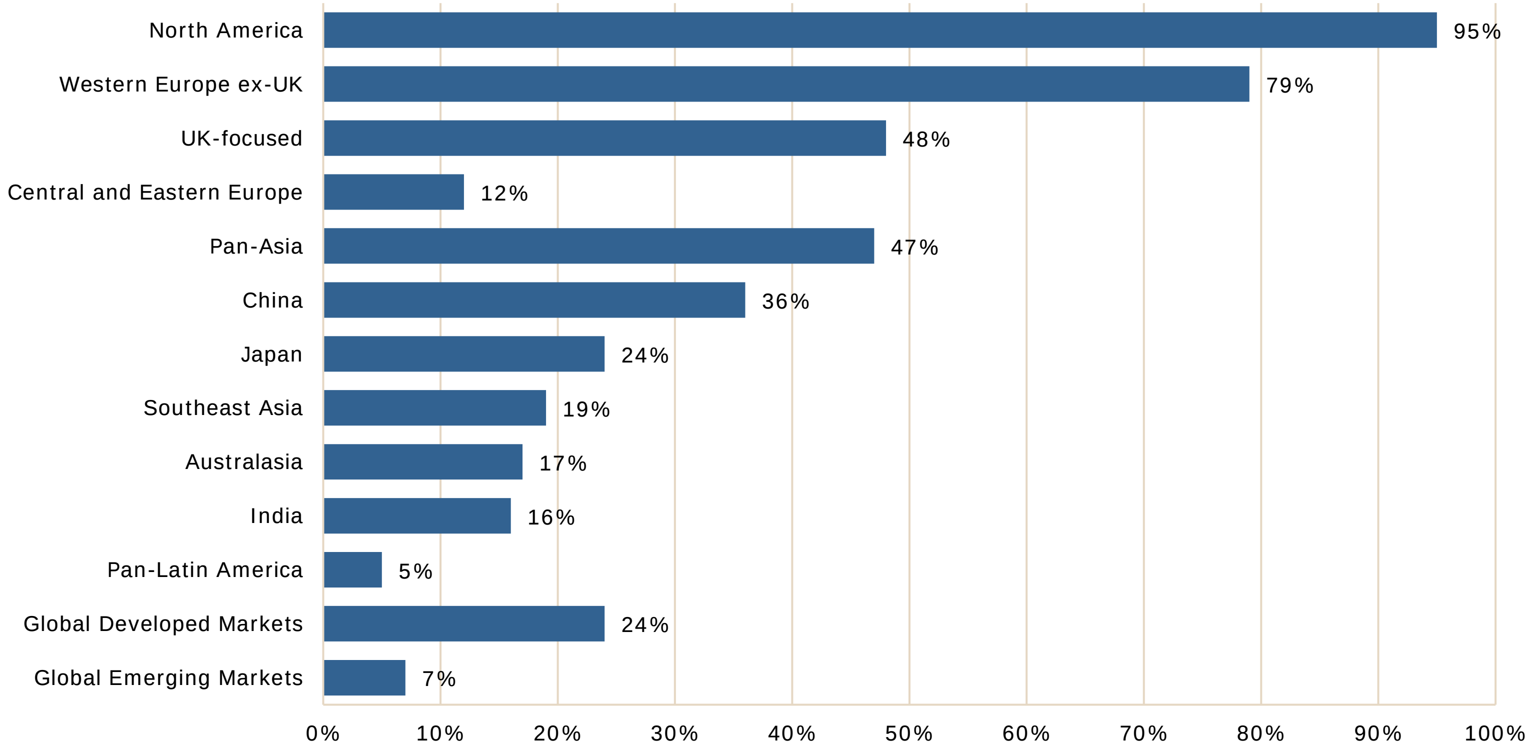
# Alternative Sectors of Interest: Commentary

- As they were in April, middle-market buyouts and growth capital led investor interest globally, while venture capital did well, especially in North America
  - There was significantly more interest in large buyouts is Asia, with 69% of Asian responses targeting them
- Distressed debt/special situations funds led investor interest in the debt sector, much higher than its level of interest in 2019 and on par with results in our April survey
- Interest in infrastructure investing remains strong, especially in renewables and digital infrastructure, while on a comparative basis interest in private real estate has declined
  - However, interest in real estate debt has increased compared to other sub-categories of real estate
  - Only 7% of European respondents were targeting real estate
- Interest in the major natural resource sectors remains weak, and the energy sector has of course been badly hit by the pandemic
- Since April, interest in co-investments has remained strong while interest in secondaries has decreased – but only after significant amounts of secondary fundraising since the crisis began

# Geographies of Interest

- North America and Europe were of the most interest to investors, with North America being the geography most targeted by European and Asian respondents, besides being the area of most focus by its home market investors
- There was also significant interest in Pan-Asian funds as well as funds targeting the U.K. instead of Western Europe in general

**Chart V Geographies of interest to my firm currently:**




*Source: Probitas Partners' COVID-19 Impact Survey: Follow-up*

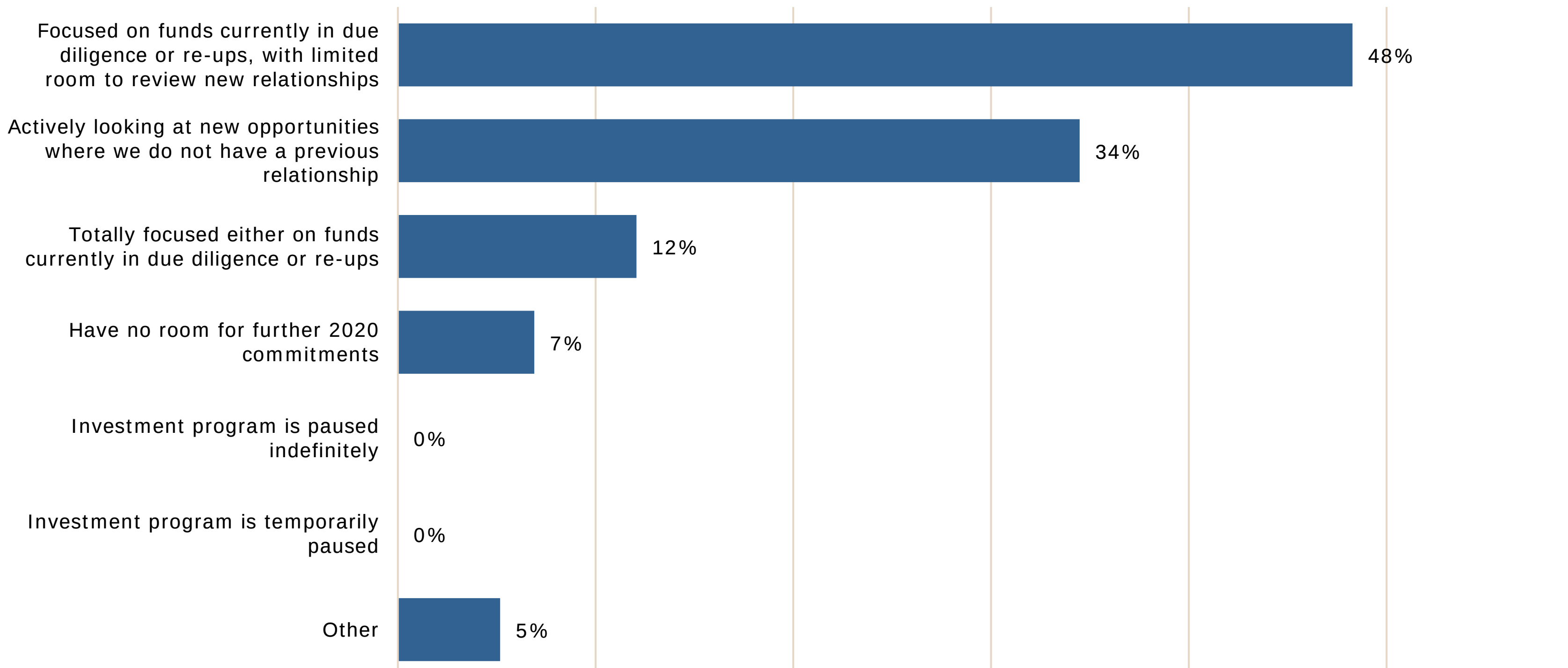
# Geographies of Interest: Commentary

- Chart V does not include a number of countries or regions that were listed as options on the survey but that no respondent picked
  - Notably in this group were Brazil, Sub-Saharan Africa and the MENA Region
  - Interest in closed-end funds in emerging markets has never been strong in our past surveys, but this result was striking
- Since April, interest in investing in China dropped significantly, from being a target of 54% of investors then to 36% now
  - Notably, North American interest in China fell from 49% in April to 32% now in the midst of increasing tensions between the U.S. and China
- As the Brexit process reaches its final stages, interest in the U.K. was significant – but not as strong as investor interest in the rest of Western Europe as a whole
  - Interestingly, more continental Europeans are targeting the U.K. than are North American or Asian respondents, a reversal of the trend we found in our 2019 Private Equity Survey

# Current Investing Status

- 8% of respondents had paused investing in our April survey; no respondents reported that this time
- There were distinct differences geographically; 43% of European investors were actively looking at new opportunities, while only 36% of North American and 25% of Asian respondents reported that that was the case

**Chart VI My firm's current investment status for closed-end fund alternative investing:**

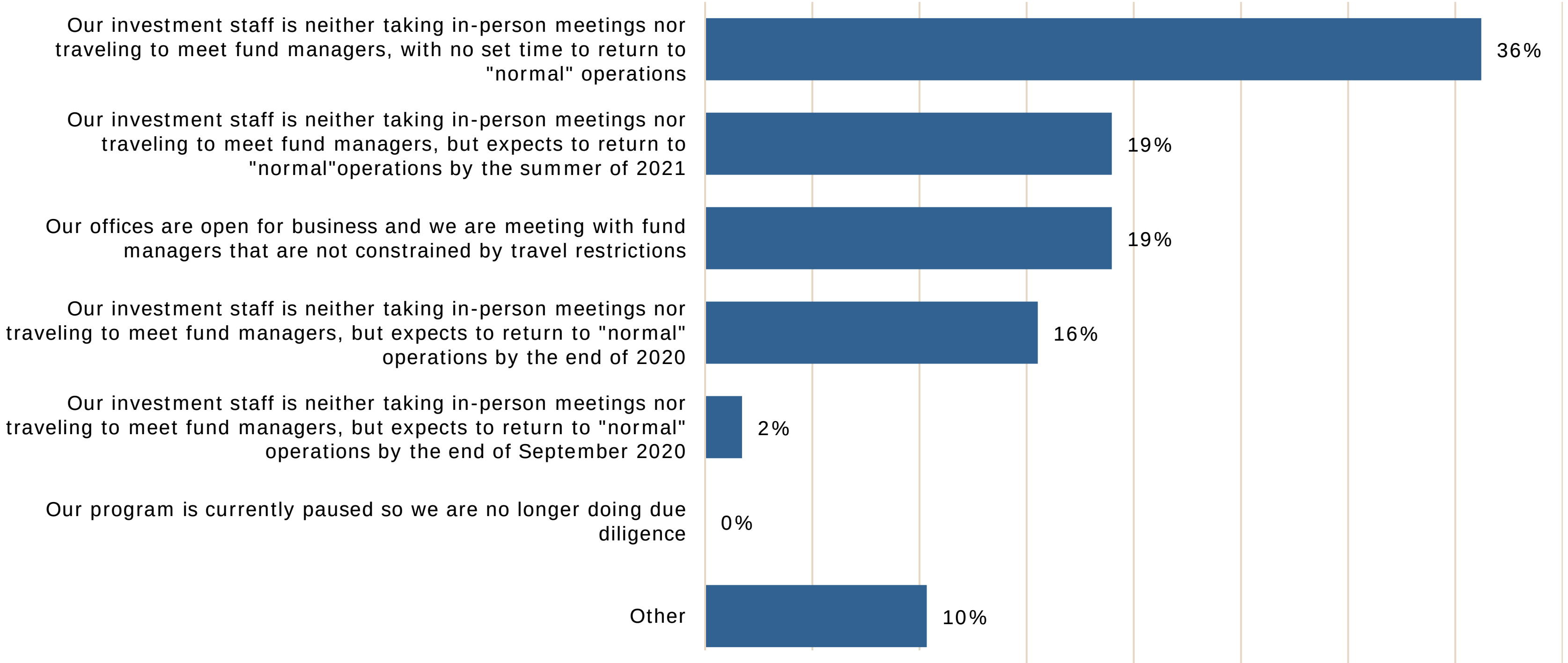



*Source: Probitas Partners' COVID-19 Impact Survey: Follow-up*

# Due Diligence Policies and Practices

- Most investors report that they are still not taking in-person meetings and most staff are working remotely, while some are forecasting re-opening for “normal” operations at various points over the next nine months
- Only 19% of the respondents reported that their offices were open for business, that they were operating somewhat normally and that they were meeting with fund managers who were not constrained by travel restrictions

**Chart VII My firm's current due diligence policies and practices:**

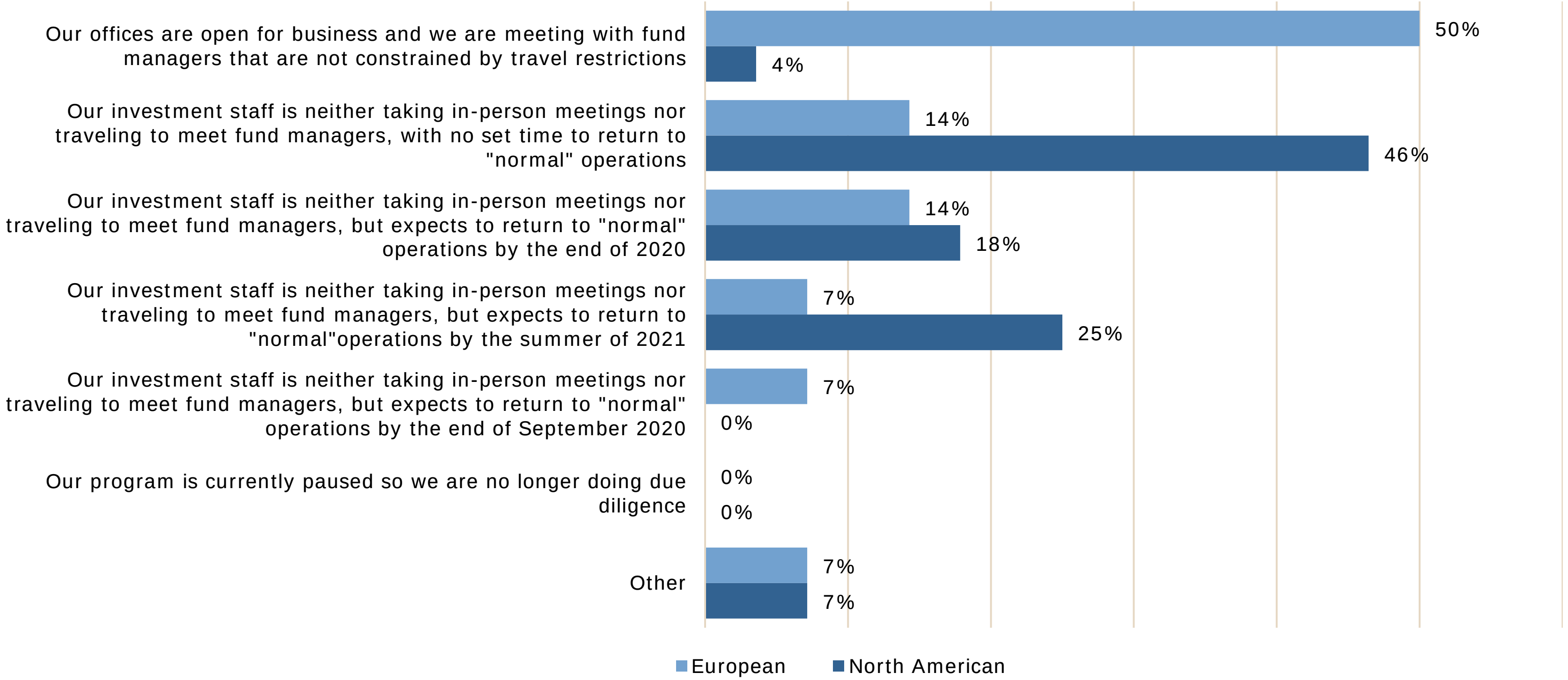



*Source: Probitas Partners' COVID-19 Impact Survey: Follow-up*

# Due Diligence Policies and Practices by Geography

- Much of Europe had re-opened over the summer and travel restrictions within Europe had declined – though there are now discussions of a rebound in restrictions with fears of a second wave of the pandemic
- However, as of September the situation was such that there were huge differences in due diligence practices across the globe, and Chart VIII highlights the current differences between European and North American investors

**Chart VIII My firm's current due diligence policies and practices:**
European vs. North American Respondents

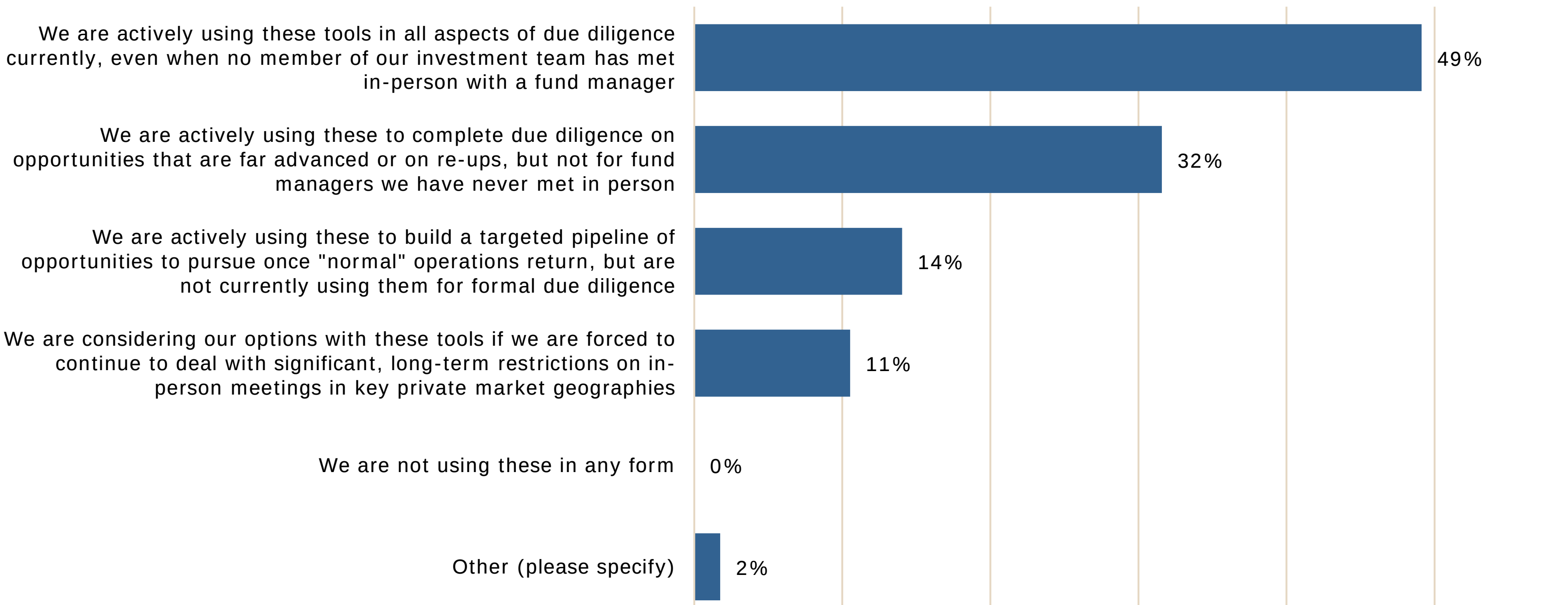



*Source: Probitas Partners' COVID-19 Impact Survey: Follow-up*

# The Use of Virtual On-line Meetings

- Respondents are heavily using virtual on-line meetings for due diligence in various manners, and those that have been reluctant to use them for “virtual on-site due diligence” are considering them as the pandemic continues
- There are geographic differences; for example, 71% of North American respondents use these tools even in situations where they have not meant the fund manager in person, while only 14% of Europeans feel so as it has been easier for Europeans to meet other Europeans currently; Asian respondents fall almost exactly in between

**Chart IX  As far as remote or virtual on-line meetings:**

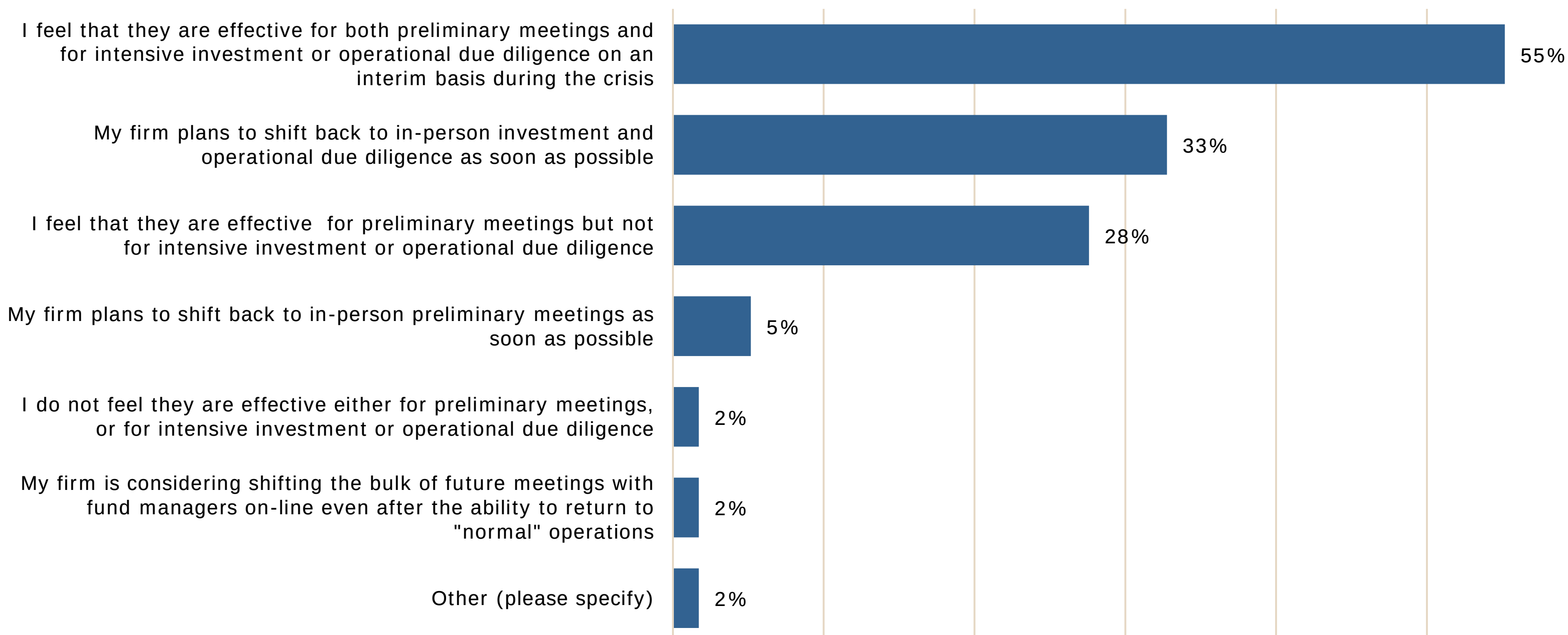



*Source: Probitas Partners'  COVID-19 Impact Survey: Follow-up*

# The Quality of Virtual On-line Meetings

- Globally, respondents felt that virtual meetings, especially as a replacement for on-site investment and operational due diligence, while useful as an interim measure during the crisis, are not part of their long-time plans
- Respondents felt that they were more effective for preliminary meetings rather than as a replacement for true on-sites

**Chart X  As far as the quality of virtual diligence:**




*Source: Probitas Partners'  COVID-19 Impact Survey: Follow-up*

# Commentary: The Quality of Virtual Due Diligence

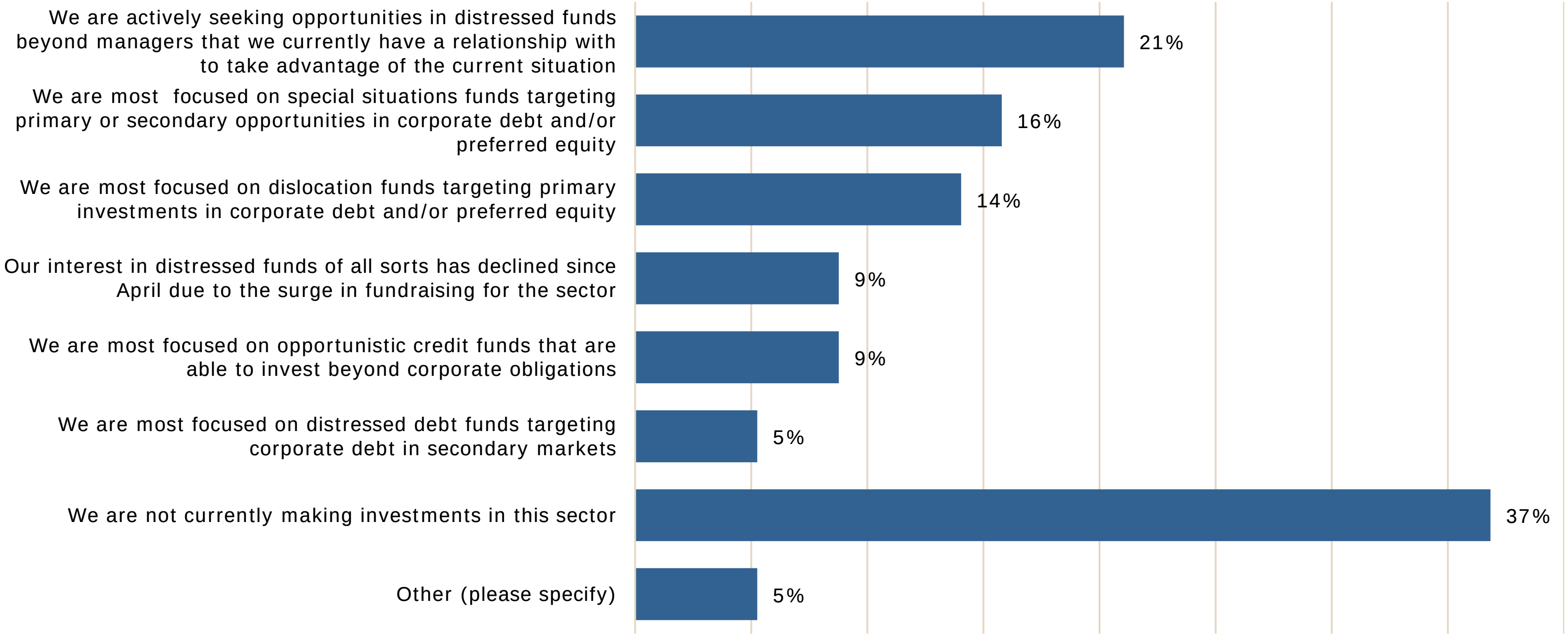
- In discussions with LPs, a few individuals favored virtual due diligence, seeing it as a more efficient use of their time as it limits their need to constantly travel – though those individual opinions may not reflect firmwide policy

- A respondent to the survey had an interesting comment:
  - *While they are not as good, they are sufficient when coupled with additional diligence procedures. Prior to COVID, we actively used Zoom for both preliminary meetings as well as on-site due diligence as we often have some staff in person and some staff via video to enhance the diligence process with additional perspectives.*

# Current Interest Within Distressed Debt/ Special Situations

- One of the few sectors that attracted increased investor attention in our April survey was distressed debt/special situations – though it has always been a sector that some investors avoid
  - However, a few respondents did feel that strong fundraising over the last 5 months has diminished their appetite for the sector
- This survey details that interest continues to remain relatively strong – but that interest that is scattered across a number of sub-strategies

**Chart XI Within distressed debt/special situations, my firm is focused on:**

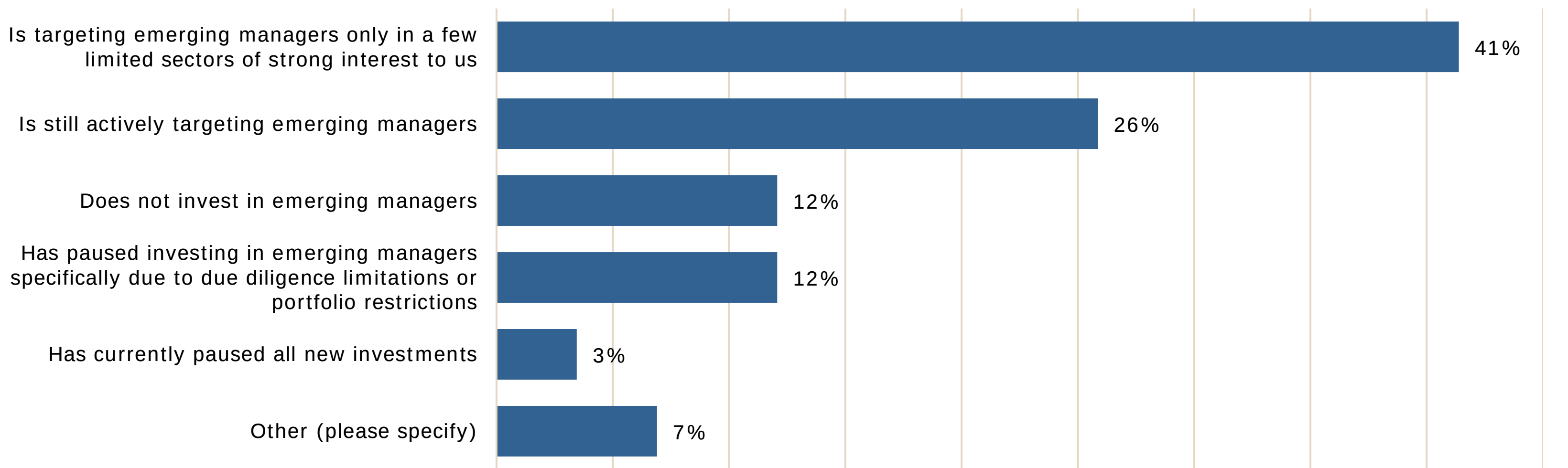



*Source: Probitas Partners' COVID-19 Impact Survey: Follow:up*

# Interest In Emerging Managers

- Even with the difficulties of performing due diligence for new opportunities during the pandemic, many investors are still pursuing first-time and emerging mangers, though a number of investors have narrowed their focus to funds targeting a few limited sectors of strong interest to them
- These sectors include such areas as dislocation funds, special situations vehicles, digital infrastructure and renewables
- 12% of respondents have paused emerging manager efforts due to due diligence constraints

**Chart XII As far as emerging managers/first-time funds, my firm:**

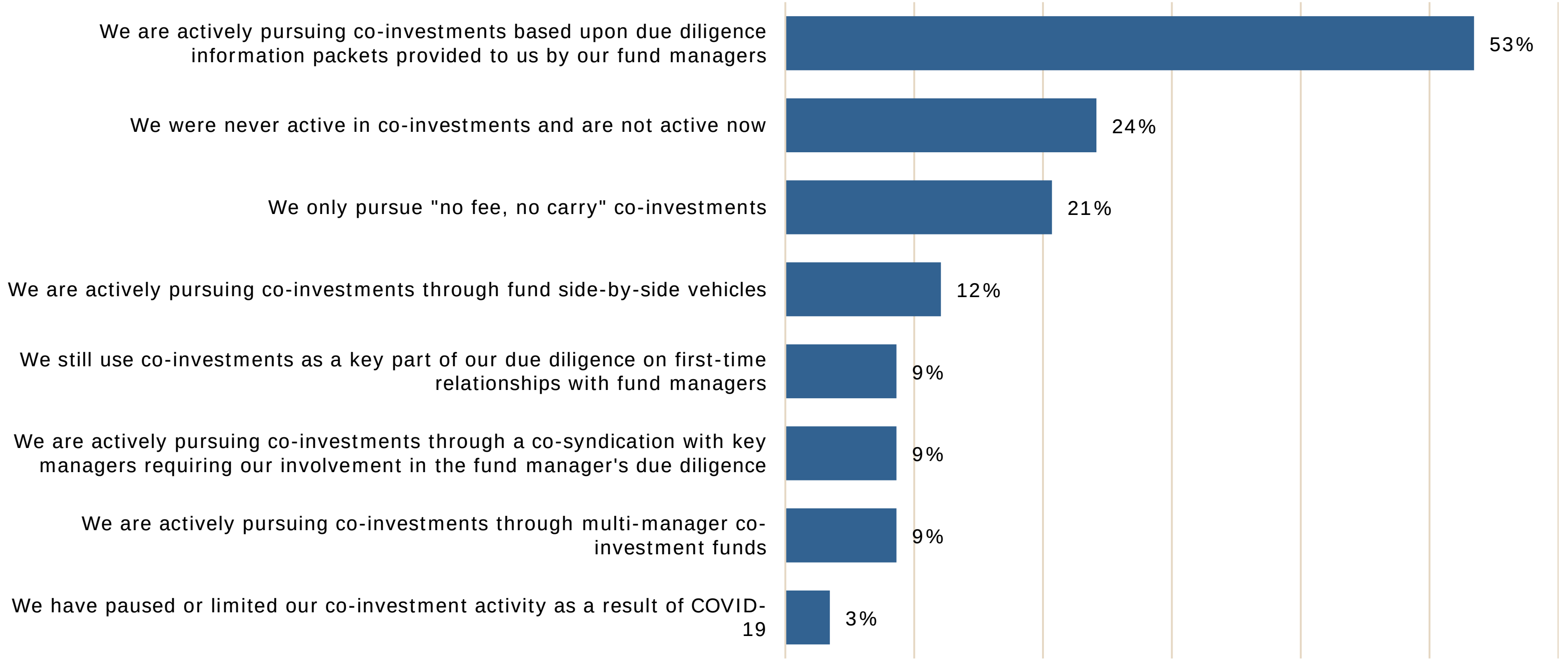



*Source: Probitas Partners' COVID-19 Impact Survey: Follow-up*

# Interest in Co-investments

- Interest in co-investments remains strong, with a majority of investors focused on the traditional approach of making quick decisions based upon due diligence materials provided by the fund manager – though there are a variety of other approaches
- 21% of respondents stated that they pursued only “no fee, no carry” co-investments even though access to strong co-investment opportunities is becoming more difficult

**Chart XIII As far as co-investments are concerned:**



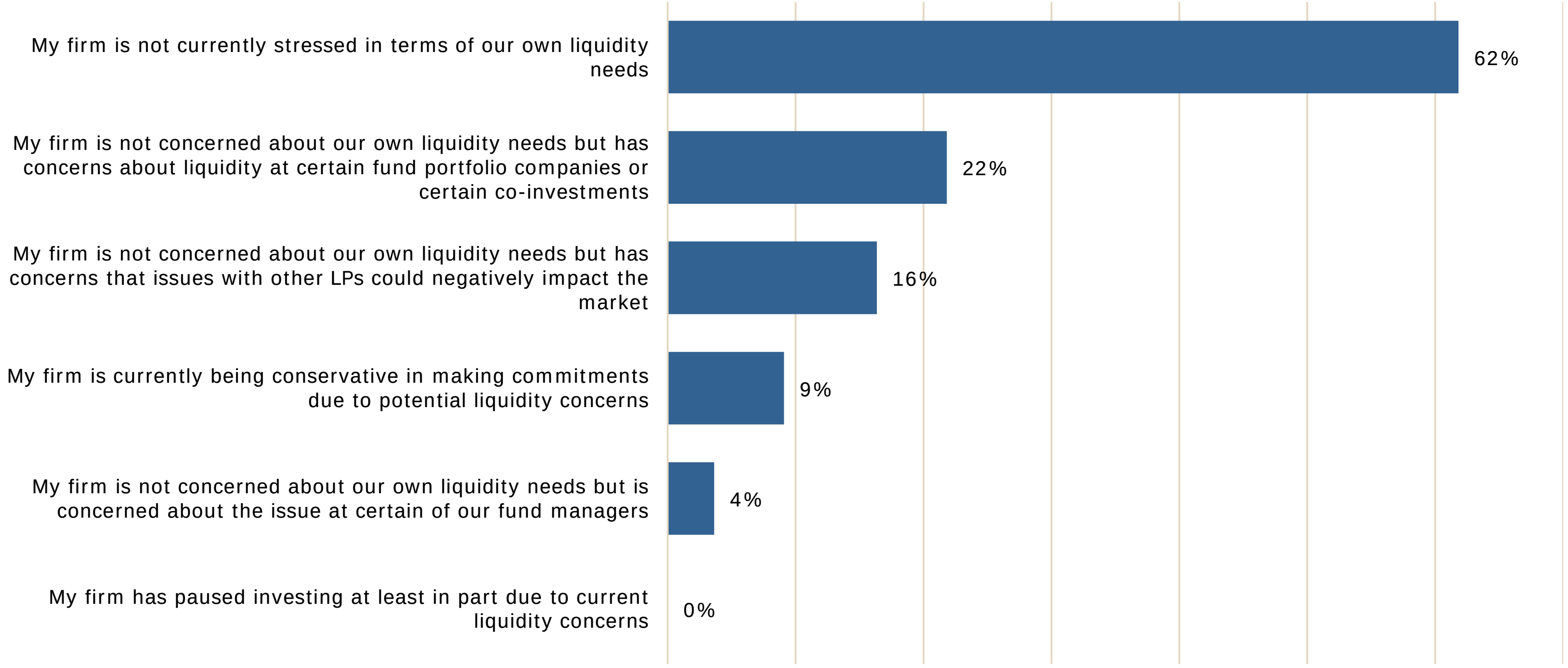

*Source: Probitas Partners' COVID-19 Impact Survey: Follow-up*

# Liquidity Issues

- Respondents profess not to be concerned about their own liquidity, though 16% expressed the concern that other LPs might have issues that could affect the market
- One respondent, obviously a consultant, did comment, however:

  *"Certain types of our clients have liquidity issues - primarily endowments"*

**Chart XIV As far as issues of liquidity are concerned**:

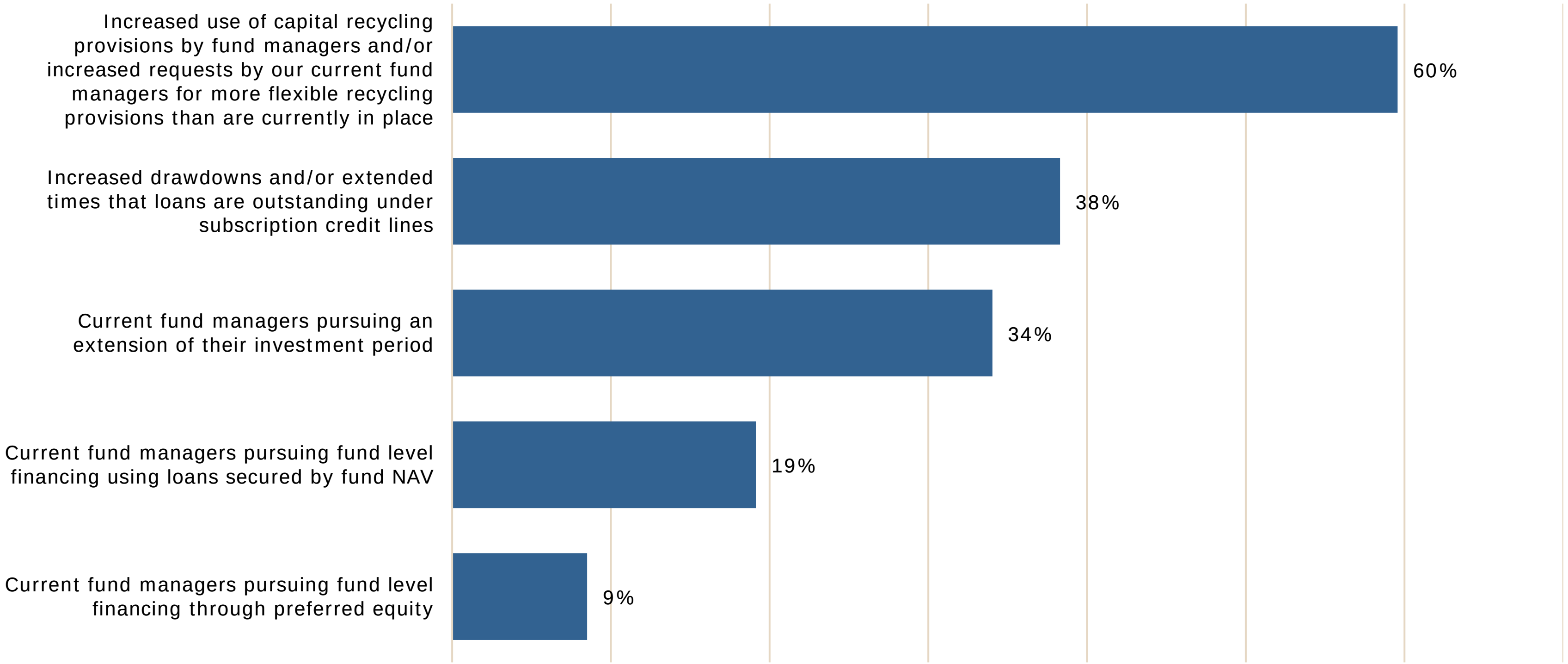



*Source: Probitas Partners' COVID-19 Impact Survey: Follow-up*

# Changes to Fund Terms, Conditions and Fund Financing

- In reaction to the pandemic and potential needs for liquidity, fund managers have approached a number of limited partners about changing certain fund terms and conditions or to seek different avenues of fund level financing
- Changes to capital recycling seem to be the most common approach

**Chart XV  As far as changes to fund terms, conditions and fund financing, we are seeing:**

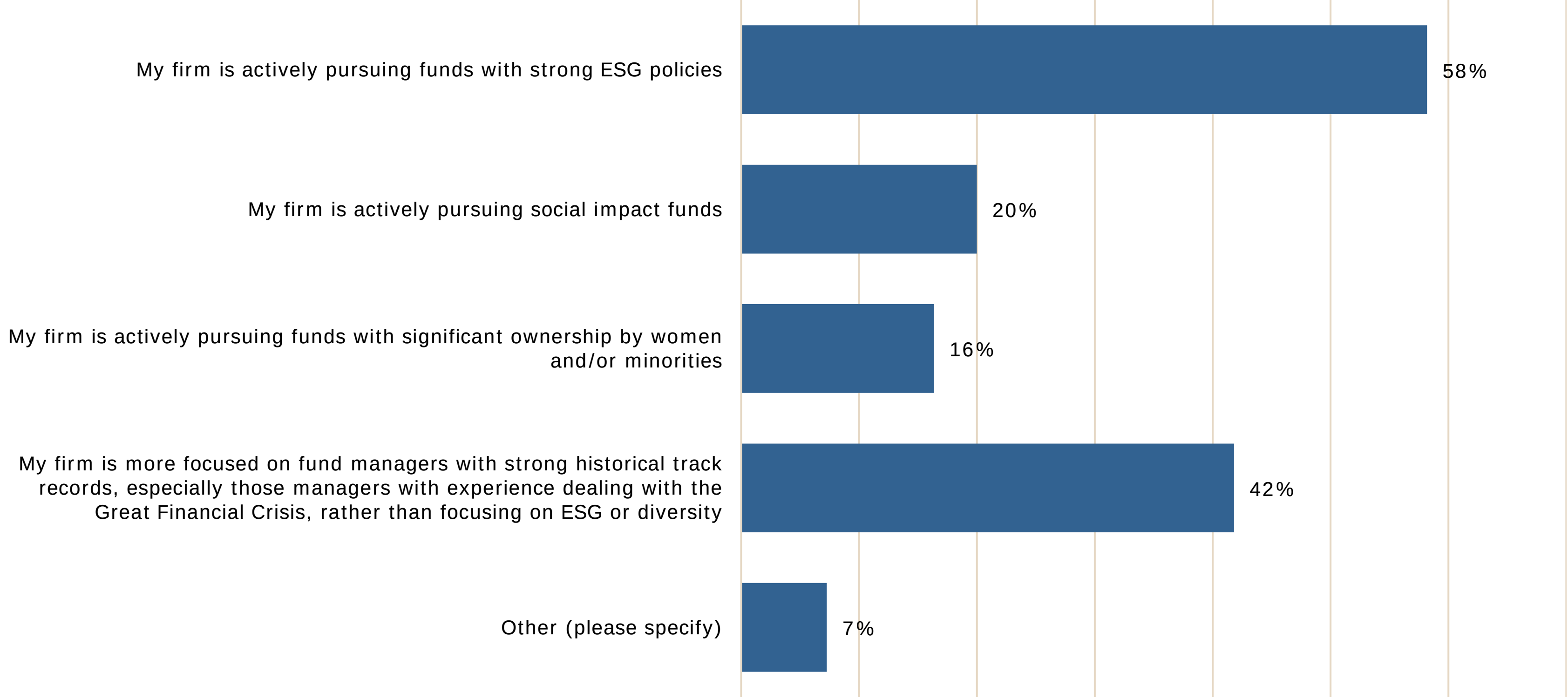



*Source: Probitas Partners' COVID-19 Impact Survey: Follow-up*

# Interest in ESG and Diversity

- Over the last five months investor focus on ESG investing has increased, from 46% in our April survey to 58% on the current survey, with those responding that they were most focused on historical performance declining from 48% to 42%
- The interest in social impact funds also increased from 13% to 20%

**Chart XVI In the current market, as far as ESG and diversity:**

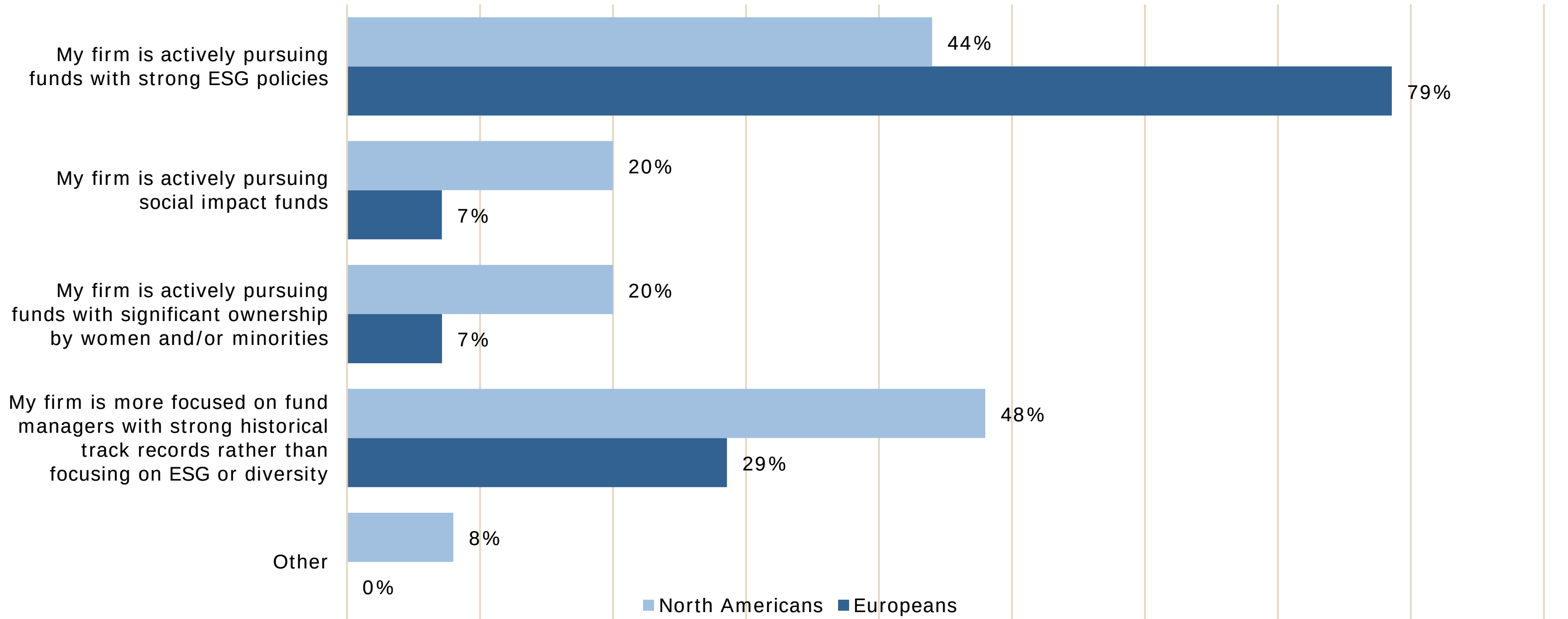



*Source: Probitas Partners' COVID-19 Impact Survey: Follow:up*

# Interest in ESG and Diversity: Geographic Differences

- However, there are distinct differences between investors from different geographies
- As is evident below, Europeans, are much more interested in funds with strong ESG policies than North Americans, with many more North Americans focused on historical track records
- Asian responses fell somewhere in between the two

**Chart XVII In the current market, as far as ESG and diversity:**




*Source: Probitas Partners' COVID-19 Impact Survey: Follow-up*

# Commentary on ESG

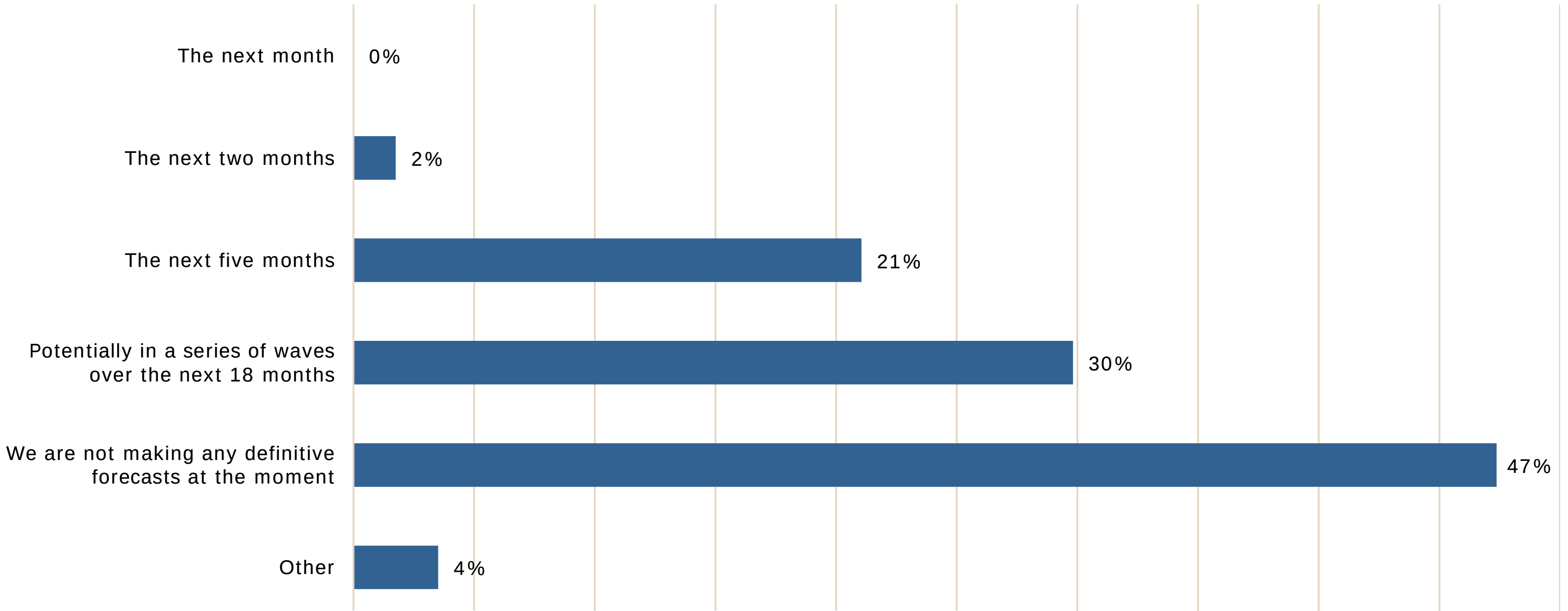
- There were several interesting comments on ESG from survey respondents providing further details on where they stood:
  - *My firm is increasingly focused on ESG and diversity as separate and distinct criteria within our investment program but will not invest solely based on those criteria.*
  - *We are focused on best in class managers with future expected returns as the criteria.*
  - *Increasingly ESG is a focus for us, but we are still early days of creating a framework for investing.*

# How Long Will Major Disruptions Go On?

- Since April, more investors are forecasting a longer-lived problem while a larger number having simply stopped forecasting
- One comment left by a respondent was telling:

  *"We expect the earliest we will back in the office is March 2021 with less than a 10% probability, a 50% probability by June 2021 and a 40% probability greater than June 2021."*

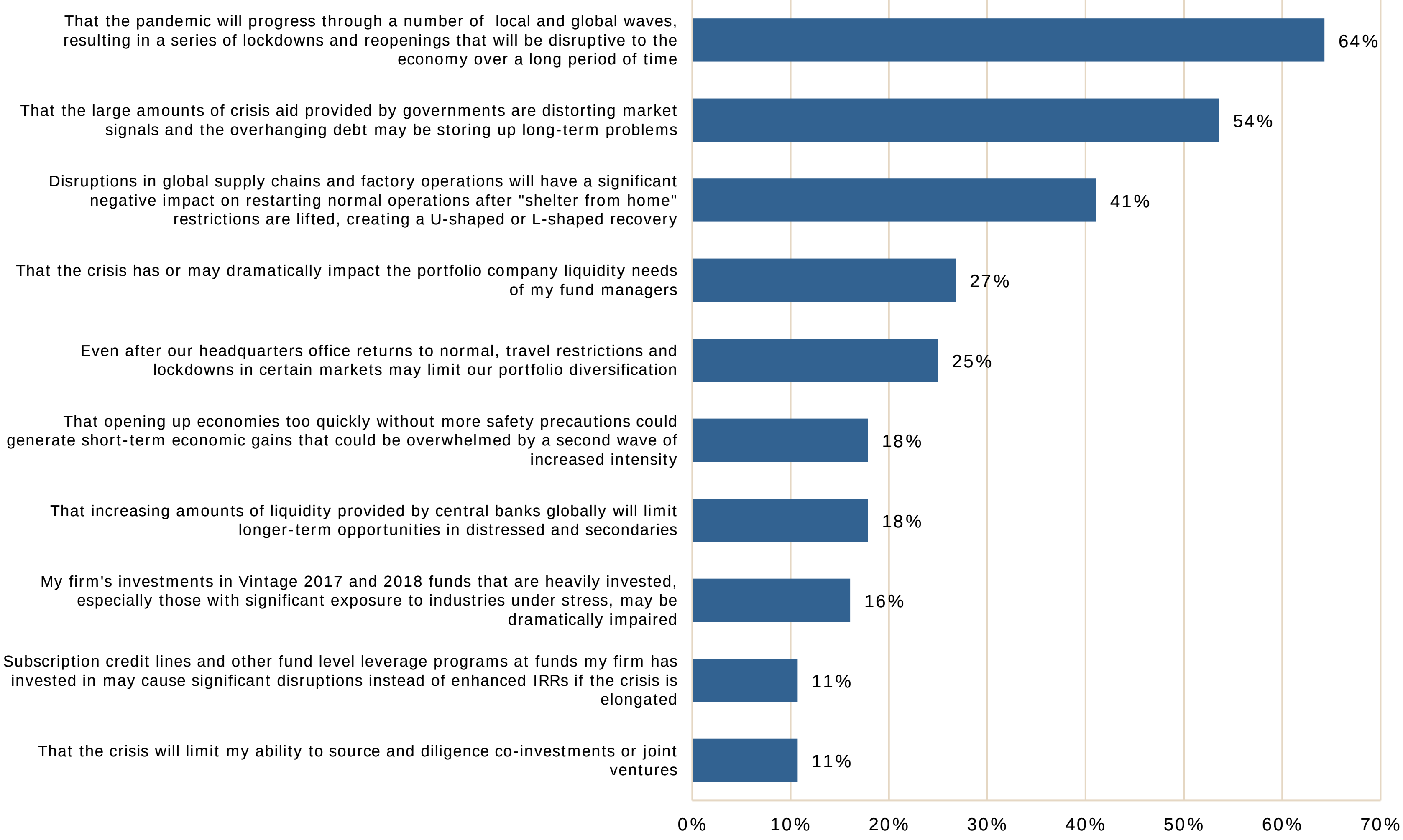
**Chart XVIII My firm is currently planning for major disruptions caused by COVID-19 over:**




*Source: Probitas Partners' COVID-19 Impact Survey: Follow-up*
*Note: Percentages in the chart do not sum to 100% as two respondents had multiple responses*

# Greatest Investment Fears of Respondents

**Chart XIX Greatest investment fears regarding the crisis**
Our four greatest investment fears regarding the crisis at the moment are:




*Source: Probitas Partners' COVID-19 Impact Survey: Follow-up*

# Greatest Investment Fears by Geography

**Table I**

| Greatest Fears | Overall Respondents | North American | European | Asian |
|---|---|---|---|---|
| That the pandemic will progress through a number of local and global waves, resulting in a series lo lockdowns and reopenings that will be disruptive to the economy over a long period of time | 64% | 67% | 64% | 60% |
| That the large amount of crisis aid provided by governments are distorting market signals and the overhanging debt may be storing up long-term problems | 54% | 56% | 64% | 40% |
| Disruptions in global supply chains and factory operations will have a significant negative impact on restarting normal operations after "shelter from home" restrictions are lifted, creating a U-shaped or L-shaped recovery | 41% | 30% | 64% | 40% |
| That the crisis has or may dramatically impact the portfolio liquidity needs of my fund managers | 27% | 15% | 50% | 27% |
| Even after our headquarters office returns to normal, travel restrictions and lockdowns in certain markets may limit our portfolio diversification | 25% | 15% | 29% | 40% |
| That opening up economies too quickly without more safety precautions could generate short-term economic gains that could be overwhelmed by a second wave of increased intensity | 18% | 22% | 14% | 13% |
| That increasing amounts of liquidity provided by central banks globally will limit longer-term opportunities in distressed and secondaries | 18% | 19% | 29% | 7% |

# Greatest Fears: Commentary

- Chart XIX details those fears picked from a larger list that attracted the attention of at least 10% of the respondents
- The top two responses were the top fears of respondents across all geographies
- However, Table I – which provides a geographic breakdown of the top seven responses – shows a number of differences in investor fears below the top two
  - European respondents, for example, are much more concerned about the impact of pandemic-caused shutdowns on disrupting global supply chains and industrial operations that could lengthen economic difficulties
  - Asian respondents are more focused on disruptions to their portfolio diversification caused by travel restrictions to certain geographies
- There was one very interesting comment to this question:

  *"That the crisis will limit our ability to grow our own team."*

# Summary and Analysis

- Compared to the situation in April, investors are less concerned about their current portfolios and more concerned about the best way to pursue attractive investment opportunities in the current environment
  - As the publicly traded markets plunged in March, investors were first and foremost concerned about impacts on their current portfolio
  - Intense discussions with their fund managers on the status of their underlying portfolio companies and action steps being taken, along with the rebound in the public markets, has lessened their portfolio concerns
  - Investors are now more focused on the best way to take advantage of attractive investment opportunities given the limitations imposed by the pandemic

- As the pandemic progresses, distinct geographic differences in investor interests and responses are becoming evident as the epidemic waxes and wanes at different times in different locations
  - For example, over the summer much of Europe was able to re-open to some degree and more normal due diligence operations were able to resume
  - In the U.S. the virus is more uncontrolled, and operations for many LPs is still constrained as far as meeting managers
  - In Asia, various locations have gone through a series of lockdowns and re-openings

- Investors are having difficulties predicting how long the crisis will last
  - In April, a third of investors felt that COVID-19 would be under control by this September while another third were not making any forecast
  - While some investors have pushed out their timetables, those not making formal forecasts have increased to nearly half of respondents

# Summary and Analysis (continued)

- An increasing number of investors are concerned that a large amount of crisis aid provided by governments are distorting economic signals and are storing up problems in certain areas for the future
- As it was in April, few investors have expressed concerns about their own liquidity at the moment – but other observers are concerned that an elongated crisis with ongoing shutdowns could pressure certain types of investors

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