ARCTOS INSIGHTS

Q1 2024 Keystone Market Update

An update on the private markets ecosystem and Arctos' NOWCAST

March 2024

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Q1 2024 Keystone Market Update Executive Summary

Key themes for both GPs and LPs based on this quarter.

GP Key Themes

- Still in a fundraising downturn akin to the post-GFC era, with a continued flight to quality and/or scale
- Historically difficult exit environment remains tough
- Sponsors need to focus on fundamentals: organizational competitive advantages and alpha generation
- M&A is a response to capital scarcity from LPs. While not the only solution, we expect M&A to grow.
- Private wealth and retail strategy is increasingly critical

LP Key Themes

- Private equity NAV remains overvalued by ~10-15%
- The ‘excess NAV’ problem fueling allocation issues (a ‘numerator effect’) is not lessening
- Overvaluation, overallocation, and high levels of secondary dry powder makes being a secondary seller attractive at present

SOURCE: ARCTOS

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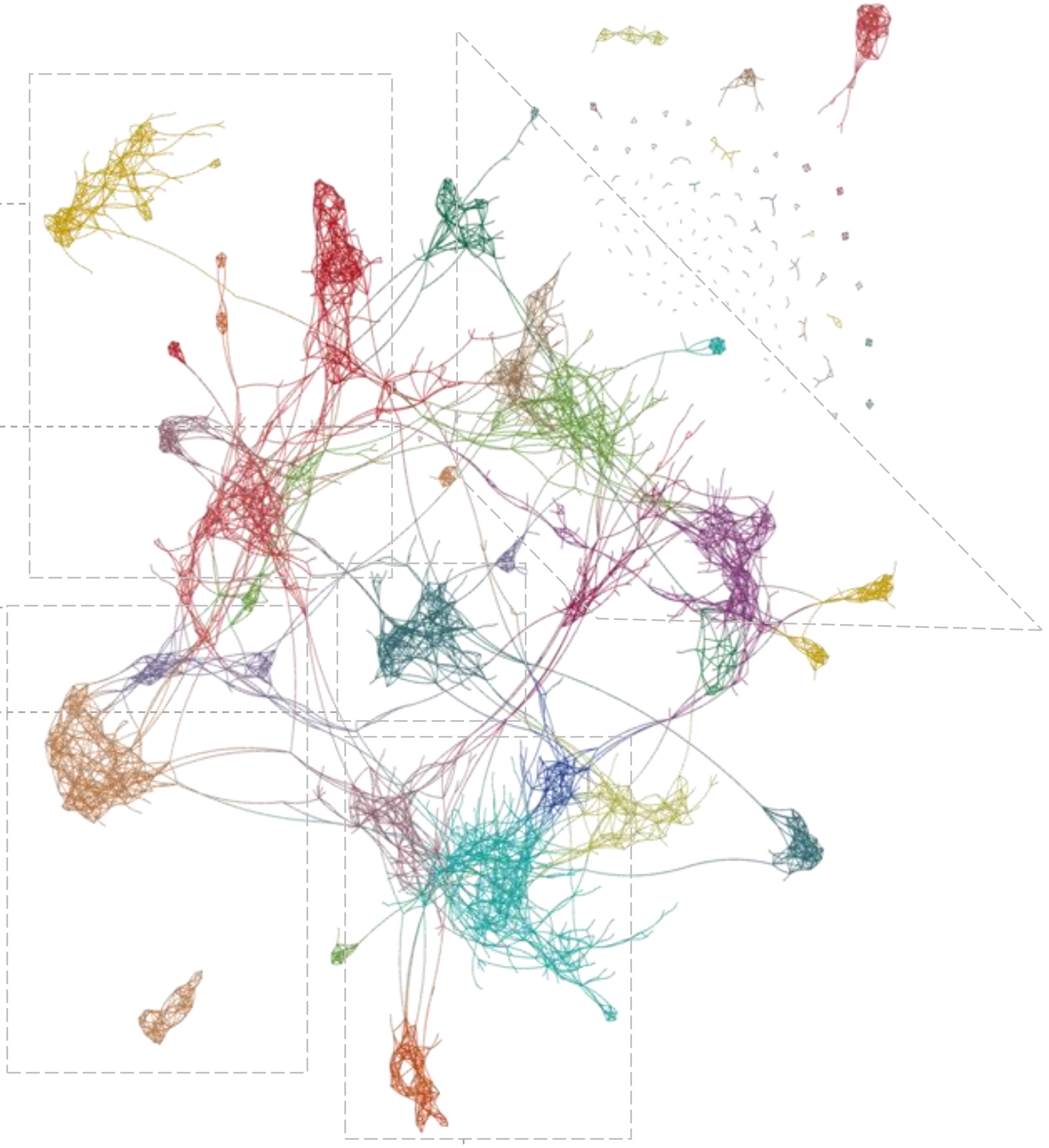
Current Private Markets NowNarrative Monitor (Q1 2024)

Our private markets narrative analysis highlights major trends, opportunities & risks in the linguistic data covering our markets and being delivered by its leaders



Dots: *Individual business news articles*
Clusters of colors*: High linguistic similarity*
Connecting lines: *High linguistic similarity across different language clusters*
Directions*: Distance reflects linguistic similarity.*

Q1 2024 NowNarrative Summary

There are two big opportunity narratives for private markets:

1. **Big Opportunity Narrative 1: Fundraising is a nightmare, what are GPs going to do?**
   - 1a: Get into private credit. But is the golden age over or just getting started?
   - 1b: Generate distributions using CVs and GP-led secondaries.
2. **Big Opportunity Narrative 2: Other than launching private credit, how do we keep growing?**
   - 2a: GP consolidation, M&A, integration and scale
   - 2b: Insurance products and retail distribution of private equity

And there are three big risk narratives:

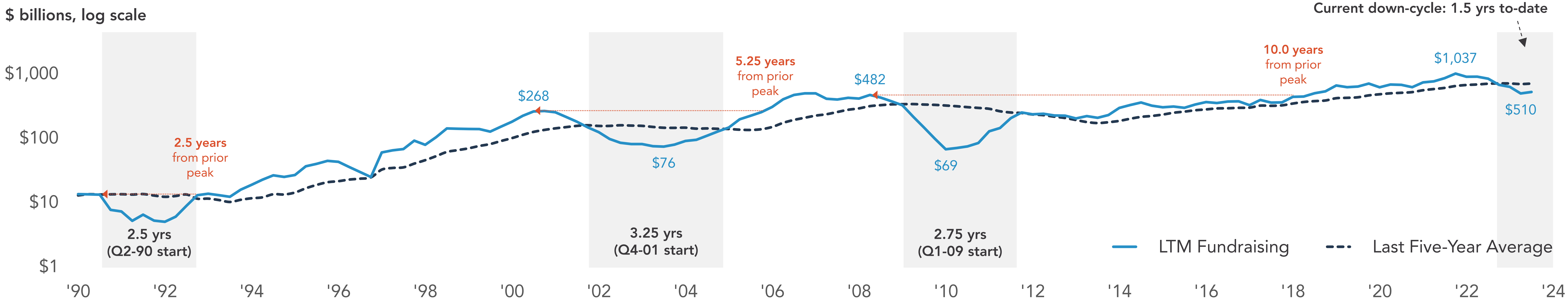
1. **Big Risk Narrative 1**: When are the CRE chickens coming home to roost?
2. **Big Risk Narrative 2**: Regulation, including a special focus on healthcare roll-ups and private credit's impact on global financial stability and insurance health.
3. **Big Risk Narrative 3**: Did the sustainability movement kill access to capital for entire industries? Is the pendulum swinging back?

SOURCE: ARCTOS

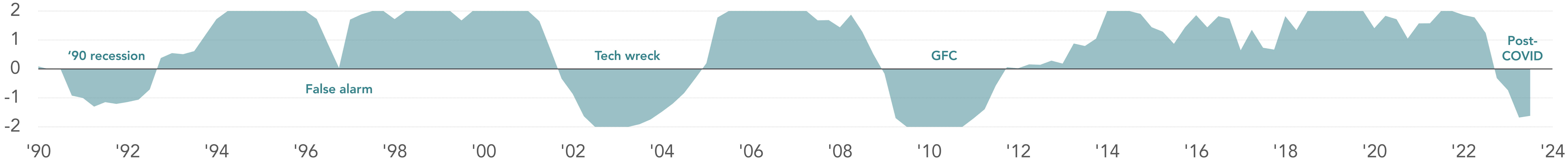
The Fundraising Recession of 2023-present

Major fundraising down-cycles tend to last 10+ quarters. We are in quarter 6 of this cycle, implying we have another 1-2 years of below-trend fundraising and likely longer before we return to prior peak levels.

Global PE Fundraising Recessions Since 1990



Cycle indicator (# st. dev.'s from average)

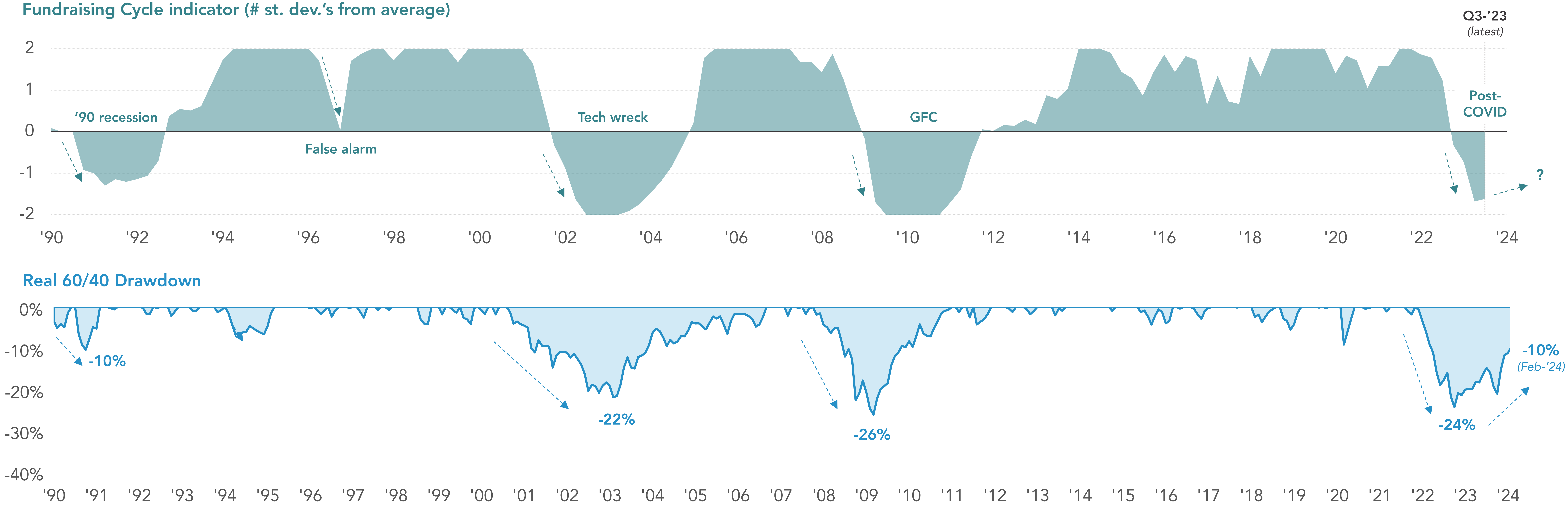


SOURCE: BURGISS, ARCTOS. AS OF FEBRUARY 2024. INCLUDES NORTH AMERICA AND WESTERN EUROPE BUYOUT, EXPANSION CAPITAL, AND VENTURE CAPITAL. ASSUMES CURRENT BURGISS DATABASE CAPTURES 50% OF TOTAL MARKET FUNDRAISING DOLLARS.

Public Market Leading Indicators Point to Some Relief Incoming

Some relief is coming from public market reflation, driven by a mix of AI / Big Tech stocks and declining long-term rates. **But there's an observable lag between public market recoveries and fundraising impact – so we still have some way to go.**

Drawdowns Asset Prices (Proxied by 60/40) vs. PE Fundraising Recession Cycle Indicator



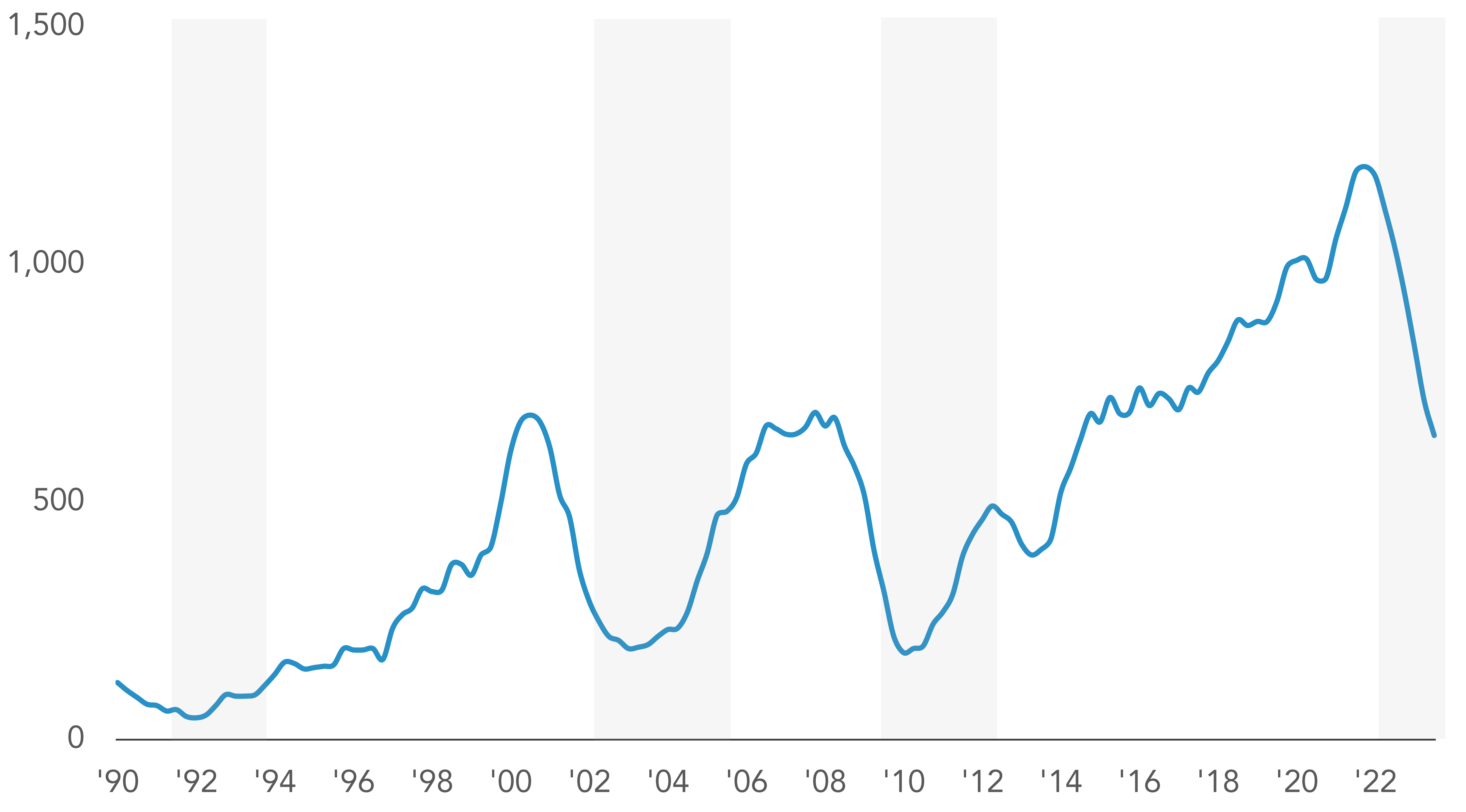
SOURCE: PREQIN, ROBERT SHILLER, S&P, BURGISS, ARCTOS ANALYSIS. INCLUDES NORTH AMERICA AND WESTERN EUROPE BUYOUT, EXPANSION CAPITAL, AND VENTURE CAPITAL. ASSUMES CURRENT BURGISS DATABASE CAPTURES 50% OF TOTAL MARKET FUNDRAISING DOLLARS. USES INFLATION-ADJUSTED (REAL) 60/40 PORTFOLIO MONTHLY RETURNS. AS OF FEBRUARY 2024.

Fund Closings Down, Fund Sizes Up

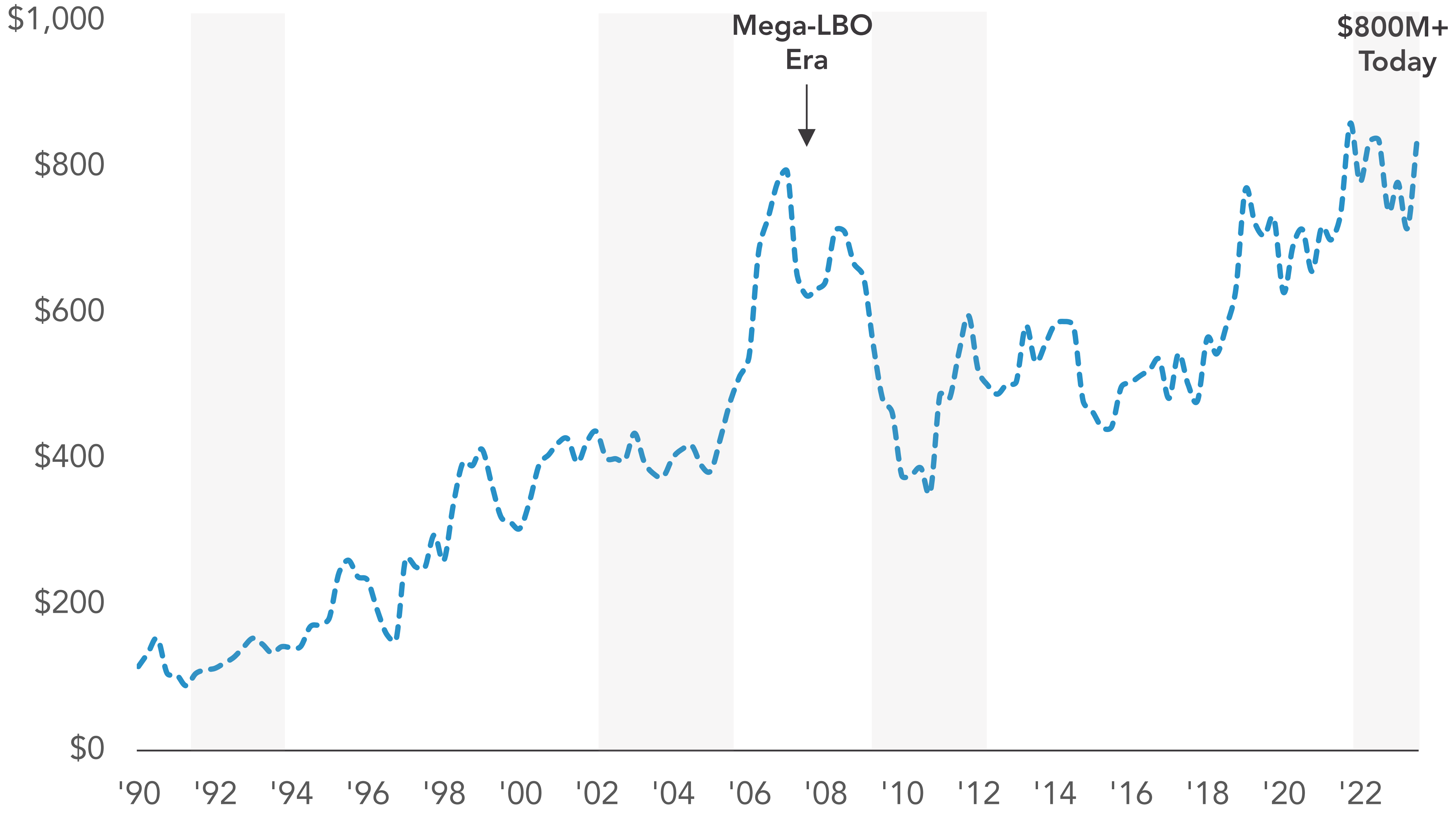
The number of successful funds closed is down nearly 50% from its Q4-21 peak, but funds that are successfully raised have tended to be larger, consistent with the "flight-to-quality" and "capital concentration" themes

Global PE Fundraising: LTM # Funds w/ Closings & Avg Fund Size

of Funds



Avg Fund Size ($M)



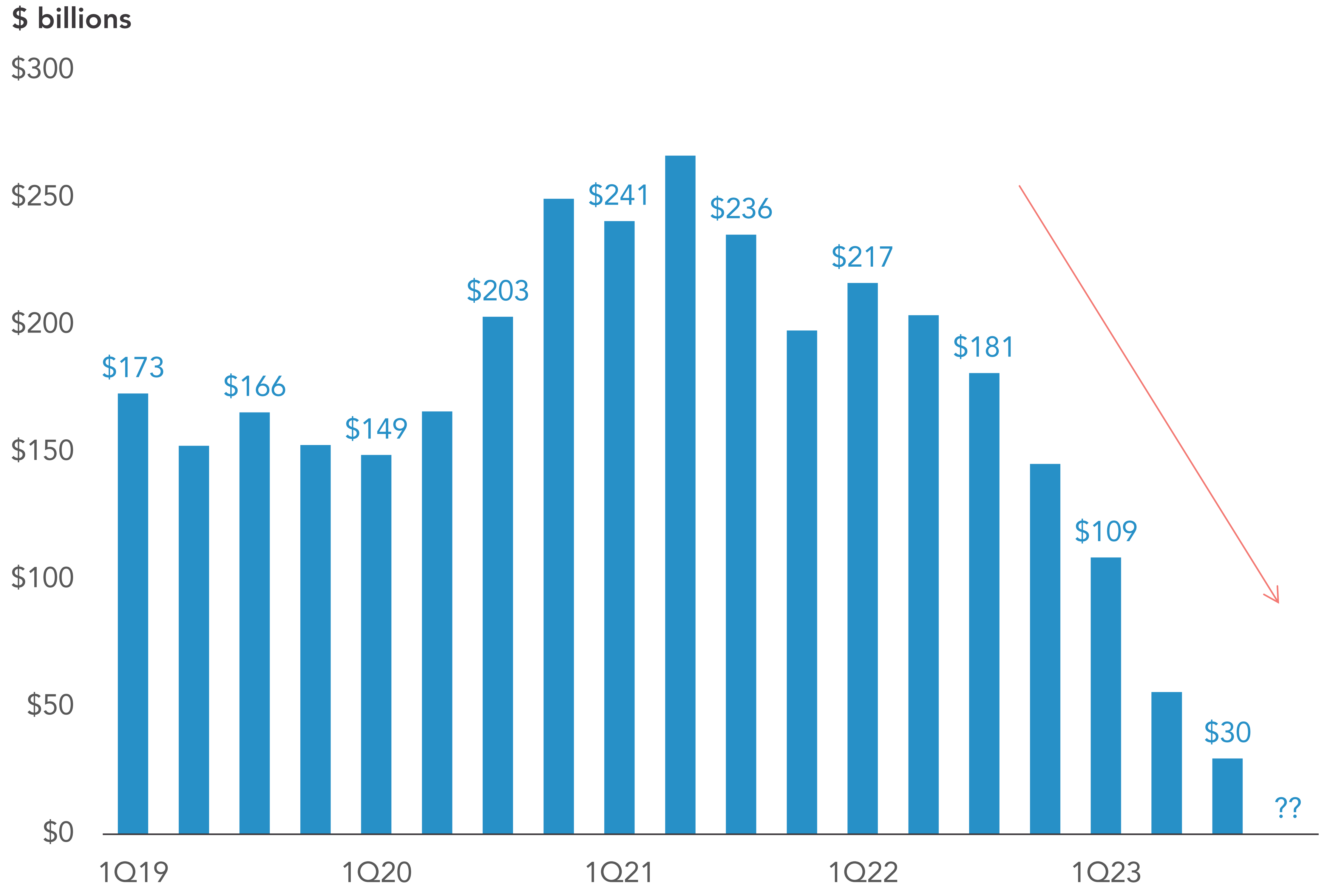
Fundraising recession

SOURCE: PREQIN, ROBERT SHILLER, S&P, BURGISS, ARCTOS ANALYSIS. INCLUDES NORTH AMERICA AND WESTERN EUROPE BUYOUT, EXPANSION CAPITAL, AND VENTURE CAPITAL. ASSUMES CURRENT BURGISS DATABASE CAPTURES 35% OF TOTAL FUND CLOSINGS. USES INFLATION-ADJUSTED (REAL) 60/40 PORTFOLIO MONTHLY RETURNS. AS OF FEBRUARY 2024.

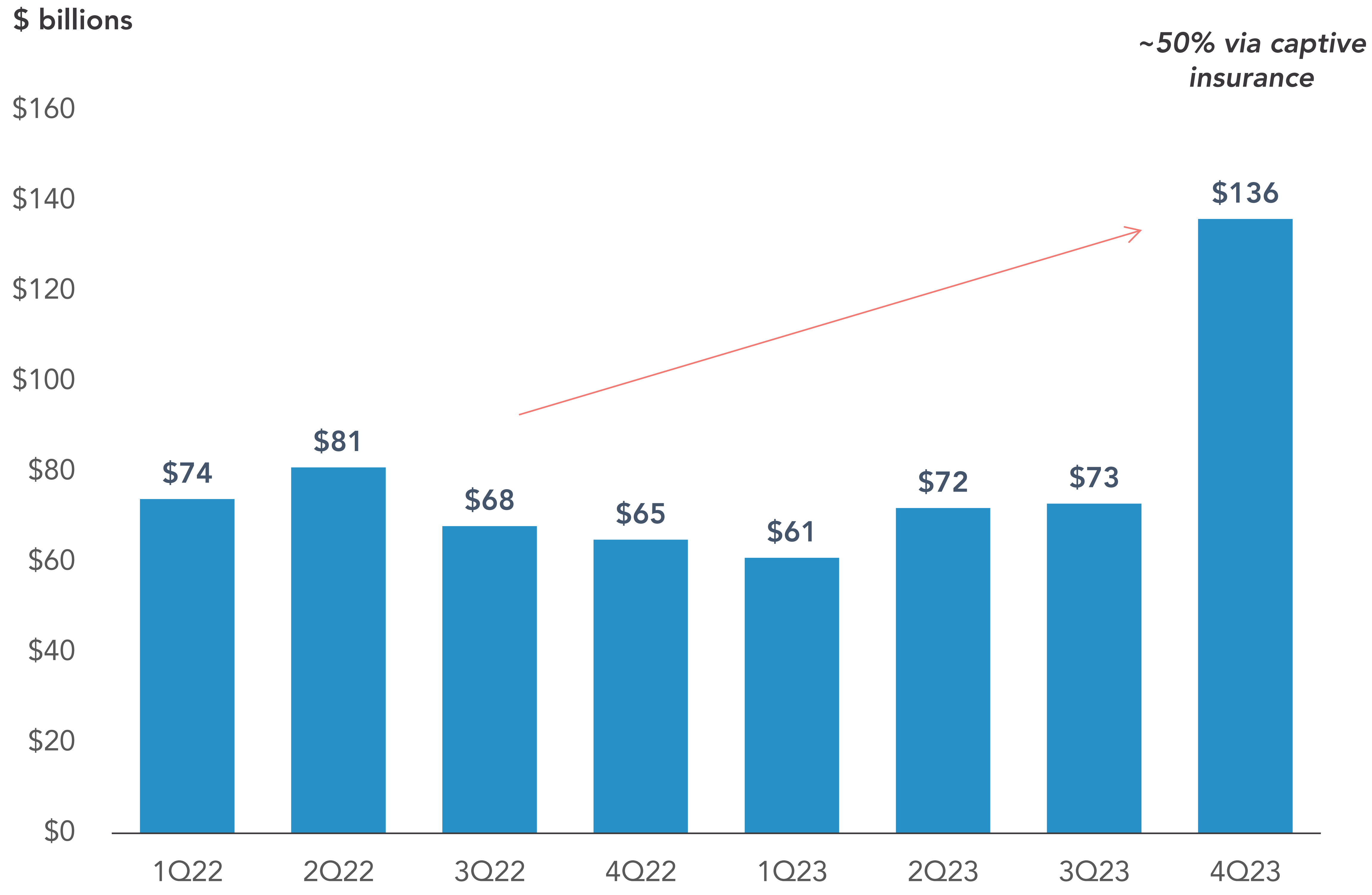
Private Credit Boom (For the Mega-GPs)

Raw closed end fund data would suggest a significant pullback in private credit. But credit is being intermediated mainly (i) via the top managers and (ii) through permanent capital and insurance vehicles. There's no pullback for the largest GPs!

Private Credit Fundraising – Burgiss (Closed End Funds)



Reported Credit Fundraising by Top 10 Public GPs

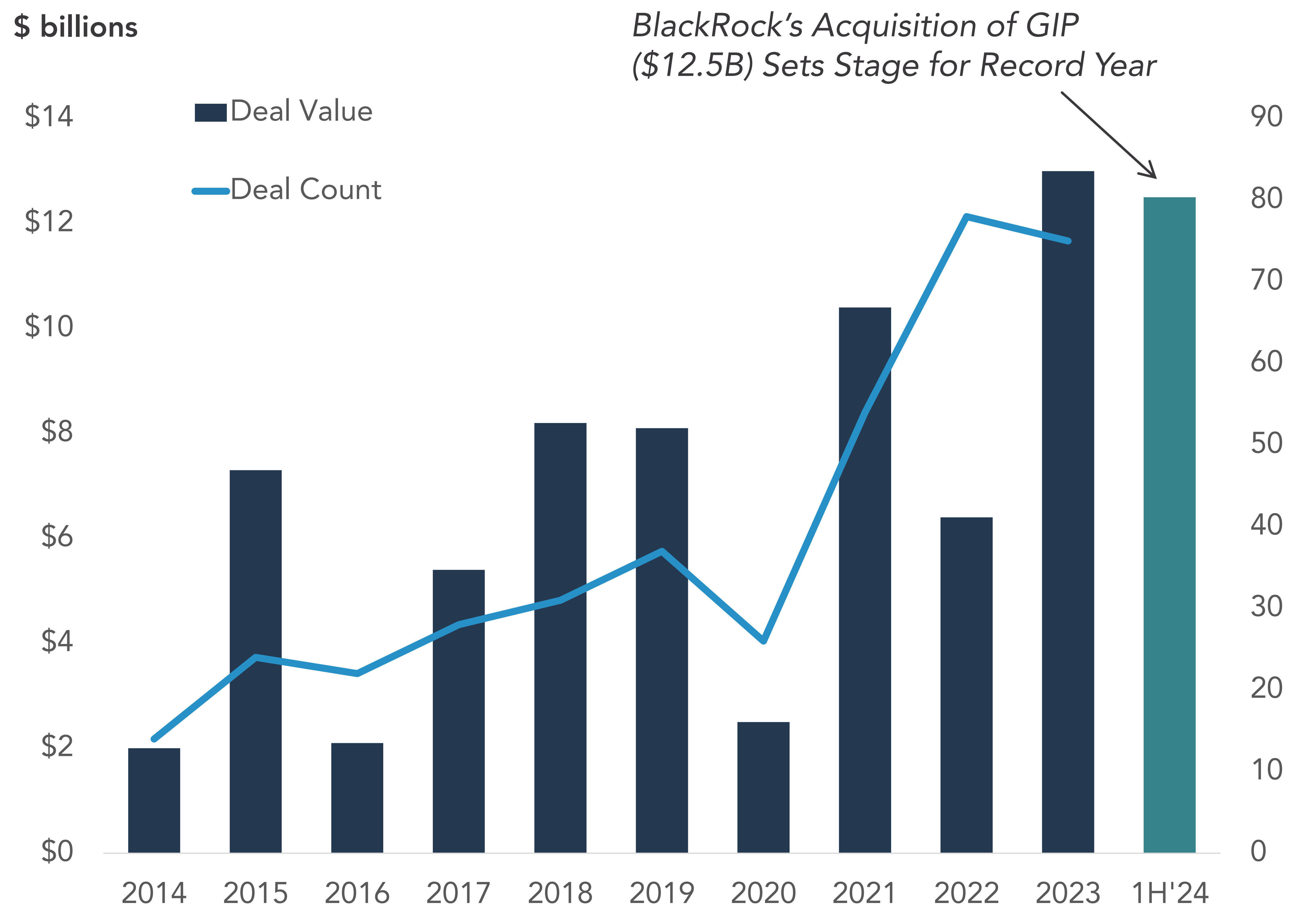


SOURCE: BURGISS, PUBLIC COMPANY FILINGS, ARCTOS ANALYSIS. AS OF FEBRUARY 2024.

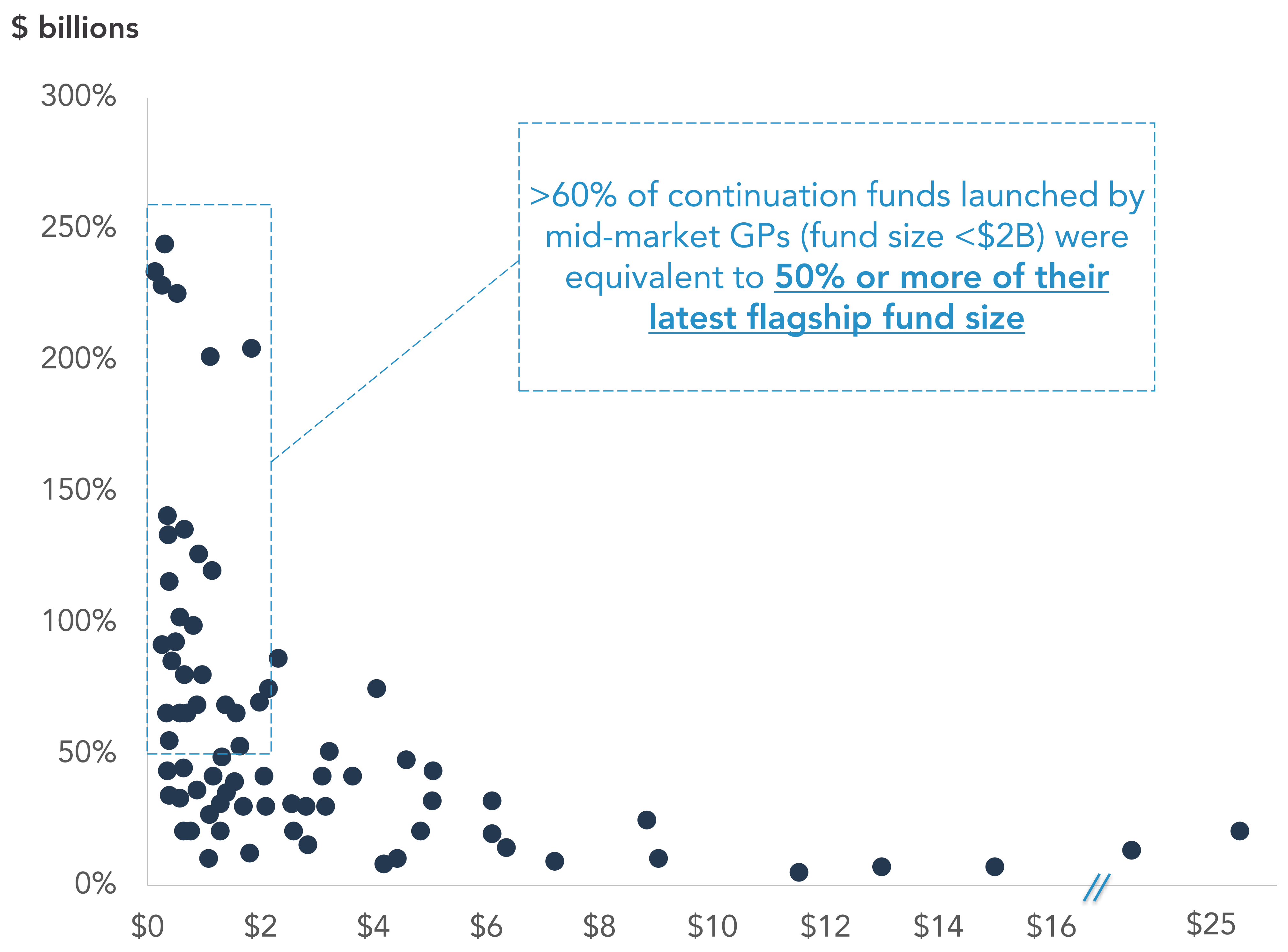
How GPs Are Responding to the Slowdown

Current market dynamics have led to a race for scale and a dramatic increase in M&A. The persistent poor exit environment has led to rapid CV and "GP solutions" utilization, which are "non-organic" AUM/FRE growth strategies.

Annual Asset Management Consolidation(1)



Continuation Fund Size as % of Latest Flagship(2)



(1) SOURCE: PITCHBOOK, ARCTOS ANALYSIS. AS OF FEBRUARY 2024.
(2) SOURCE: LAZARD. REPRESENTS CONTINUATION FUND SIZE AS A PERCENTAGE OF LATEST FLAGSHIP FUND.

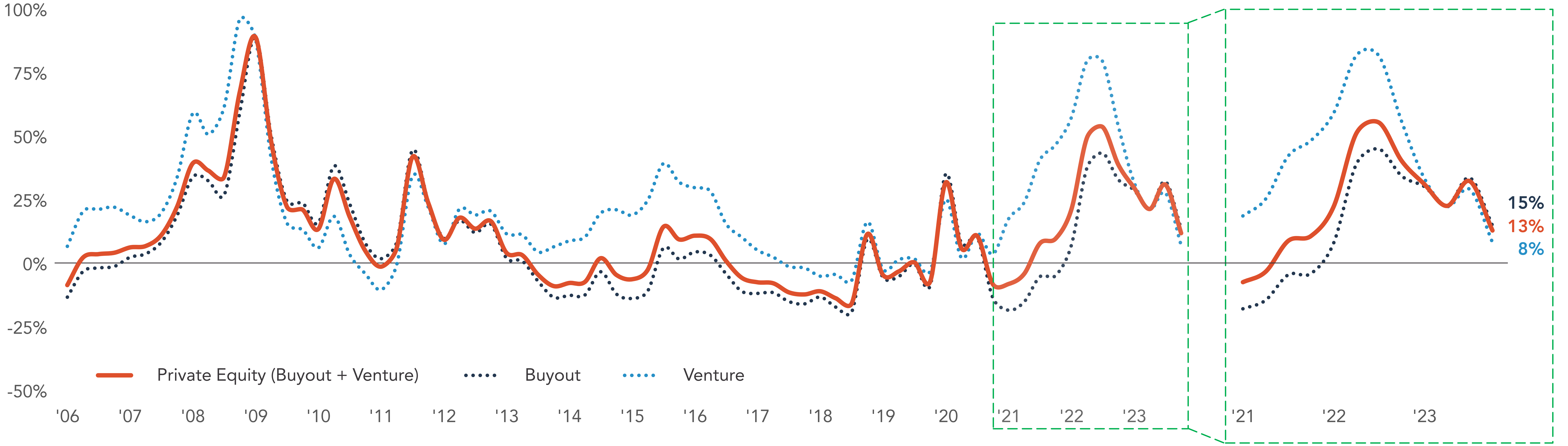
ARCTOS INSIGHTS

NAV Overvaluation Has Declined

Private equity is still likely overvalued by 10-15%, though this is down from ~30% overvalued as recently as Q1 ‘23. This improvement has been driven entirely by public proxy reflation, making it somewhat precarious.

The Asset Class is Likely Still Overvalued Despite Public Proxy Reflation

Public-Private Proxy: North American Buyout and Venture NAV Over- / (Under-) Valuation[(1)]



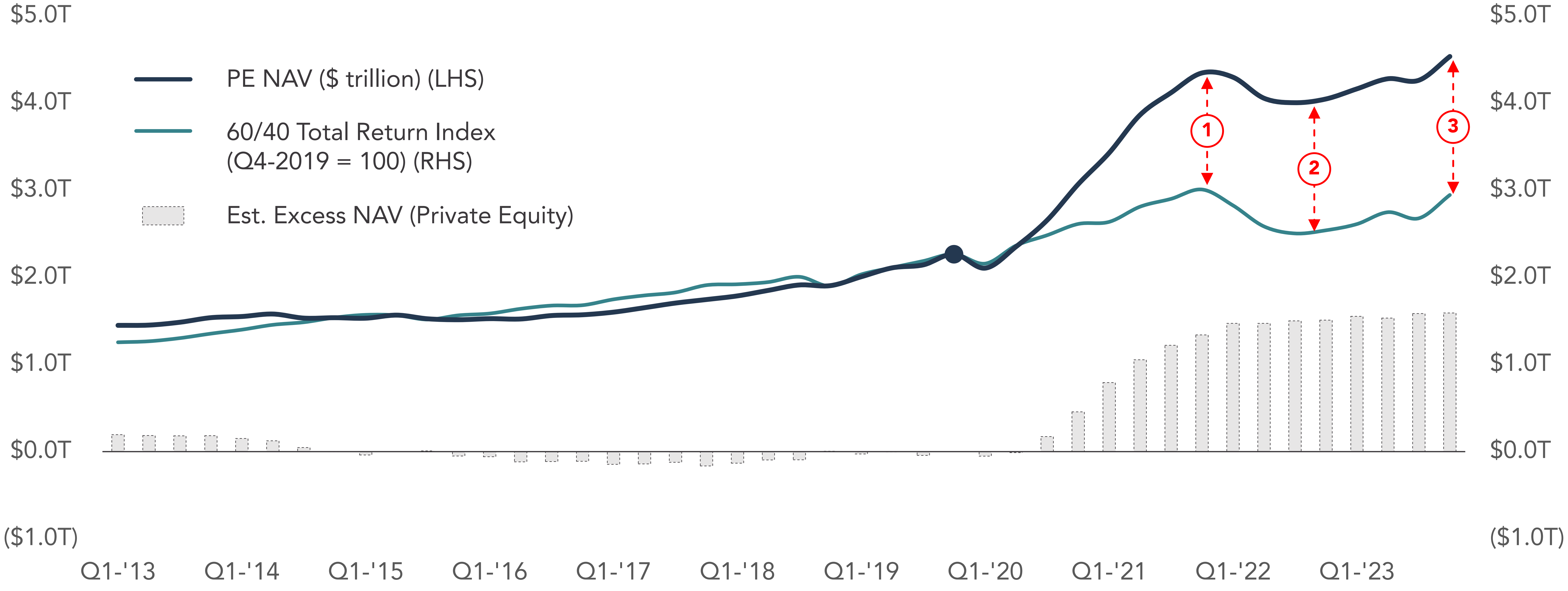
SOURCE: BURGISS, ARCTOS ANALYSIS; AS OF FEBRUARY 2024.
(1) USES ARCTOS NOWCAST EST. OF NAV FOR Q4 ‘23 FOR NORTH AMERICAN BUYOUT AND ASSUMES 0% NAV GROWTH IN Q4 ‘23 FOR NORTH AMERICAN VENTURE.

An Update on the 'Numerator Effect'

Overvaluation lessening has not changed the fundamental allocation picture. We estimate 'excess NAV' (i.e., NAV less an indexed proxy for aggregate financial wealth) powering the numerator effect remains >$1.5 trillion.

Significant PE NAV Writeups Driving Over $1.5T of Excess NAV Relative to Public Assets

Est. PE NAV [(1)] vs. 60/40 Nominal Total Return (Matching 60/40 Level to Q4-'19)



Timeline

1. Before 2021 correction, we had a problem.
2. 2021 correction made it worse & spooked investors.
3. Where we are now.

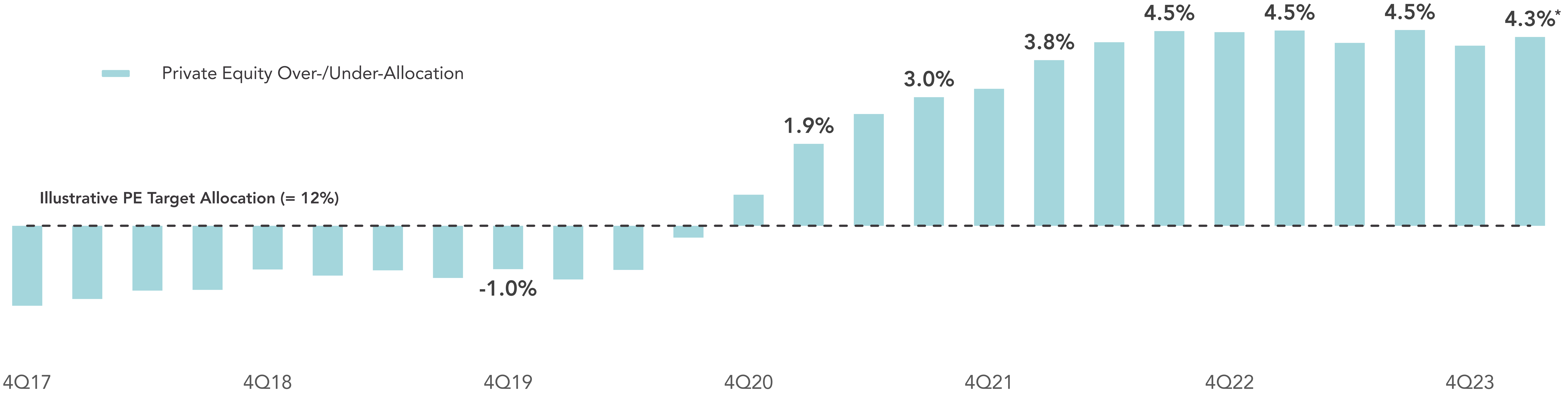
SOURCE: BURGISS (PRIVATE MARKET CASH FLOWS), ARCTOS ANALYSIS; AS OF FEBRUARY 2024. ST. LOUIS FED (CPI DATA), ROBERT SHILLER (HTTP://WWW.ECON.YALE.EDU/~SHILLER/DATA.HTM; STOCK & BOND PRICES). LATEST QTR AVAILABLE IS Q3-2023; WE USE OUR Q4 '23 NOWCAST TO FORECAST Q4-2023 PRIVATE EQUITY NAV.
(1) NORTH AMERICA AND WESTERN EUROPE BUYOUT, GROWTH, AND VENTURE CAPITAL (EQUITY), VIA BURGISS. WE ASSUME BURGISS HAS 60% COVERAGE OF THE NORTH AMERICA + WESTERN EUROPE PE MARKET.

Overallocation Burden Not Budging

Since 9/30/23, the 60/40 reflation has been +13%, but our NOWCAST for Q3 and Q4 NAV growth is similarly strong, and exit activity is not expected to help ease this. Anecdotally, we've heard some LPs are capitulating / accepting higher NAV allocations.

We Believe the Average Institutional Investor Is ~35% Overallocated to PE

Illustrative Pension Model: Assumes -1% Under Target Pre-COVID(1)



***Uses our nowcast est. of NAV and NCF for Q4-'23 and Q1-'24. Uses public market returns / prices as of 2/28/24.**

SOURCE: BURGISS, ARCTOS ANALYSIS; AS OF FEBRUARY 2024. LATEST QTR AVAILABLE IS Q4-2022. ST. LOUIS FED, ROBERT SHILLER (HTTP://WWW.ECON.YALE.EDU/~SHILLER/DATA.HTM; STOCK & BOND PRICES), ARCTOS ANALYSIS, AS OF JUNE 2023. (1) NORTH AMERICA AND WESTERN EUROPE BUYOUT, GROWTH, AND VENTURE CAPITAL (EQUITY), VIA BURGISS.
(1) ASSUMES 12% PE TARGET ALLOCATION.

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ARCTOS NOWCAST

Arctos NOWCAST Framework

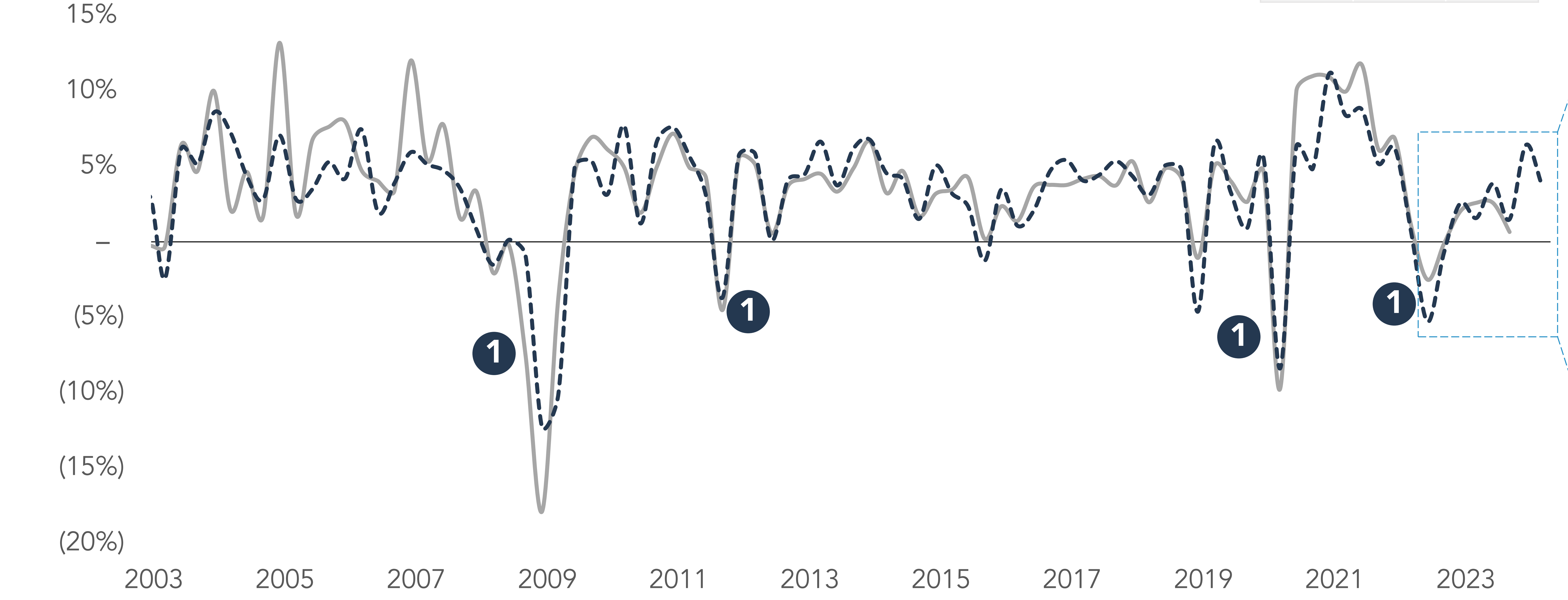
- We use historical data and time series forecasting models generate "nowcasts" – i.e., forecasts of current, and very near-term, activity for data that is released on a lag, as is common in private markets.

- Our proprietary models capture the interaction between past values of major macro, public market, and private market variables with current values of private market metrics we care about: NAV growth, contribution rates, distribution rates, cash flow activity, fundraising and secondary market value.

- Our goal is to build and regularly update an objective model of the present and near-future that we believe can help every investor and manager remain grounded and make better decisions, despite the "narrative noise" of the moment, which is often biased, momentum-driven, or influenced by a specific agenda.

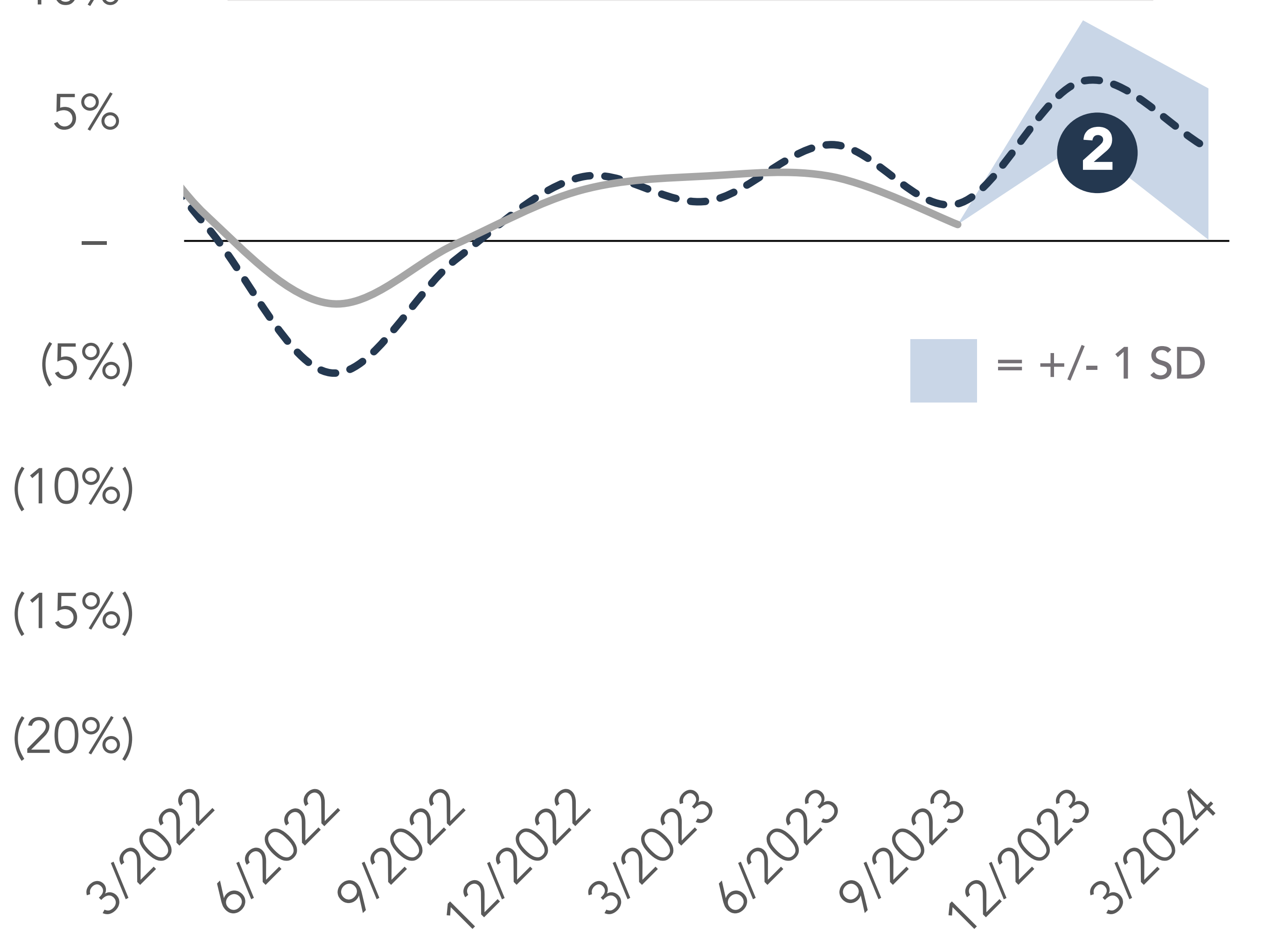
ARCTOS NOWCAST: NAV Growth

20-year Average		
-1 σ	Mean	+1 σ
-0.9%	3.7%	8.3%



NOWCAST

	Q3 '23	Q4 '23	Q1 '24
Actual	0.7%	n/a	n/a
NOWCAST Q3	1.5%	7.6%	n/a
NOWCAST Q4	**n/a**	**6.4%**	**2.8%**



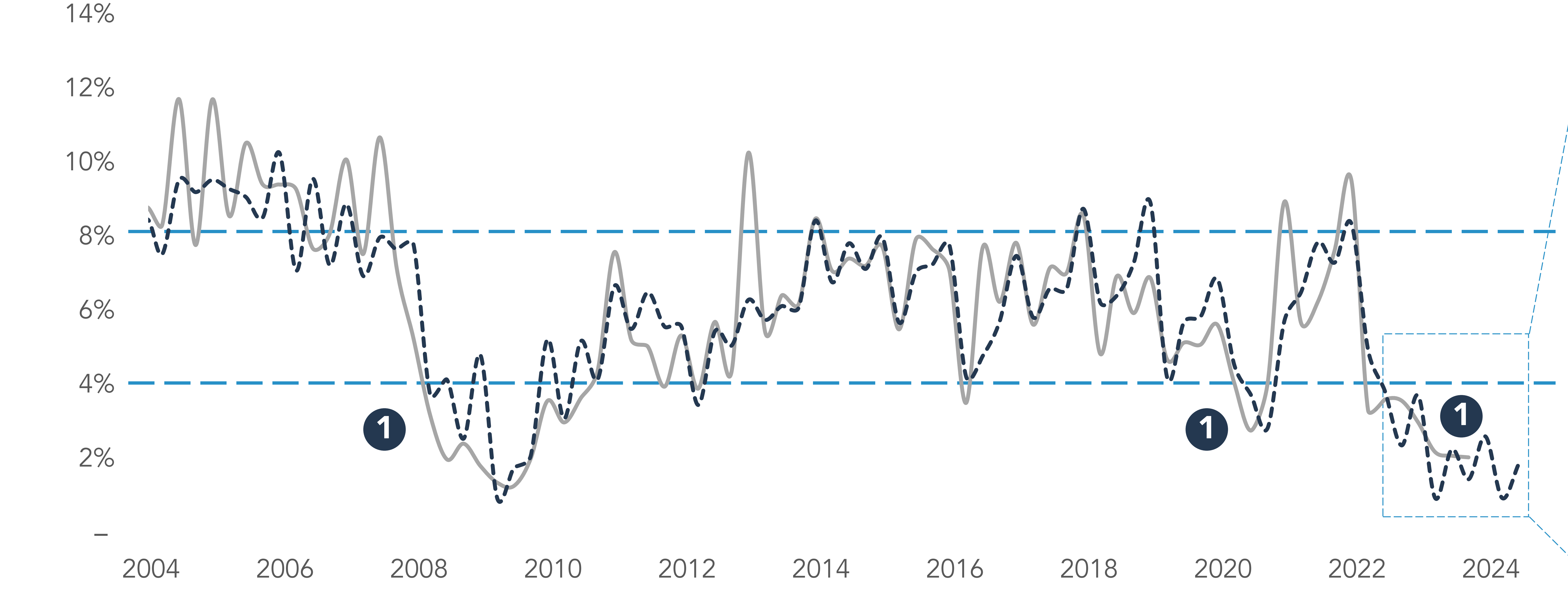
1 Unrealized NAV declines are exceptionally rare, as evidenced by the GFC, Euro Debt Crisis, COVID, and the 2022 meltdown.

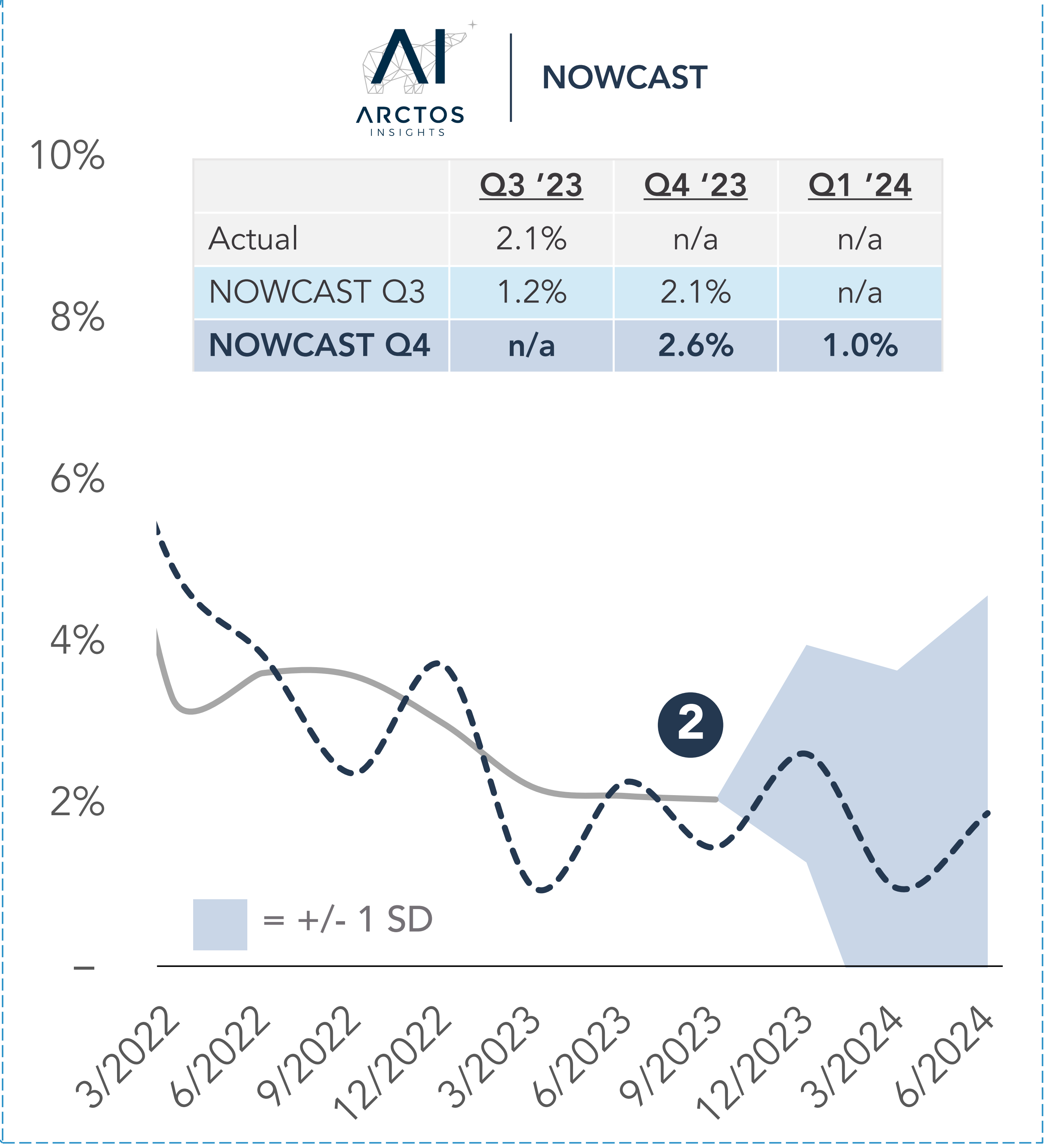
2 Recent appreciation in both the S&P 500 and Russell 2000 indicate strong NAV growth of ~6% predicted for Q4 2023 and ~3% for Q1 2024. However, U.S. public mega cap GPs (Apollo, Blackstone, etc.) reported Q4 NAV growth of only 3.1% (lower than our NOWCAST).

SOURCE: ARCTOS ANALYSIS.

ARCTOS NOWCAST: Quarterly Distribution Yield

-1 σ	20Y Avg.	+1 σ
3.6%	6.1%	8.7%





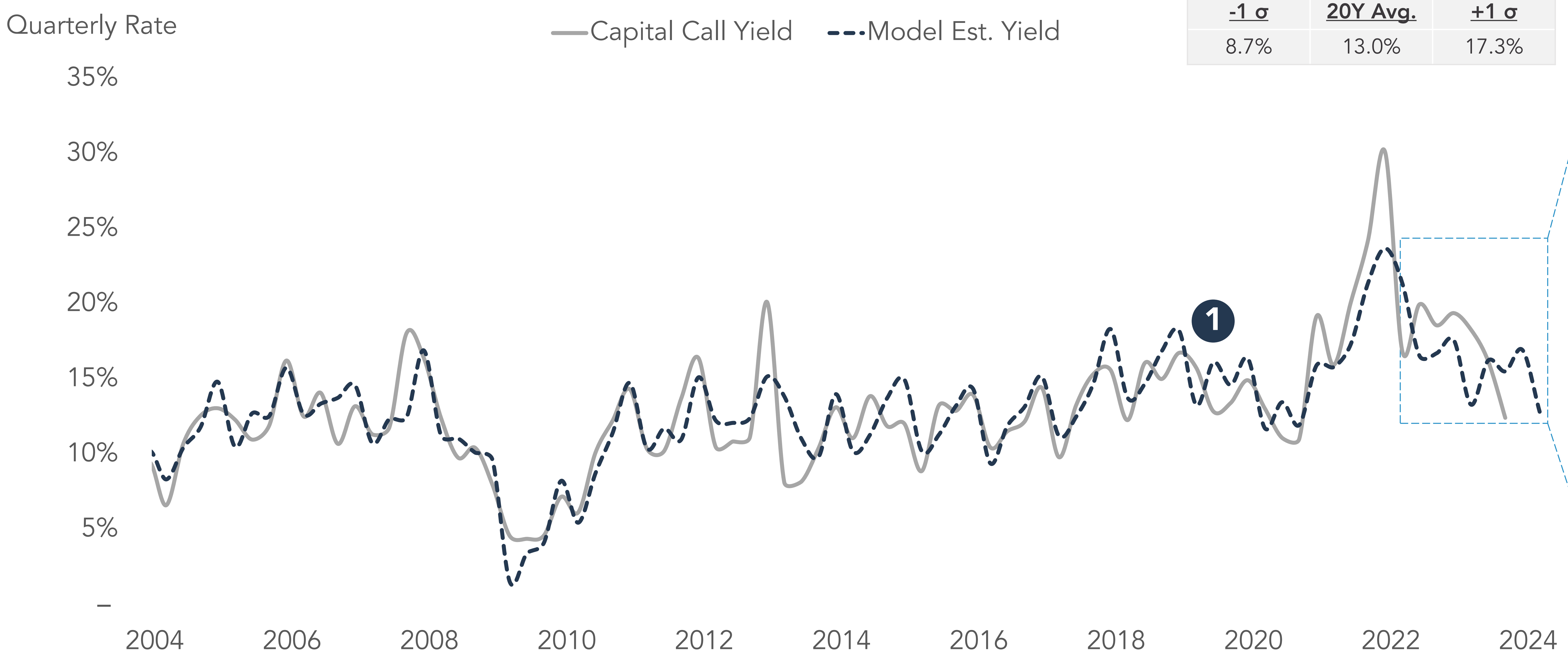
	Q3 '23	Q4 '23	Q1 '24
Actual	2.1%	n/a	n/a
NOWCAST Q3	1.2%	2.1%	n/a
NOWCAST Q4	**n/a**	**2.6%**	**1.0%**

1. Quarterly distribution yield of 4-8% has been remarkably stable for two decades, except for one quarter in the depths of the pandemic, three years post GFC and right now. **The exit market is broken, but global liquidity metrics are improving**

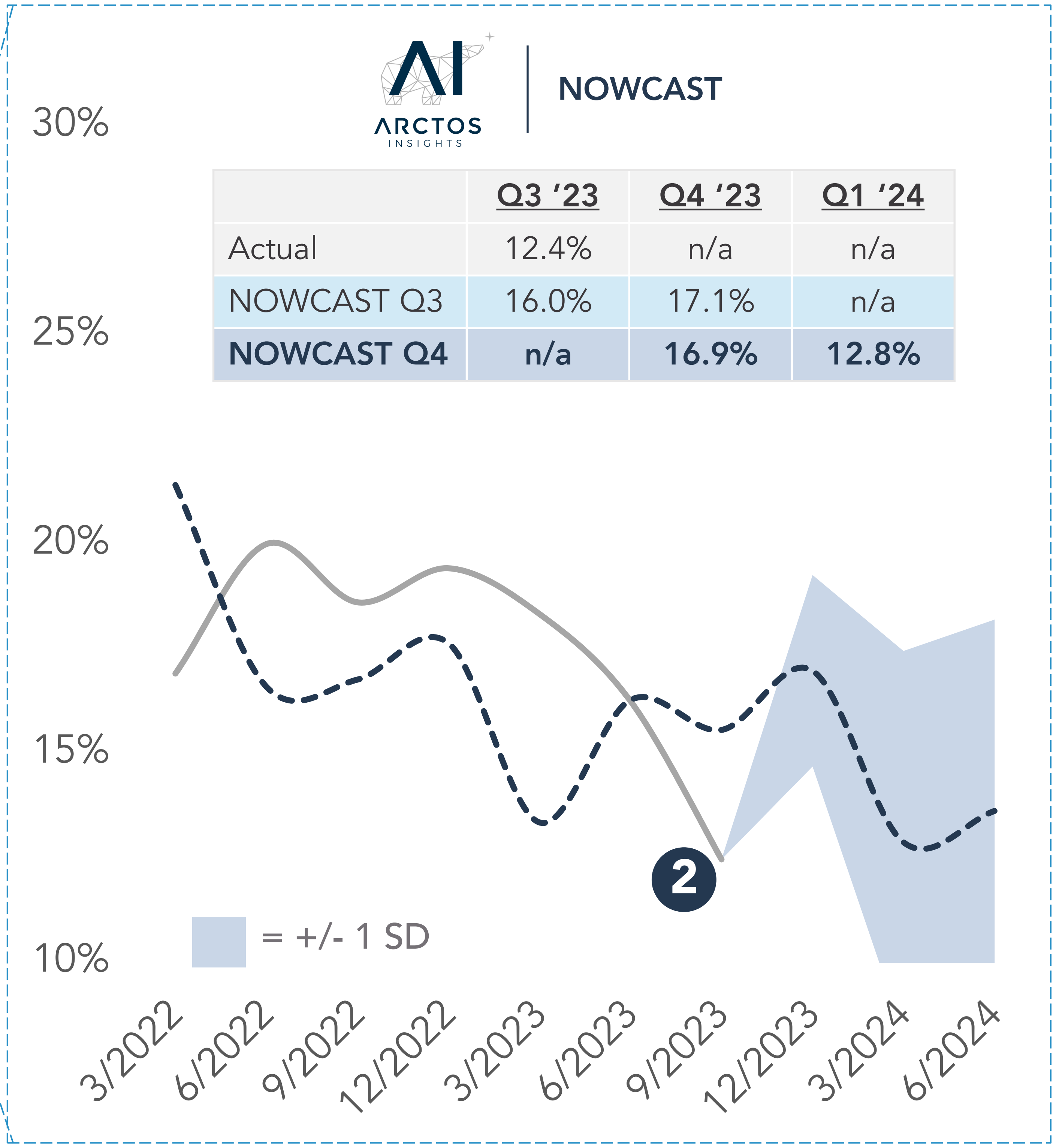
2. We expect very weak distribution yield to continue through Q1 2024. The sheer scale of unrealized NAV (>$4T) masks this with a historically "average" dollar distribution amount. Private equity is more illiquid than normal today.

SOURCE: ARCTOS ANALYSIS.

ARCTOS NOWCAST: Quarterly Contribution Yield



-1 σ	20Y Avg.	+1 σ
8.7%	13.0%	17.3%

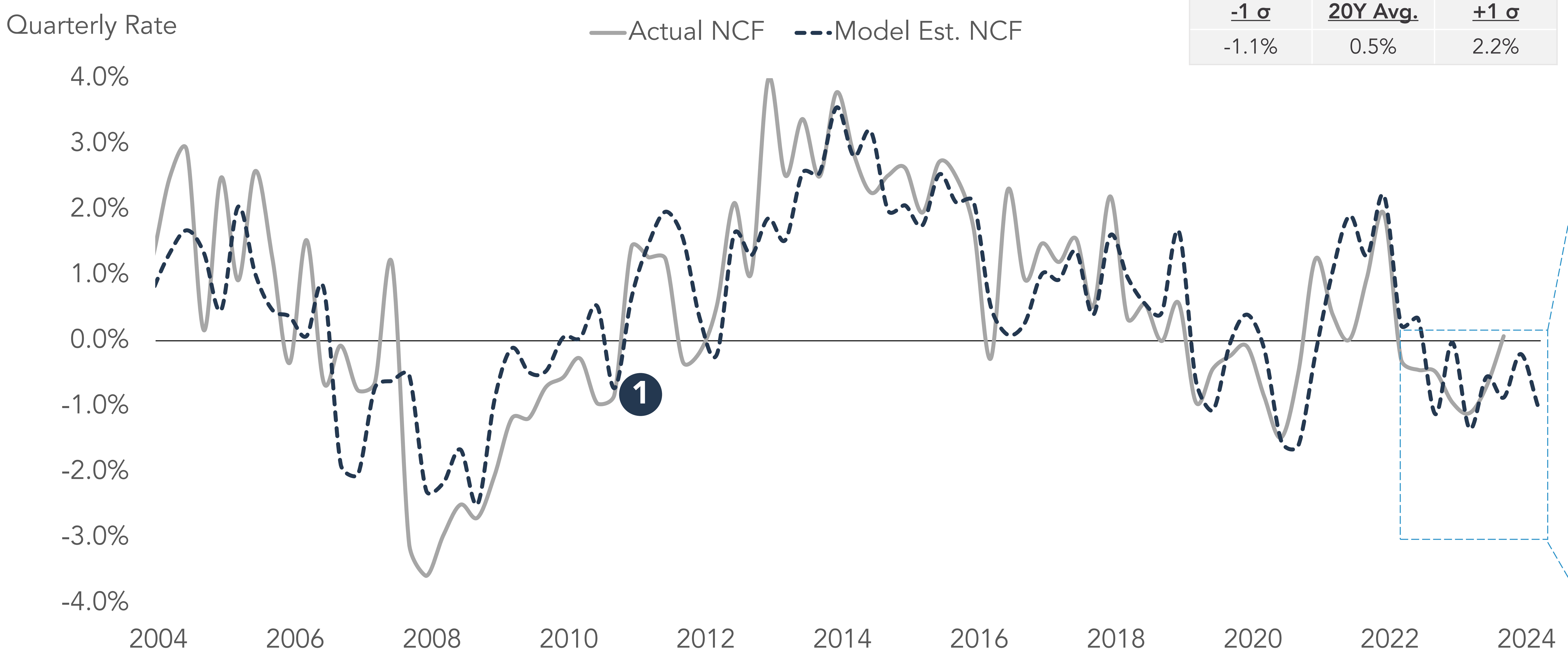


	Q3 '23	Q4 '23	Q1 '24
Actual	12.4%	n/a	n/a
NOWCAST Q3	16.0%	17.1%	n/a
NOWCAST Q4	**n/a**	**16.9%**	**12.8%**

1. Weirdly, quarterly contribution yield was stable during very active investment years (2016-21) but jumped to abnormal levels over the last 12 months, despite low deal activity. We suspect this is explained by fund line of credit utilization whipsaw, highlighted in our prior analyses here and here.
2. The slowdown in deal activity is creating more dry powder pressure and our estimates suggest drawdowns will remain strong through Q1 2024.

SOURCE: ARCTOS ANALYSIS.

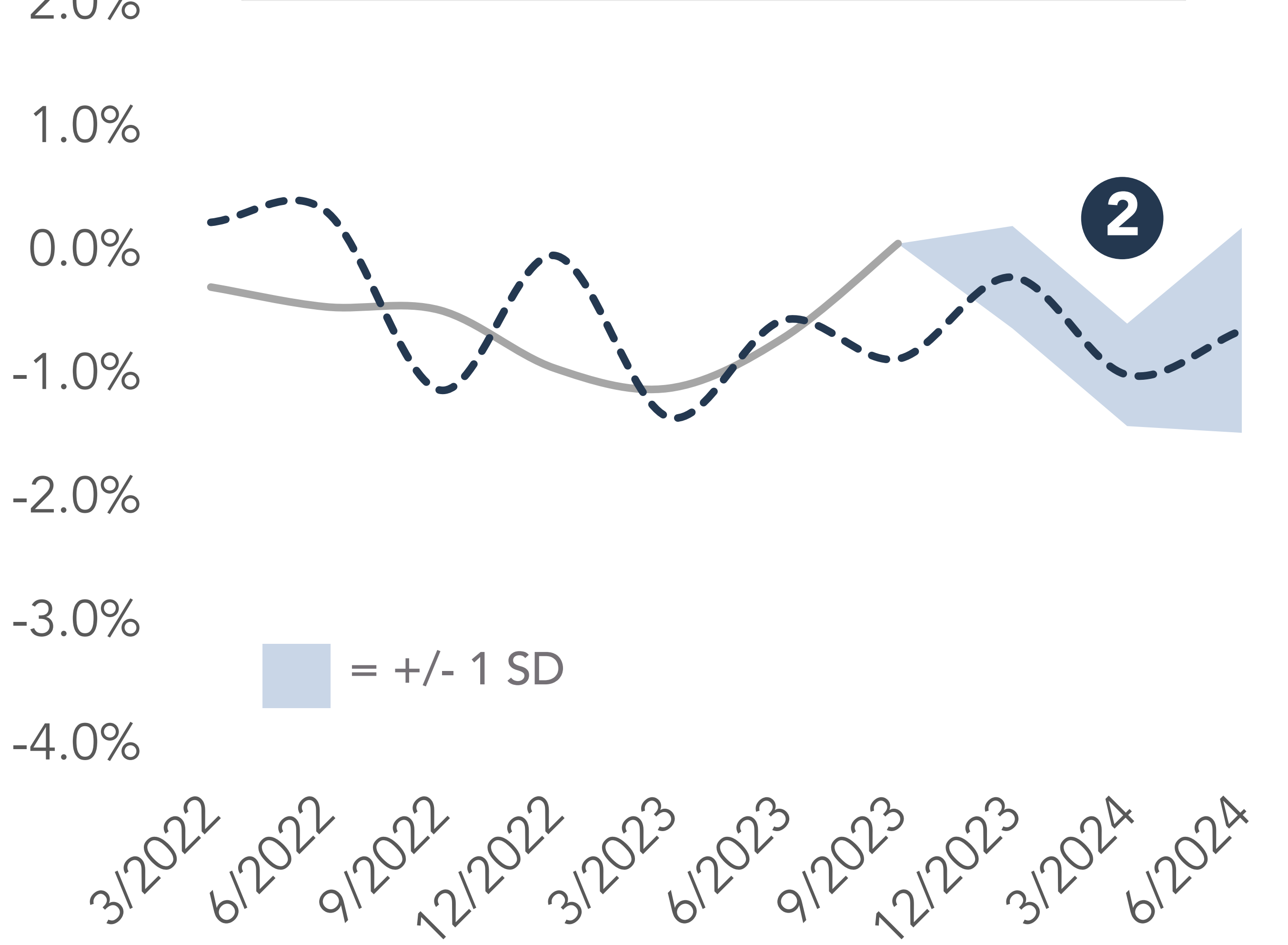
ARCTOS NOWCAST: Net Cash Flow Forecast



-1 σ	20Y Avg.	+1 σ
-1.1%	0.5%	2.2%

NOWCAST

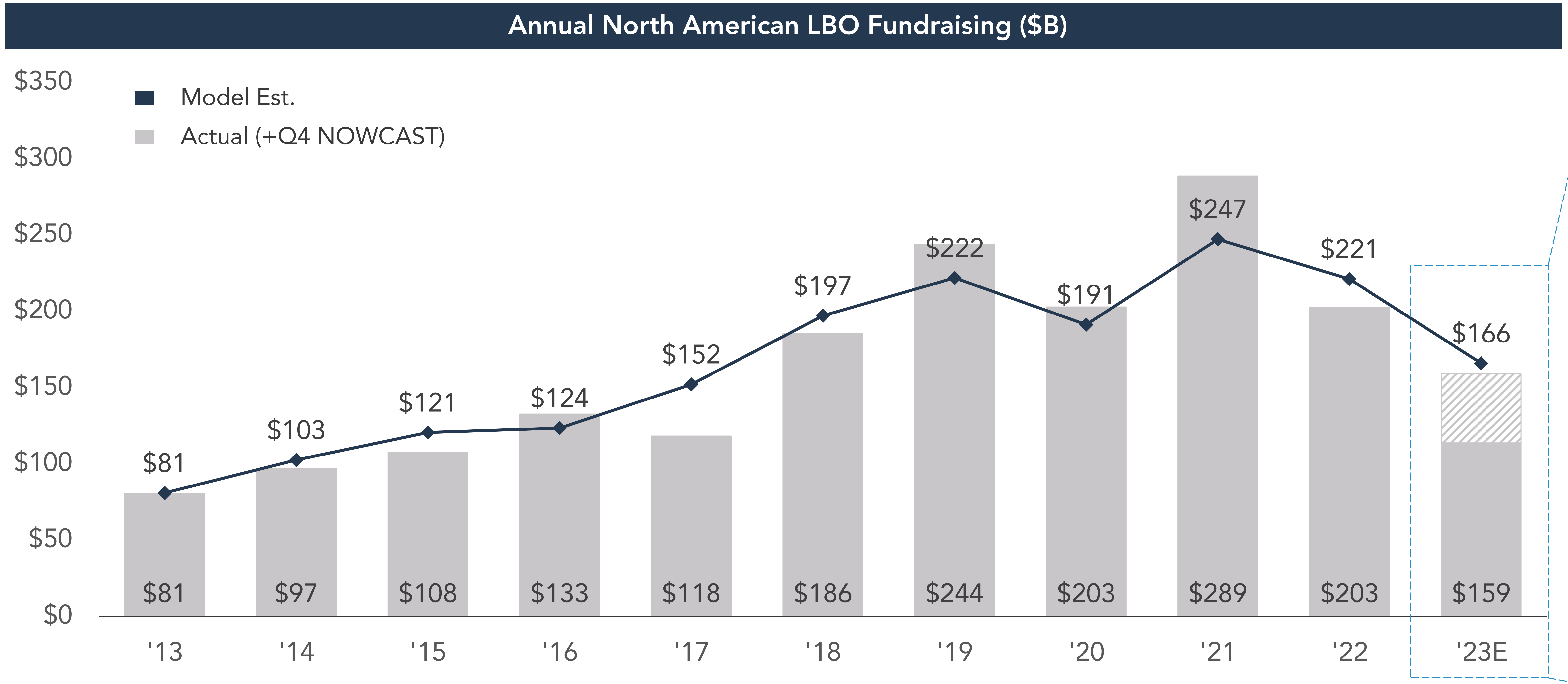
	Q3 '23	Q4 '23	Q1 '24
Actual	0.1%	n/a	n/a
NOWCAST Q3	-1.2%	-0.5%	-0.8%
NOWCAST Q4	**n/a**	**-0.2%**	**-1.0%**

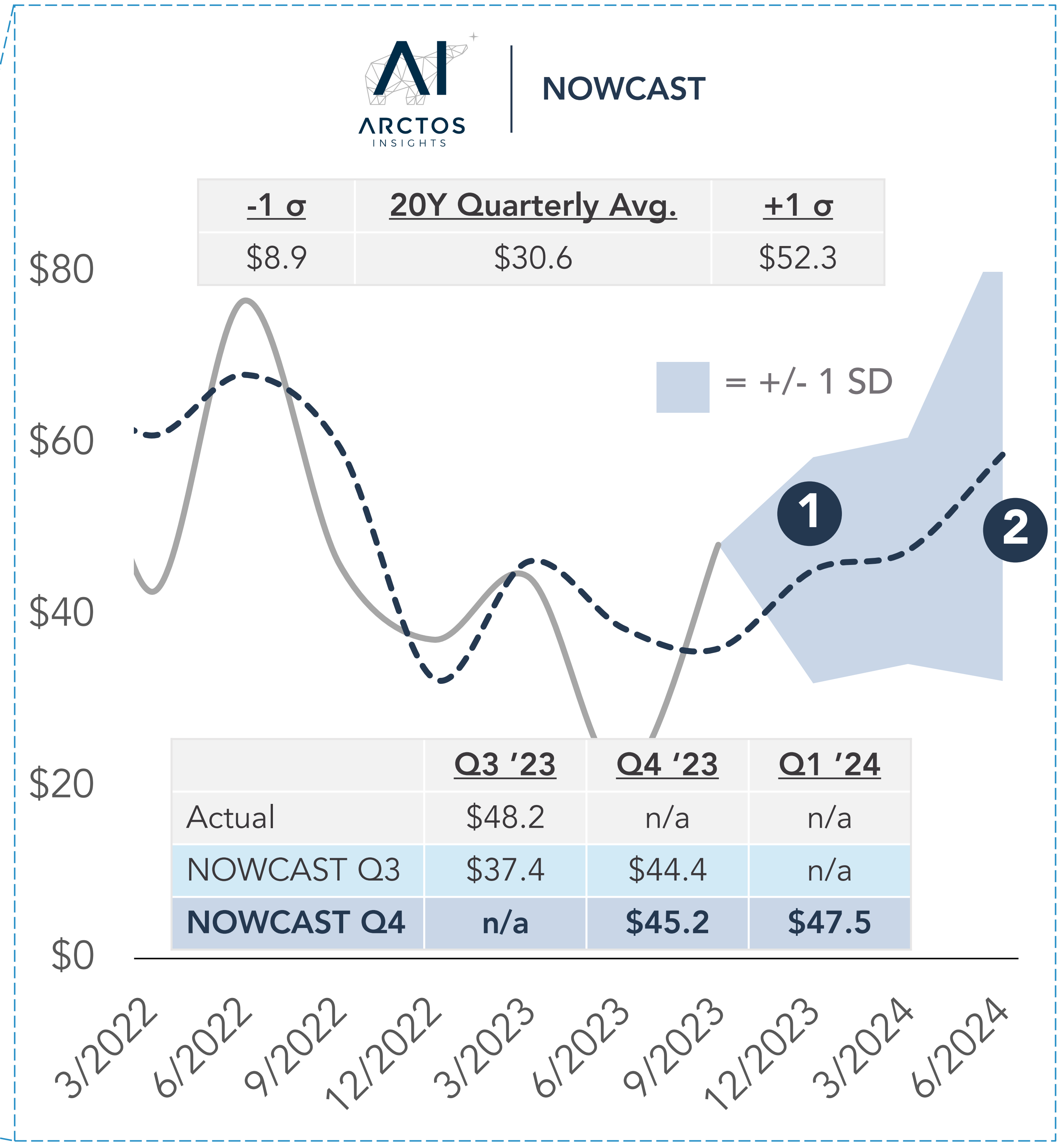


1. After a decade of almost constant aggregate positive net cash flow, developed market private equity is entering a period of liquidity consumption similar to 2007-2011.
2. Q3 saw lower than anticipated contribution activity and higher than anticipated distribution activity, yielding breakeven NCF for the first time since Q4 2021. We expect NCF to remain constrained until robust exit activity resumes.

SOURCE: ARCTOS ANALYSIS.

ARCTOS NOWCAST: Fundraising Projection

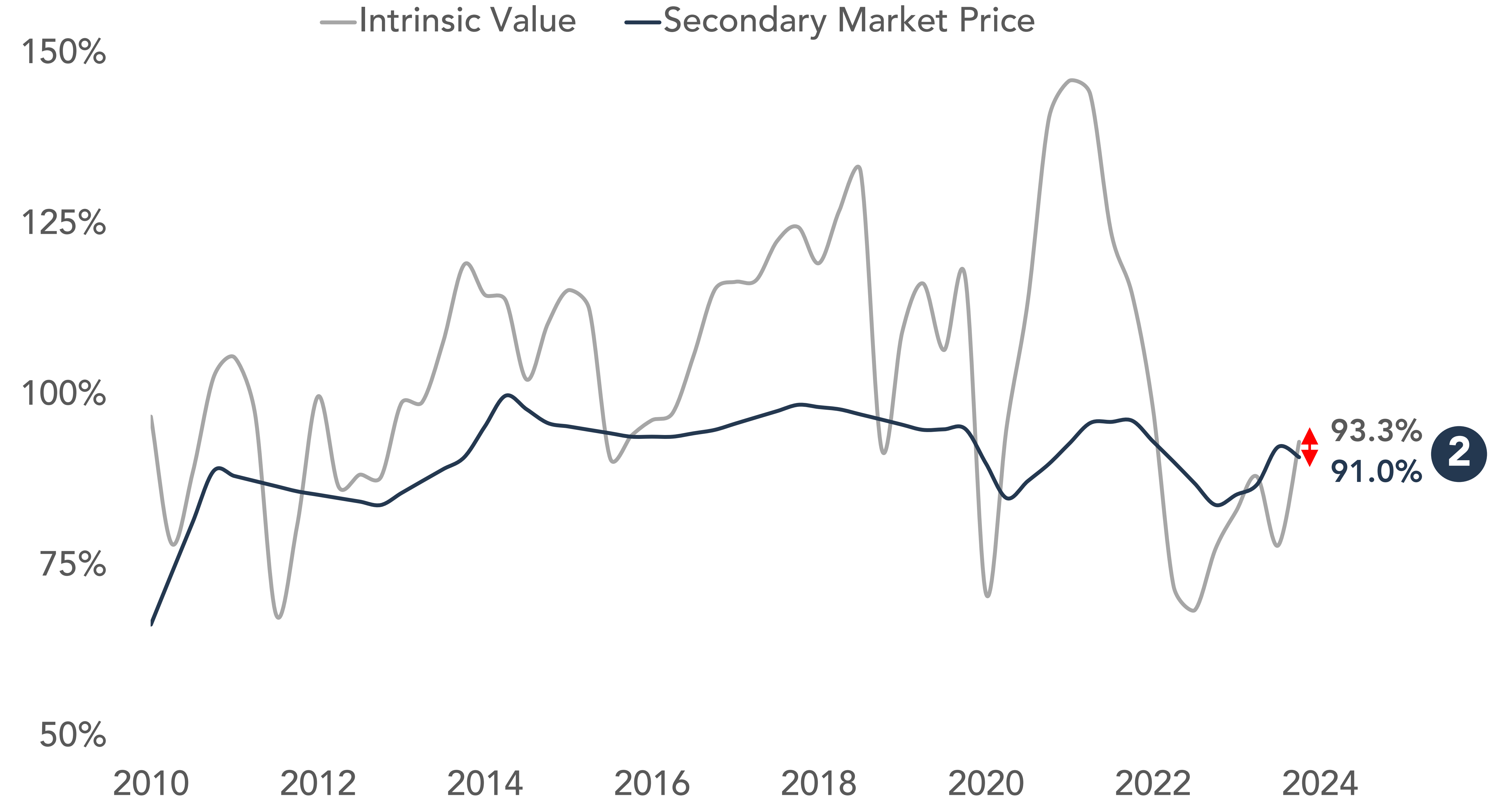




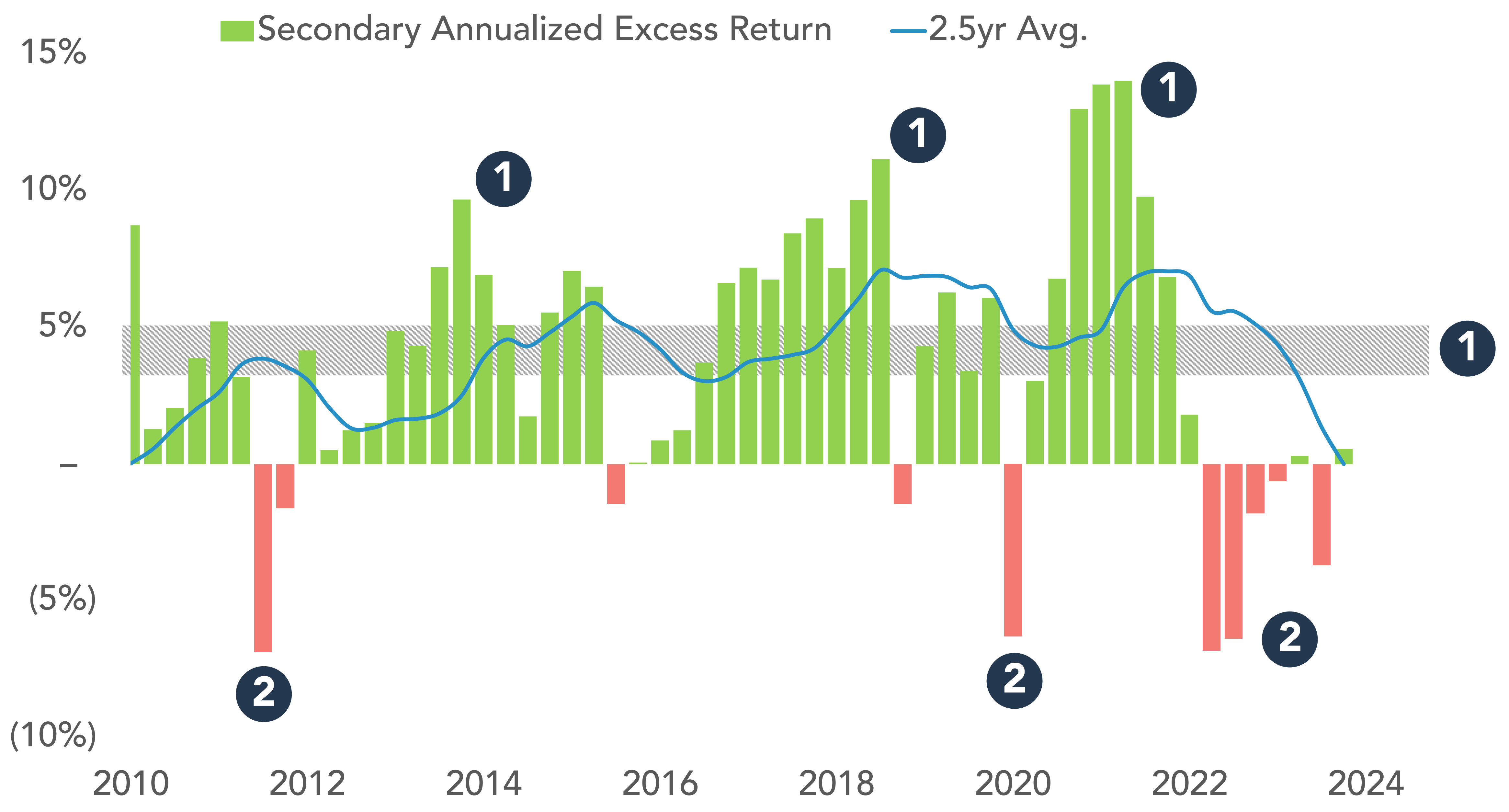
1. Q4 saw an appreciation in the 60/40 Portfolio and roughly breakeven net cash flow activity (an improvement!), both of which are near-term positives for fundraising.
2. Our model projects an increase in fundraising during the early quarters of 2024, though we forecast it should remain below 2021 levels.

ARCTOS NOWCAST: Secondary Return Environment

Annual North American LBO Intrinsic Value vs. Secondary Market Price (%)



Annual Secondary Market Alpha Harvest (%)



1. The secondary market can harvest excess return by purchasing assets below intrinsic value and then harvesting that arbitrage quickly via realizations. The alpha harvest needs to exceed 4-5% annually to offset secondary fund fee and carry.
2. Despite the recent increase in intrinsic value, our models still suggest the secondary market, by paying roughly fair value, is still overpaying for beta during a period with historically low liquidity – not a great formula for alpha harvest. **This is a supportive environment for traditional LP secondary sellers.**

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Our Takeaways & Recommendations

Distributions remain a key differentiator. *This exit liquidity environment is* ***as bad as the GFC****, and most LPs are struggling to justify re-ups.*

- ✓ LPs need liquidity more than ever, but we advise caution regarding novel structures like NAV loans. Continuation vehicles can be pursued opportunistically, but we believe LP sentiment here is shifting negatively. GPs must ensure strong alignment with their LPs and maintain close communication with their LPACs regarding any such options.
- ✓ All else equal, LPs place a premium on organic liquidity, and GPs should be dedicating resources to "sourcing" exits. While liquidity is tight, GPs are sitting on record levels of dry powder (>$2.5T in PE alone) and selling GPs should consider transactions that allow them to generate distributions, even if it means selling at a slightly lower MOIC. Consider partial exits or earnouts to retain some MOIC upside.
- ✓ There are still some LPs looking to go on the offensive, and GPs should leverage co-investments or minority recap transactions to solidify relationships with their largest, most sophisticated LP relationships while providing liquidity to LPs who need it.

GPs must accept the end of "auto-pilot" growth in their strategies and ***focus on organizational competitive advantages and alpha.***

- ✓ In our view, the most "at risk" GPs are those that lack clear differentiation and a "right to win" in the markets in which they operate.
- ✓ As the ZIRP era ends and we exit a period where most GPs outperformed prior vintages, GPs will need to better articulate their organizational competitive advantages (OCAs) and historical alpha generation. We have helped build and pioneer tools that can help you measure and assess these metrics rigorously and objectively.
- ✓ GPs should focus on bolstering their entire organization, with an emphasis on LP facing functions (investor relations, fundraising, etc.) and on talent density & star player retention as you consider efficiencies or cost rationalizations.

GPs of all sizes must deal with competition and capital scarcity. *It need not mean M&A, but expect M&A to continue.*

- ✓ In response to the difficult fundraising environment, the largest GPs are using M&A to drive inorganic growth to hit growth targets and diversify product mix to meaningfully de-risk their growth plans (sometimes in advance of an IPO process).
- ✓ M&A is also (and more fundamentally) a response to pressure from traditional capital sources; scale gives you easier access to novel capital formation opportunities, especially insurance, private wealth, and retail. This is a driving force behind a lot of recent M&A. Honing your strategy here is critical.

ARCTOS
INSIGHTS

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