

Value in vogue?

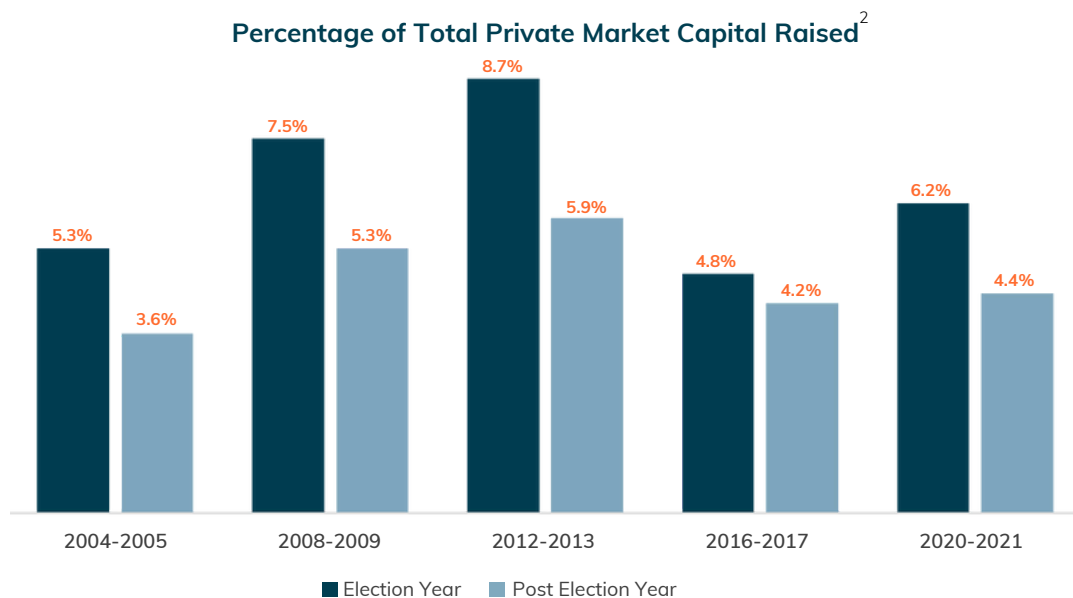
Value-oriented private equity strategies and what they offer prospective investors amidst an ever-changing global economic landscape

Underpinned by swift changes in key economic policies globally, an increasingly complex decoupling of relationships with China, and new world conflicts/wars, the private markets fundraising backdrop over the past two years has been extremely challenging. Furthermore, as we turn towards the second half of 2024 and the year ahead, geopolitical risks to the global economy are inherently heightened, with this year's global elections providing a potential runway of risk events that could redraw the geopolitical map, with over half of the global population going to the polls throughout 2024 to decide the fate of countries that represent over 60% of the world's economic output.¹

Facing this interesting backdrop, Asante has noticed an increasing appetite from limited partners seeking "value-oriented" exposure. At its simplest level, value-oriented managers are focused on buying companies at a discount to their intrinsic value, which typically means these are businesses that are often overlooked due to situational complexities, inefficient operations, poor management or a variety of other factors that may not be obvious. Importantly, value-oriented strategies tend to be equipped to capitalize on dislocations in the marketplace, irrespective of conditions, enabling them to be active, consistent participants during uncertain economic times, and overall tend to be less reliant on financial leverage. On the contrary, growth-oriented strategies tend to derive value from future cash flows further out in the future, so they tend to exhibit more sensitivity to economic conditions, including changes in underlying interest rates, which has certainly been topical since March 2022.

Value-oriented capital raising before & after US elections

Based on data reviewed by Asante, it was apparent that capital flowing into value-oriented strategies during U.S. presidential election years, typically years with heightened uncertainty, is significantly greater than the year that follows:



¹ RBC Capital Markets, "World Elections Threaten Global Geopolitical and Economic Stability"

² Preqin. Value-oriented data is an aggregation of capital raised for managers categorized as Turnaround, Distressed and Special Situations



Key advantages to investing in value-oriented strategies

Resilience in Market Downturns:

Companies acquired through value-oriented strategies may be more resilient during economic downturns as a result of lower debt levels, efficient cost structures, and a focus on operational efficiency rather than expansion.

Lower Risk of Overpaying:

Value-oriented strategies tend to be disciplined in their approach to buying, often avoiding paying excessive premiums for companies, a common pitfall in more growth-oriented strategies.

Focus on Fundamental Analysis:

Value-oriented private equity strategies typically involve thorough fundamental analysis of target companies. This focus on understanding the underlying business fundamentals can help investors identify opportunities where the market has mispriced assets.

Operational Improvements vs. Leverage:

Company profiles tend to vary in their level of undermanagement, under-investment in systems and processes, or lack of sales and marketing capabilities. However, value-oriented managers generally have the capabilities to restructure or significantly supplement many of these operational processes to enhance the company's efficiency and output, thereby significantly increasing profitability and also potentially creating multiple arbitrage through enhancement of the overall platform.

An increase in demand for value-oriented strategies

Value-oriented strategies are seemingly becoming more relevant for global limited partners. This is increasingly becoming visible in our conversations, as we continue to hear from limited partners that they are seeking to find general partners who have a focus on prudently deploying capital into businesses that are not reflecting rich entry multiples nor relying on financial engineering to generate returns. Some recent examples include:

UK Insurance Company

"While we are not particularly looking to add anything new this year due to allocation constraints, we'd be most inclined to add a GP with a value / complexity tilt to compliment what we feel is a very balanced portfolio."

US Public Pension

"Value-oriented buyout managers would be at the top of our priority list - we are currently geared towards optimizing our portfolio by adding higher alpha managers in the lower and middle market landscape."

UK Family Office

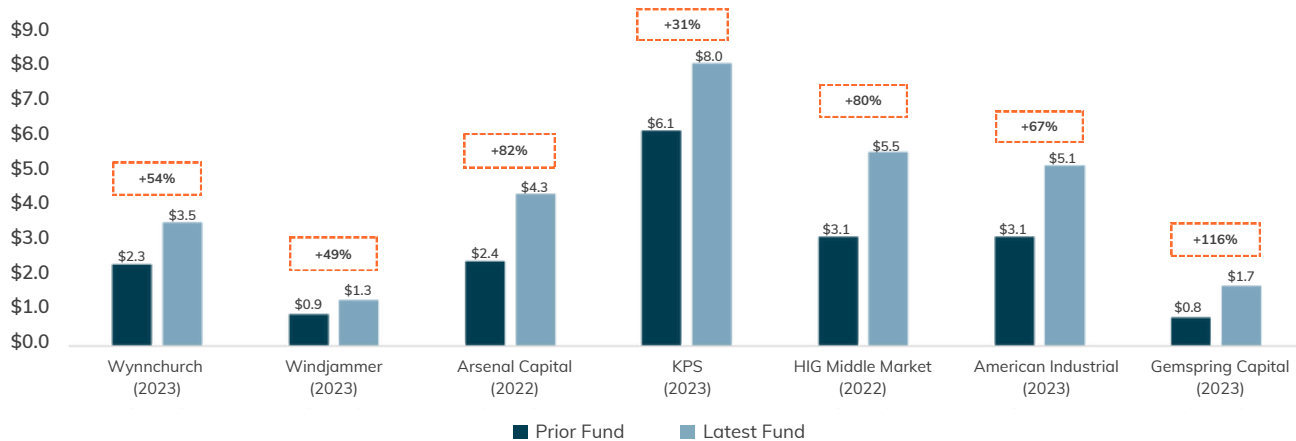
“We feel well covered in traditional buyout and growth equity in the US, and are now planning to veer towards value-oriented funds on the opposite end of the spectrum.”

US Investment Consultant

“We take a strong bottoms-up approach to evaluating managers and are specifically homing in on groups with strong value orientation - GPs that are tangibly able to grow EBITDA are of high interest to us at this time. We see opportunity for value-oriented investing across healthcare, industrials, and infrastructure services.

We have seen a number of value-oriented managers demonstrate exceptional success in an arduous fundraising environment with multiple accounts of being oversubscribed and hitting hard cap, as well as moving in and out of market in record time periods compared to the latest market average. By way of example, Wynnchurch recently announced that they launched and closed their latest fund, Wynnchurch Capital Partners VI, L.P, in less than 5 months.³ This in comparison to McKinsey’s report showing that funds that closed in 2023 were open for a record-high average of 20.1 months.⁴ Expanding on this further, an increase in demand can also be demonstrated by increase in fund size. By way of further example, Gemspring Capital Management publicly announced a single close of their most recent fund, Gemspring Capital Fund III, at \$1.7 billion, within 4 months from launch, up from c.\$800m in their prior fund. The fund managers in the below graphic were oversubscribed and closed in this turbulent environment and managed to achieve meaningful increases over the predecessor fund size.

Prior Fund Size vs. Latest Fund (\$M)



Various ways to invest in value-orientated strategies

Value can often be played by investors in various ways – often times either focused on a single, event driven strategy or through various combinations of strategy types, including:

Distressed / Turnaround Strategies

Companies facing financial distress where private investors have the opportunity to provide rescue capital in exchange for control of the company. Distressed investment opportunities have been limited over the last decade, but as debt defaults and insolvencies climb, deal flow is accelerating. Bankruptcy filings by US private equity portfolio companies reached an all-time high in 2023 and are on pace to nearly match that record in 2024, according to an S&P Global Market Intelligence analysis of bankruptcies filed between January 1 and April 30.⁵

3 Wynnchurch Capital, “Wynnchurch Capital Closes on Fund VI at \$3.5 Billion”

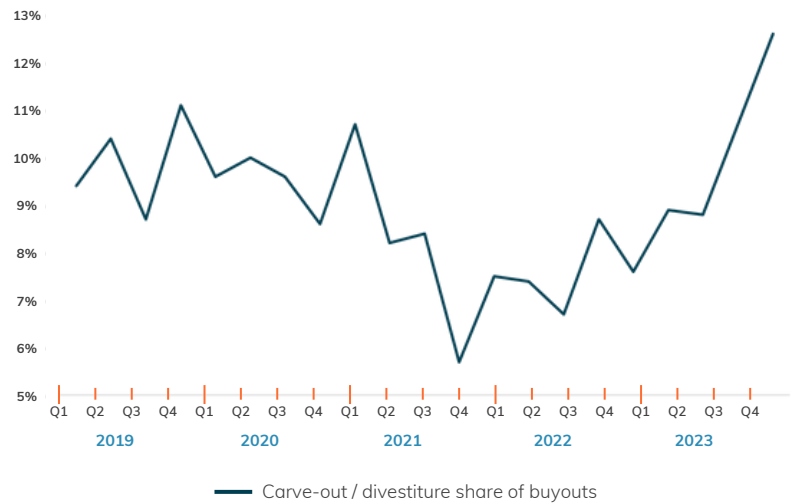
4 McKinsey & Company, “McKinsey Global Private Markets Review 2024: Private Markets in a Slower Era”

5 S&P Global, “Portfolio Company Bankruptcies Remain Elevated; Funding Rounds Fall in April”

Special Situations Strategies

Special situations is typically an umbrella strategy which includes elements from turnaround / distressed playbooks, but can also target companies that remain profitable but are encountering low margins and stagnant growth. These deals typically arise from event-driven circumstances such as corporate carve-outs and restructurings that typically tend to encompass debt, equity or a combination of the instruments. In particular, corporate carve-outs have seen a lot of momentum with many large companies looking to divest their non-core assets. Carve-out deals accounted for 12.6% of all U.S. PE buyout deals, a 110% increase since the end of 2021.⁶

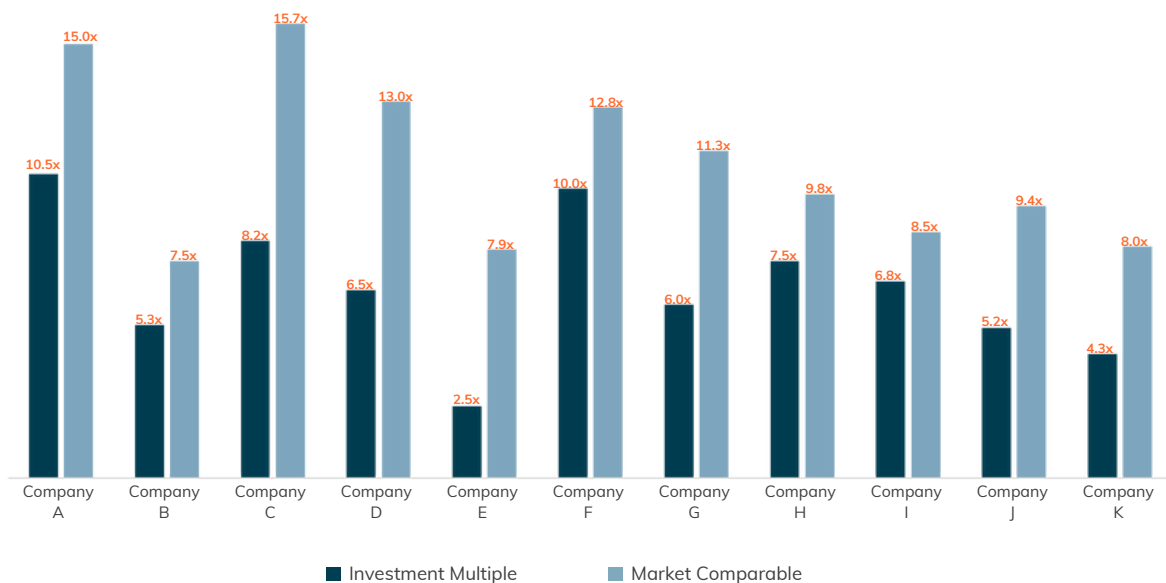
Divestitures as a percentage of all US PE buyouts



Buying at discounted entry valuations

Value can also simply be put as “buy low, sell high.” However, value investors typically have robust in-house sourcing to uncover overlooked undervalued companies relative to market comps. There is much more skill that goes into the “buy” including navigating complex management transitions, getting comfortable with complex diligence points that most PE firms might shy away from such as customer concentration, or navigating an inefficient sale processes. In these cases, discounted entry multiples on day one equates to a greater margin of safety. This embedded downside protection from the skilled “buy” complimented various value creation levers results in added multiple expansion. Below is a representation of a general partner that deploys a value-oriented approach on the buy:

Anonymized EV/EBITDA multiples at Entry vs. Market Comps



Typical levers of value-creation

Value-oriented private equity strategies often deal in complex transactions, where GPs have a myriad of levers to pull to drive value and ultimately, exit pricing. Levers where we see GPs most effective are in the following:



Operations

Optimizing operational processes within the company to reduce costs, improve productivity, and enhance overall efficiency. More often than not, this may include streamlining supply chains, improving manufacturing processes, and/or renegotiating supplier contracts.



Growth Initiatives

Focusing on driving top-line growth through various strategies such as market expansion, implementing new products and/or services, entering new geographical markets, or enhancing sales / marketing efforts.



Management Enhancements

Improving corporate governance practices and strengthening the management team by recruiting new talent, providing leadership development, or implementing performance-based incentives.



Digital Transformation

Investing in technology to improve operational processes, enhance customer experience, or leverage data analytics for better decision-making.



Customer / Market Focus

Improving customer service processes and gaining deeper insights into customer needs and behaviors to drive growth and customer loyalty.

Historical value-oriented returns and notable risk

As stated above, private equity value-oriented PE strategies are generally known for their ability to deliver strong returns by identifying undervalued assets, restructuring them for efficiency, and ultimately realizing their increased worth, with limited use of leverage. Value-oriented strategies have consistently outperformed other private equity approaches over the long term, delivering an average annual return of 17.7% compared to 14.7% for other strategies.⁷ Additionally, a study by Cambridge Associates underscores the resilience of value-oriented strategies during economic downturns, with these investments demonstrating superior risk-adjusted returns compared to growth-focused counterparts.⁸ The success of value-oriented strategies underscores the importance of disciplined investment approaches and hands-on operational involvement in driving value creation within the private equity landscape.

⁷ Bain & Company, "Global Private Equity Report 2021"

⁸ Cambridge Associates, "Private Equity Benchmarks"



Sector Focus

Value-oriented funds targeting distressed assets have delivered median net internal rates of return (IRR) of over 15% over a ten-year horizon, outperforming funds with a broader investment focus.⁹



Geographic Variation

Value-oriented funds in emerging markets have demonstrated strong performance in recent years, with median net IRRs exceeding 20%.¹⁰

While value-oriented strategies offer potential advantages, they also come with their own risks and challenges. These can include longer investment horizons, the need for active management and operational improvements, and the potential for value traps where companies fail to realize their intrinsic value.

Conclusion and outlook

Like most private investment firms attempting to fundraise in the last 24 months, value-oriented managers are competing for a downsized capital allocation pool in an environment with increased investor conservatism. Despite the decrease in capital allocated in the most recent of years, real-time feedback from investors on a global basis would suggest that we will see a strong rebound in deployment to value-oriented and special situation strategies in 2024 and into 2025 and beyond. However, we caution that this trend may not last long-term. “The most important thing to look out for is the pickup in M&A markets because that will be the clear indicator that we’re on the road to recovery and the market has bottomed out,” says Asante’s Founding Partner, Fraser van Rensburg.

9 Preqin Insights: Private Equity & Venture Capital
10 EY Global Private Equity Watch, “2023 in Review”





For any questions, please contact:
info@asantecapital.com

LONDON

Asante Capital Group LLP
25 Old Burlington Street, London
W1S 3AN, UK
+44 (0) 20 3696 4700

NEW YORK

Asante Capital Group Advisors LLC
10 East 53rd Street, Fl 12
New York, NY 10022
+1 646 694 9624

HONG KONG

Asante Capital Group HK Limited
Level 44, Champion Tower
3 Garden Road Central, Hong Kong
+852 2297 2849

MUNICH

Asante Capital Group Germany GmbH
Maximilianstrasse 13, 3rd Floor
Munich, Bayern 80539, Germany
+49 89 5419 5728

This material is for information purposes only and is not intended to provide a basis for evaluating any investment acquisition or disposal. It does not constitute a financial promotion and should not be considered as investment research, advice or a recommendation in relation to any investment or in connection with any product or service of the Asante Capital Group. Where relevant, this material is only being directed to persons who are legally able to receive it in the jurisdiction in which they are situated and no one else should place any reliance on it whatsoever. This material is issued by and copyright © Asante Capital Group LLP 2023. All rights reserved.