

WHITE PAPER | Q4 2023

THE SECONDARY PRIVATE EQUITY OPPORTUNITY

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01 INTRODUCTION

What are the liquidity options in illiquid funds? Private equity investments are closed-ended funds typically characterized by ten-year terms plus multiple extensions. The private equity secondary ("secondaries") market is the only option available for limited partners ("LPs") to sell their investment ahead of that long-dated dissolution date, and a lot can happen over the course of 10+ years. There are many reasons for why investors would seek to sell their private equity investments before the end of their natural terms. These include, but are not limited to:

Market Dislocations

- distressed selling, due to the inability to finance future unfunded commitments or other urgent needs for liquidity – particularly relevant in the current economic environment due to a slowdown in distributions;
- the denominator effect, as the weighting of private equity assets may increase in a portfolio due to a fall in publicly traded securities, which imposes a re-balancing effort in order to comply with allocation targets within an investor's portfolio policy;

Through the Cycle

- strategic selling and active portfolio management (e.g. to lock-in returns);
- changes to an investment strategy driven by modifications to an existing business model, personnel changes, other organizational factors or M&A; and
- portfolio rebalancing to capture different geographic, vintage or sector diversification.

Additionally, the managers or General Partners ("GPs") of private equity funds may work alongside secondary investors in offering solutions. Some or all of the assets are typically acquired by secondary investors through a new continuation vehicle ("CV") managed by the GP ("GP-led"), enabling the manager to secure more time and capital to capture additional value for trophy assets whilst also providing existing investors with a liquidity option. The current environment has increased the prominence of GP-leds in the secondary market due to:

- Closure of IPO windows (30% drop in H1 2023 vs. H1 2022¹) and restricted access to equity capital markets for traditional company exit routes;
- Slowdown in M&A, namely sponsor-backed M&A (60% drop in H1 2023¹) limiting the universe of potential buyers;
- Decreases in asset valuation linked to the drop in public markets;
- Restricted access to financing due to the increase in interest rates; and
- Significant dry powder from secondary investors (currently at +c.\$200bn as at Q3 2023²).

Further detail on the primary types of secondary transactions can be found in Appendices A and B of this paper.

¹ Lazard, 'Interim 2023 Secondary Market Report'

² PJT, 'Q3 2023 Secondary Market Insights'

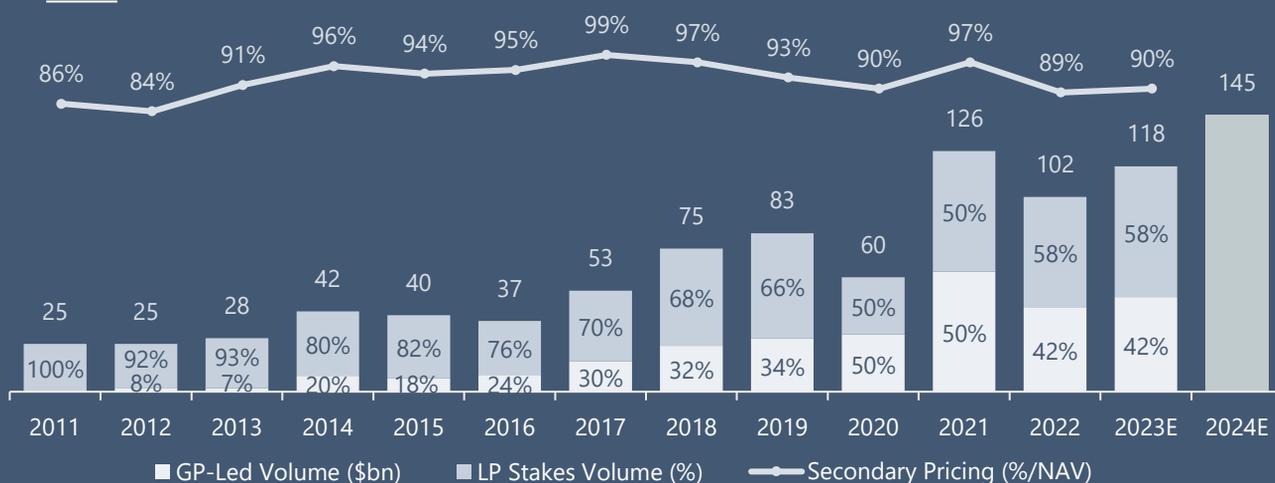
Secondaries market volume has grown significantly in recent years, driven by increased active portfolio management by institutional investors, a broader adoption of GP-led liquidity offerings as an alternative exit path for portfolio companies, and market volatility driven by Covid and the current uncertain macro and geopolitical environment.

After the post-Covid momentum in 2021, and a slowdown in 2022, secondary advisors have again estimated growth in the secondary transaction volume and expect 2023 to be the second-best year in history.

GP-led transactions are expected to continue to contribute to a similar share of market volumes to that of 2022, a sign that the secondaries market has grown into a mainstream liquidity provider for both GPs and LPs.

Despite the expected transaction volumes, the secondaries market has plenty of room left to grow and continues to attract both new investors and new asset managers alike. Annual secondary transaction volumes currently only account for less than 2% of total private equity asset value.

Historical Secondary Volume (\$bn) and Pricing (%)



Source: Greenhill, 2016-2023 Market reports; Jefferies, 'H1 2023 Global Secondary Market Review'; Lazard, 'Interim 2023 Secondary Market Report'

Global PE Assets under Management & Secondary Transaction Volume (% of AuM)



Source: Preqin, 2023; Greenhill, 'Global Secondary Market Review'

Secondary fund dry powder (the amount of unfunded capital that secondary buyers have to invest in secondary opportunities) has grown significantly in light of the significant growth in secondaries transaction volume. An increasing number of limited partners have committed to secondary funds as they recognize the benefits of having secondaries exposure within their investment portfolio.

In the last 5-6 years, the secondaries market has maintained a sound level of capitalization averaging around 2.2x projected annual market volumes (excluding 2020 due to Covid-19), implying that despite this growth in capital there is sufficient supply underpinning the market for continued growth.

There are multiple reasons for why it is attractive for LPs to invest in a secondaries

fund, whether as part of a wider private equity portfolio or as their first private equity investment. Some of the key reasons include:

- acquisition of underlying companies closer to their exit dates leads to the potential for earlier payback periods and shorter overall fund terms than traditional funds;
- secondaries portfolios are highly diversified, meaning investors are exposed to a wide variety of companies across different vintages, managers, sectors and geographies in an accelerated fashion; and
- secondaries buyers typically acquire investments at a discount to the Net Asset Value (NAV), generating a return uplift on day one, mitigating the J-curve effect.

Further detail on the above points can be found in Sections 3 and 4 of this paper.

Transaction Volume & Available Capital Evolution (\$bn)



Source: Greenhill, 'Global Secondary Market Review'; Jefferies, 'H1 2023 Global Secondary Market Review'

02

SECONDARIES IN THE CURRENT MACRO ENVIRONMENT

The last year has been marked by the significant increase in interest rates in response to the inflationary environment, the collapse of large financial institutions such as SVB and Credit Suisse, geopolitical tensions, as well as a decline in valuations most notably within sectors that benefited from Covid (technology and healthcare). These factors have impacted traditional exit options available to GPs, hence affecting their ability to provide liquidity to their LPs:

- M&A, especially sponsor-backed M&A, has seen a substantial decrease of 60% in the first half of 2023¹; and
- IPO proceeds have still not recovered from the decline experienced since peak levels observed in 2021.

Given the restrictions on traditional exit routes that are expected to persist in the near future, secondary transactions have emerged as an attractive alternative solution to provide liquidity to LPs, noting that:

- Secondary managers have continued to successfully fundraise and the market remains well capitalized; and
- GP-led deals are now a proven liquidity strategy that can generate strong returns for new investors. Returns at exit have exceeded 2.0x for 67% of deals surveyed¹.

Additionally, GP-leds allow managers to diversify their LP base, better handle outsized NAV exposures within a legacy fund and grow their assets under management.

For LP Stakes, more than 80% of known sellers have turned to the secondary market for portfolio management or liquidity reasons¹, showing that LPs are seeking liquidity due to the current delayed distributions environment.

All in all, the current environment has demonstrated that both buyers and sellers are increasingly relying on the secondary market to address liquidity challenges.

A RESTRICTIVE TRADITIONAL EXIT ENVIRONMENT COUPLED WITH THE PROVEN SUCCESS OF REALIZED GP LEDS SHOULD DRIVE FUTURE SECONDARY VOLUME GROWTH

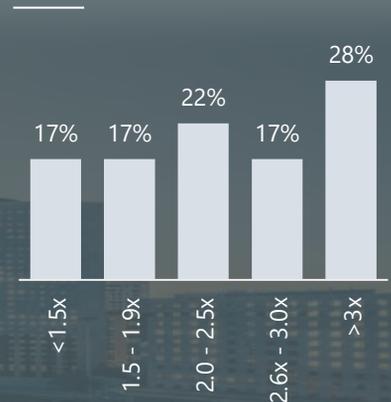
Global M&A Deal Value (\$Tn)



Global IPO Proceeds (\$Bn)



GP-Leds: MOIC on realized single-asset vehicles



Source: Lazard, 'Interim 2023 Secondary Market Report'

¹ Lazard, 'Interim 2023 Secondary Market Report'

The secondary market is well positioned to take advantage of current discounts and opportunistic scenarios. Market uncertainty and dislocations can bring attractive opportunities for the secondaries market not only in terms of increased volumes and motivated sellers but may also provide above average return opportunities.

Future decreases in valuations are already being reflected in secondary market pricing, and these additional discounts will provide future value creation risk mitigation for secondary buyers.

THE CURRENT MACROECONOMIC ENVIRONMENT IS A CATALYST FOR MOTIVATED SELLERS

GP-LED TRANSACTIONS



Restricted leveraged finance

GP-leds can provide secondary equity in lieu of M&A transactions, as well as provide capital for bolt-on M&A and other value creation levers in a restricted financing environment



Closure of IPO window

Increased utilization of GP-leds to provide liquidity for existing investors while waiting for a better exit environment



Impaired valuations

GPs motivated to hold on to trophy assets for longer through continuation vehicles



Competitive fundraising environment

GPs motivated to show early DPI as a differentiator

LP STAKES



Delay in distributions

Sale of LP positions to release unfunded commitments as well as to fund future capital calls and new make new primary investments



Denominator effect

Motivated sellers requiring to right-size private equity portfolio as a result of public market volatility



Distressed sellers

Negative net cash flows leading to urgent liquidity needs for some LPs

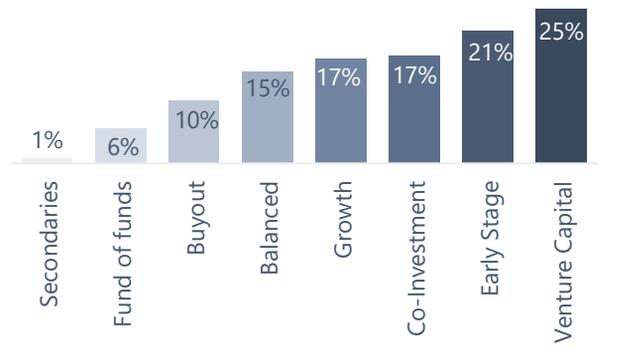
03

BENEFITS OF SECONDARIES EXPOSURE FOR ALL PRIVATE EQUITY PROGRAMS

Secondary funds typically invest in mature portfolios. According to a recent market overview of transacted volumes for 2023, the weighted average age of a fund interest purchased on the secondary market was c. 4.7 years³.

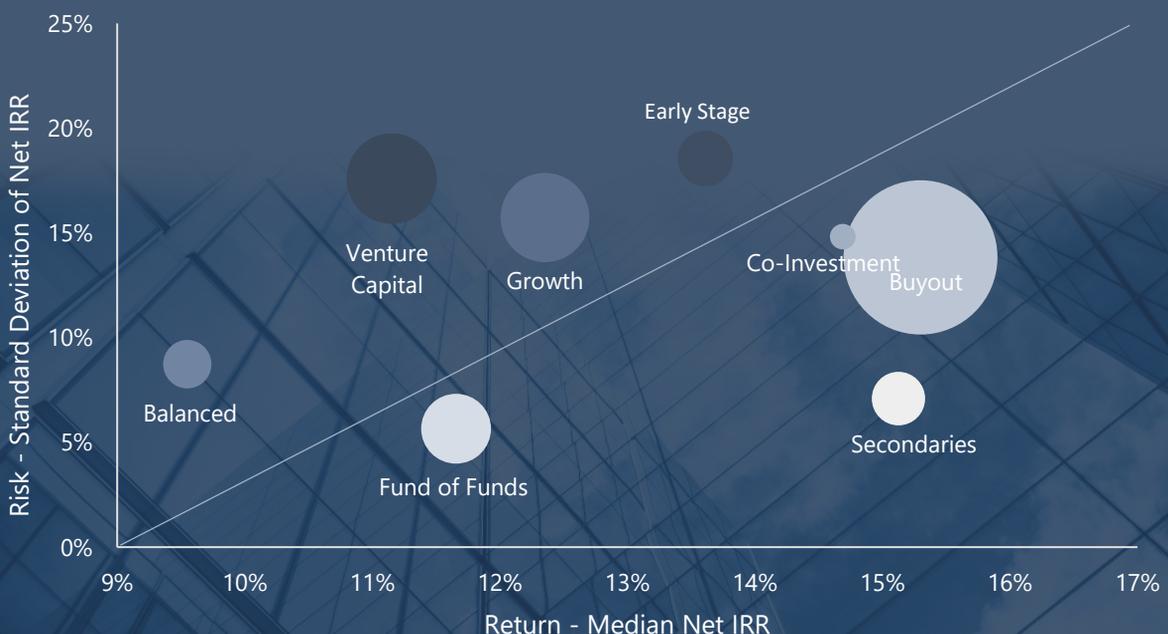
Investing in mature portfolios ensures there is a significantly lower amount of blind-pool risk associated with the strategy compared to other private equity strategies. Analysis by Preqin on volatility, returns and loss ratios confirms that private equity secondaries have indeed generated an attractive risk-adjusted return profile.

Proportion of PE funds with Net Multiple < 1.0x (By Fund Type, Vintages 2002 - 2017)



Source: Preqin, 2023

Private Equity Strategies – Risk-Return Profile



Source: Preqin, Vintages 2002-2017, 2022

³ Setter Capital, 'Volume Report H1 2023'

An additional benefit of acquiring mature portfolios is the reduction of the J-curve effect for secondary private equity LPs, typically resulting in TVPIs above 1.0x since the first drawdown. During the initial phases of a primary private equity fund or fund-of-fund, capital is called from LPs for fees, expenses and new investments. An investor in these funds will experience negative or low returns in the initial investment period as it takes time for the manager to create value in the underlying companies while they are still drawing capital from LPs for fund expenses. Secondaries funds mitigate this impact by acquiring investments not only at a discount, but also in later stages where they are well into their value-creation initiatives and closer to their exit dates. This in turn reduces the overall hold period and returns cash faster to LPs, as shown by the Preqin data below.

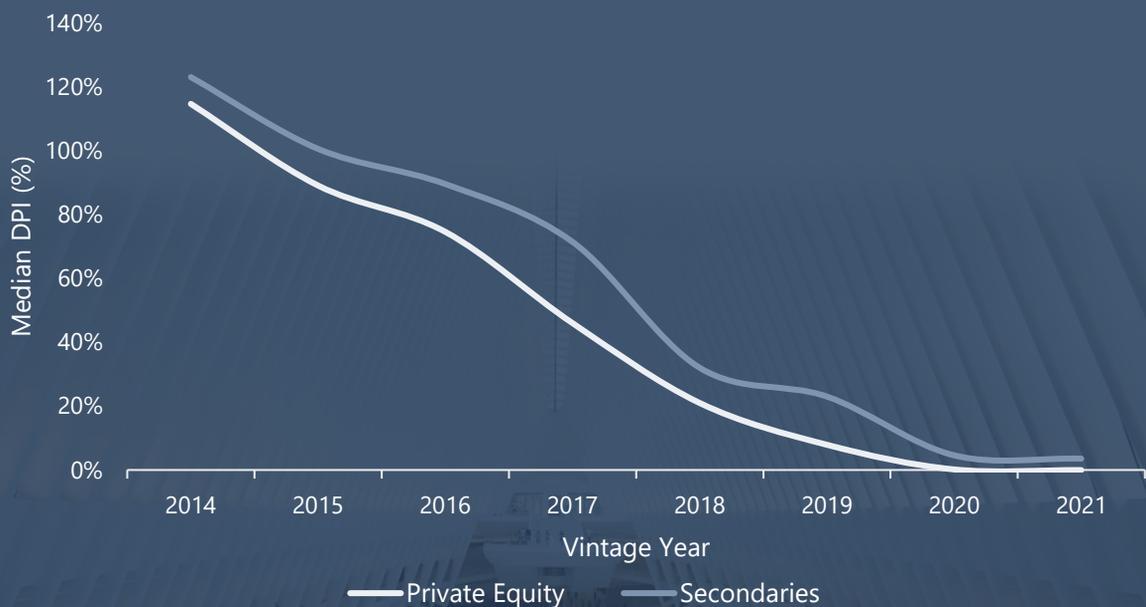
Illustrative liquidity profiles for a secondary investment, as well as for a primary and co-investment can be found in Appendix C of this paper.

Even for investors that do not have J-curve concerns for their portfolio, secondaries

investing would still add diversification and lessen volatility in more established programs, while enhancing the overall cash flow profile of the program. Managers of mature private equity programs may choose to maintain exposure to secondaries in order to reduce their overall private equity portfolio return volatility and loss ratios.

Finally, the asymmetric nature of the primary private equity market, particularly at the lower and middle end of the market, means that the secondaries market is characterized by significant price and information inefficiencies, including information on short term-value creation.

DPI Comparison Across Young Vintages



Source: Preqin, 2023

04

BENEFITS OF SECONDARIES EXPOSURE FOR NEW PRIVATE EQUITY PROGRAMS

Secondary funds offer their LPs significant diversification in fund managers as well as in underlying companies with a wide range of geographies, strategies and industries. Investors thinking of initiating a private equity program through secondaries will benefit from underlying exposure to a broad range of investments without having to make numerous individual primary commitments. Creating a new diverse private equity portfolio requires a significant amount of capital and time in order to comply with minimum commitments imposed for each fund by each underlying manager. Minimum tickets often range from \$5-10 million (or equivalent) and in certain cases can be well in excess of that, suggesting an investor could require over \$100 million for a portfolio of 10 funds.

Secondaries funds provide an investor the opportunity to create portfolio diversification with a much smaller amount of capital.

Unlike traditional fund-of-fund programs, secondary funds have the additional benefit of diversification across a variety of vintages. This enables a new private equity LP, or one that has not been investing for some time, the ability to backfill their portfolio across historic vintages.

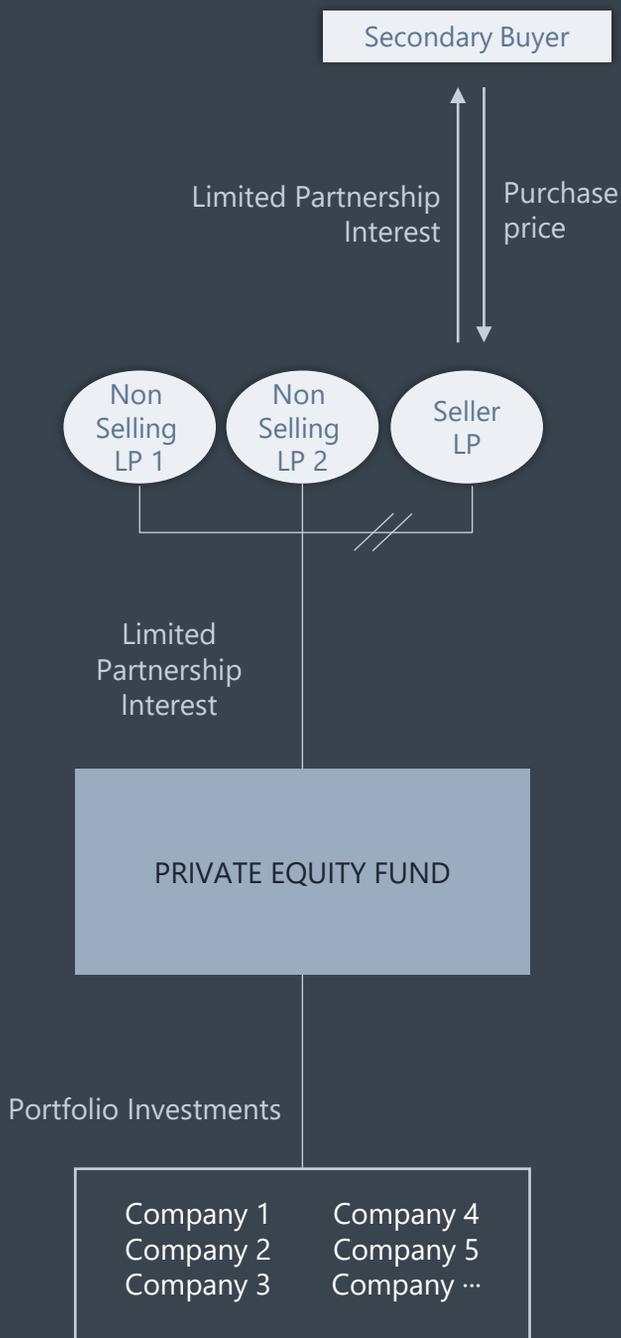
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For illustrative purposes only

Appendix A

OVERVIEW OF LP INTEREST TRANSACTIONS

An LP interest transaction occurs when an existing investor (“Limited Partner” or “LP”) in a private equity fund sells its interest, or a portfolio of interests, to a secondary investor. The secondary investor purchases the funded part of the fund at a price equal to a percentage of the Net Asset Value (“NAV”) but also commits to assuming any future unfunded commitments that the interest entails.

A straight sale of an LP interest between the primary and secondary investor is the most common transaction structure. Other, more complex structures can help the seller achieve a variety of different needs. Some examples have been highlighted below:

- Strip sale: the secondary buyer acquires a percentage of one or multiple LP interest(s) held by the primary investor, rather than the entire interest outright. This enables the primary investor to reduce their overall PE exposure while also maintaining their existing relationships with the underlying fund managers and benefit from future value creation.
- Stapled secondary: the secondary buyer acquires one or multiple LP interest(s) combined with a commitment to a new fund to be managed by the underlying manager. A stapled request facilitates the underlying manager’s fundraise of their successor fund.
- Structured secondary: the secondary buyer establishes a special-purpose vehicle (an “SPV”). The SPV, financed by the buyer, acquires the seller’s interests, who in exchange receives the upfront proceeds of the sale as well as an interest in the SPV. A structured transaction is typically used to create a bespoke cash flow (future calls and distributions) shared between the buyer and the seller. The share can be purposefully designed to be asymmetric (e.g. initially heavily weighted towards the seller for downside protection) to solve for liquidity needs, reduce risks, or provide capital call relief, among others.

Appendix B

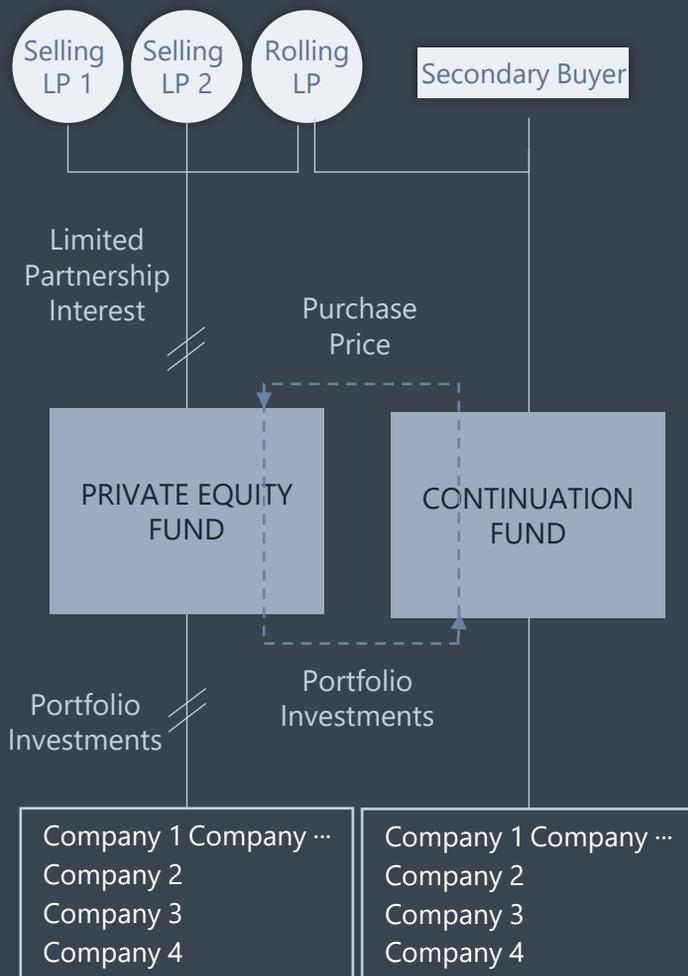
OVERVIEW OF GP-LED TRANSACTIONS

A GP-led transaction occurs when the manager (“General Partner” or “GP”) of a private equity fund decides to initiate a liquidity process for one or more funds they manage by offering existing LPs the option to sell their exposures to a new secondary investor. The sale can be carried out by creating an SPV to be managed by the GP and financed by the secondary buyer(s). The SPV, typically called a continuation vehicle, will acquire the residual portfolio companies from the existing private equity fund(s). Existing investors are typically given the option to either sell or roll their interests to the continuation vehicle.

The continuation vehicle provides more time beyond the existing fund’s life for the GP to maximize the value of its remaining assets, while also allowing existing LPs to receive early liquidity from their investments should they choose. GP-led transactions can also include additional capital for follow-on investments, thus providing the GP with additional flexibility to create additional upside for its residual portfolio. A reset of terms, in particular carried interest, enables a realignment of interests between the investor and the manager in terms of future value creation for the assets.

Additional examples of GP-led transactions have been highlighted below:

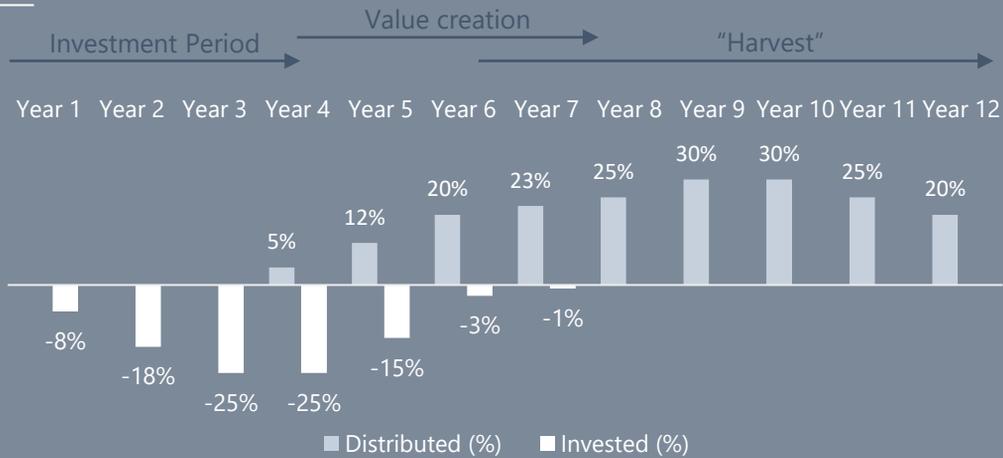
- Single asset continuation vehicles: identical in structure to a continuation fund but with one asset only. This is typically a “trophy” asset where the GP wants to generate more upside by extending the holding period.
- Tender offers: a GP-initiated sale offering of partnership interests in an existing fund. The secondary buyer underwrites a percentage of volume to be sold at a certain price and, much like an LP interest transaction, receives exposure to the existing fund.



Appendix C

UNDERLYING INVESTMENT PROFILES ACROSS DIFFERENT STRATEGIES

Primary Investments



MOIC
2.0x

IRR
15%

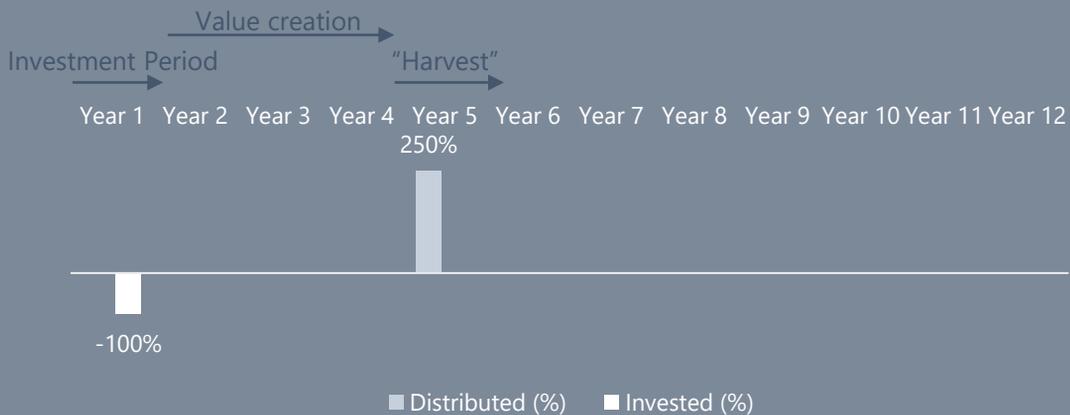
Secondary Transactions



MOIC
1.7x

IRR
15-20%

Direct Co-Investments



MOIC
2.5x

IRR
+20%

For illustrative purposes only

Appendix D | GLOSSARY

Alternative Assets: This term describes non-traditional asset classes including private equity, venture capital, hedge funds and real estate.

Assets Under Management ("AuM"): The sum of a fund's Dry Powder plus the Unrealized Value of the investments in a fund.

Balanced Fund: An Alternative Assets fund ("fund") that invests in companies at all stages of development, from early stage to buyout.

Blind Pool Risk: Risk related to a commitment with little or no visibility in the underlying assets (related to a high degree of unfunded).

Buyout Fund: A fund that typically invests equity in established private companies, often with the intention of improving operations and/or financials.

Capital Call / Draw Down: When a General Partner has decided where it would like to invest its fund, it will approach its investors in order to "draw down" the money. The money will already have been pledged to the fund but this is the actual act of transferring the money so that it reaches the investment target.

Capital Commitment: The specified sum of capital a Limited Partner has agreed to contribute to a fund. The sum of commitments to a fund equals the total size of the fund.

Capital Overhang: Refers to the available Dry Powder as a proportion of the Market Volume of a particular Alternative Asset strategy.

Closed-Ended Funds: A fund with a fixed life span that typically does not allow redemptions or the entry of additional investors after the initial formation of the fund. Closed-end funds typically acquire a portfolio of companies/assets during an initial investment period and distribute the

sales proceeds.

Distributions to Paid-In ("DPI"): The proportion of the called-up capital that has been distributed or returned back to Limited Partners.

Dry Powder: The amount of capital that has been committed to a fund minus the amount that has been drawn down by the General Partner from the fund's Limited Partners. Dry powder also includes any undrawn amounts on the fund's credit facilities.

Fundraising: The activity whereby a private equity fund seeks to raise new Capital Commitments from external sources of supply.

General Partners ("GPs"): The partner in a limited partnership (a fund) responsible for all of the management decisions of the partnership.

Gross IRR: The IRR based upon the performance of the investments of the fund, calculated before deductions for the fund's management fees, carried interest, or other fund costs.

Investment Period: The period defined in the limited partnership agreement whereby a fund is allowed to complete platform investments.

Internal Rate of Return ("IRR"): Calculated based upon the realized cash flows and the valuation of the remaining interest in the partnership. IRR is an estimated figure, given that it relies upon not only cash flows from and to the Limited Partners but also the Unrealized Value.

Limited Partners ("LPs"): A third party investor that contributes capital to a private equity fund. A limited partner commits money in exchange for shares in the limited partnership or fund, having restricted voting power on company business and no day-to-day involvement in the business.

Appendix D | GLOSSARY

Limited Partnership Agreement ("LPA"): The contract that specifies the compensation and conditions governing the relationship between investors (LPs) and the general partners (GPs) for the duration of a private equity fund's life.

Loss Ratio: The percentage of transactions realized below a MOIC of 1.0x.

Market Volume: Market Volume refers to the total value of the market at a defined period of time, and corresponds to the sum of Dry Powder and Unrealized Value.

Multiple on Invested Capital ("MOIC"): The sum of Realized Proceeds and Unrealized Value as a proportion of Invested Capital. MOIC is a gross metric, meaning it is calculated before deductions for the fund's management fees, carried interest, or other fund costs. It can be calculated at the investment level or the aggregated portfolio level to evaluate the performance of both realized and unrealized investments.

Invested Capital: The total amount of commitments already committed and allocated to portfolio investments by the fund, including both drawn and undrawn amounts.

Net Asset Value ("NAV"): The remaining value of a fund, or the remaining value of a Limited Partner's share of the fund (an "LP Interest"), less its net liabilities. The NAV of an LP Interest is calculated net of accrued carried interest.

Net Internal Rate of Return ("IRR"): The return considers the daily timing of all cash flows and NAV as of the end of the reported period. The Net IRR deducts fund costs, management fees and carried interest generated by an investment in the fund.

Paid-in Capital: The cumulative amount of committed capital a Limited Partner has transferred to a fund as a proportion of the Limited Partner's total commitment to the fund.

Primary Investment: A Capital Commitment made by an LP to a fund during its fundraising period. Primary fund investments will have most, if not all, of the commitments allocated to unfunded capital.

Realized Investment: An underlying investment of a fund that has been exited.

Realized Proceeds: Cash and/or securities received by a Limited Partner.

Remaining Value to Paid-In ("RVPI"): The ratio of the current value of all remaining investments within a fund to the total contributions of Limited Partners to date.

Turnaround: Strategy aiming to revitalize companies with poor performance or experiencing trading difficulties.

Total Value to Paid-In ("TVPI"): The sum of distributions received and NAV as a proportion of capital called. TVPI deducts fund costs, management fees and carried interest generated by an investment in the fund.

Unrealized Investment: An underlying holding that has not yet been sold or fully written off.

Unrealized Value: The fair market value of unrealized investments.

Unfunded Commitments: Typically calculated as the total Capital Commitments to a fund less capital called. It is the remaining capital that the Limited Partner is obliged to pay to the General Partner of the fund for future investments.

Vintage Year: The year of fund formation and/or its first takedown of capital.

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