KEYNOTE INTERVIEW

Evergreens come of age

Specialisation trends are beginning to emerge in the evergreens space, allowing for more structured investments, according to Pantheon's Michael Hutten and Victor Mayer

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Q What are the main advantages of evergreen vehicles, and what is driving current demand?

Michael Hutten: Pantheon has been managing evergreen vehicles for more than three decades, and the surge in demand has hit in the last five years. A lot of private wealth platforms and smaller institutional clients are trying to increase their exposure to private markets, but realise there are substantial challenges to doing so with traditional locked-up vehicles – namely, capital calls and having money returned, but then effectively having it put back into the ground. Evergreen vehicles allow investors to manage their allocations more effectively, with target allocations met on the commitment date.

The drivers of current demand come down to five points, with the first being instant diversification. Our evergreen private equity fund has approximately 350 investments diversified by vintage, geography, manager, stage and sector. It provides incredible diversification for clients that they could not achieve the traditional way.

The second driver of demand is not having to deal with the J-curve – clients like private equity, but they do not like the J-curve. Then there is the ability to manage your private investment allocations more efficiently. The fourth driver is better liquidity management, since the demand and timing of liquidity needs differ from client to client. Lastly, the absence of capital calls is a significant advantage.

Victor Mayer: In closed-end funds, capital is committed but it is not necessarily invested. The first two to three years are spent dealing with the J-curve and capital calls. Years four to seven then see a climax in total multiple returns and a certain level of NAV is achieved, before year eight onwards sees distributions and NAV come down.

The differentiating aspect of evergreen funds is compound interest. When your closed-end fund reaches seven years' maturity and NAV starts to come down, an evergreen fund starts compounding at a significantly higher relative pace, because the fund manager is putting that money back to work. The maths is compelling: a 15 percent return over 15 years is 8x your capital; to get that by yourself in private markets is really hard.

The beauty of compound interest is that the more patient you are and the more you trust the process of recycling, the faster your returns may compound.

Q What specialisation trends are emerging in the evergreens space?

VM: Evergreen funds are nothing new; semi-liquid multi-asset strategies have been around a while. But previously, with a multi-asset fund investing into multiple private asset classes, you were telling clients what they needed to do.

The latest wave of specialisation gives clients choice. End investors welcome the ability to combine different clean allocation bricks to create diversification and a bespoke allocation, delivering a customised risk-reward. We see the emergence of a number of high-profile model portfolios where providers have combined different strategies to achieve different risk profiles and solutions for clients. That has a lot of power at a time when adoption comes with unprecedented conviction.

MH: We're seeing this reflected in the evergreen strategies offered and the structures delivered. There is a growing trend of evergreen managers focusing on style purity, as investors are being more and more specific with their investment allocations.

There is also structuring specialism, where managers are trying to make it easier for more clients to invest. In the US, an exchange-traded fund focused on private credit has just launched. We also see innovation around structuring outside the US. In the UK, there is a significant opportunity with the Long-Term Asset Fund, for example, while in Europe, the updated European Long-Term Investment Funds are creating a fair amount of demand.

Q What should investors look for when assessing evergreen fund managers?

MH: Even for the most tenured managers, evergreen funds are difficult to implement. Managers have to be able to manage cashflows, which means they need a track record through multiple cycles. Most do not have that: some 80 percent of evergreen vehicles in the US have been launched in benign markets in the last three years.

Investors should ask whether the manager is providing access to the best of what they can source and select. A large number of evergreen managers offer different dealflow to their biggest clients, whereas Pantheon provides equal access to all its deals.

VM: In this space, track record eats branding for breakfast. We are in the business of selecting funds and backing managers that have a demonstrable track record of compounding returns and liquidity management. The last thing you want as an investor going into a semi-liquid fund is to be used as an experiment by an inexperienced fund manager trying to figure out how liquidity works.

> *"The more patient you are and the more you trust the process of recycling, the faster your returns may compound"*
>
> **VICTOR MAYER**

Pantheon's goal will always be to provide a well-structured, user-friendly solution without compromising the quality of the investment content.

Q What are the challenges and opportunities presented by secondaries and co-investments as tools within evergreen vehicles?

VM: The most important thing in the secondaries market is knowing what you are buying. The discount helps with achieving a different, and sometimes front-loaded, type of return, but the majority of the return should be based on the quality of the NAV. That is why our origination platform is designed to identify pockets of inefficiency in secondaries markets. We see the discount as merely a feature of what can be extracted from a sales process.

A secondaries strategy generates compelling returns within an evergreen vehicle because the acquisition of interests in hundreds of underlying companies can achieve diversification across a large range of metrics and makes for a more diversified source of compounding engines. You are also buying assets that are closer to exit, allowing you to potentially take distributions early on and re-invest them to compound returns.

We like to deploy about half of our evergreen capital into diversified secondaries; the other half is where we seek alpha. We aim to hand-pick assets one by one, be it through co-investment or GP-led transactions, where assets are held at cost for some time and all the upside is ahead of us. As a result, holding periods are longer and distributions are further away, but in the meantime, we may get more total return because we can generate returns on our asset inventory for a longer period of time.

Co-investments also come with no fee and no carry, which plays a central role in compounding efficiency. We try to strike a balance between near-term recycling, building organic growth and building that compounding profile. Over time, that generates a sustainable level of annualised returns.

When it comes to challenges, the secondaries market is similar to the primary market, with a small number of managers raising a large amount of the capital each year. In a benign environment, that creates a competitive pricing environment, so we prefer to place our focus where we have an edge while waiting for markets to be more volatile, as they have been recently.

MH: Secondaries and co-investments are always going to be a central component of our evergreen vehicles, whether in private equity, credit or infrastructure. There is an ebb and flow of deal supply, so the most important thing is to buy the best private assets we can, backed by the best managers, regardless of what structure that comes in.

One challenge is there are a lot of evergreen funds buying heavily discounted secondaries at the beginning of their fund's life to manufacture early outperformance. There could be some industry concerns about long-term growth in these funds, since deeper discounts might reflect weaker underlying assets

Q What potential is there for tapping into the mid-market segment?

MH: We feel there is a tremendous amount of value creation that happens in the mid-market, with thousands of managers and underlying companies to back. Those situations also inherently have better growth, better exit optionality and more levers for value creation than larger companies that have been around for longer.

About 80 percent of evergreen investments are so far focused on the larger end of the market. We feel being in the mid-market is extremely advantageous and see that as the future of the evergreen space. Pantheon's DNA is in the mid-market.

VM: When comparing public and private markets, so much of public market exposure is focused on large-cap stocks with some sector or thematic concentration. In private markets, the mid-market segment provides an edge against layers of public market concentration. We back managers that are country-specific or regional specialists, and they also tend to be sector specialists, focusing on one area they know well. They may be stage specialists too, focused on growth or mid-market, for example.

Over time, that gives us access to the beating heart of the economy and some of the best-performing assets in the best sectors. For evergreens, that can create a compelling level of organic compounding.

Q What might the future look like for evergreen funds?

MH: We strive to be at the forefront of bringing well-thought-out solutions to market. We launched an evergreen credit secondaries fund in the US last year and are planning something similar for international wealth clients. We are also close to bringing an infrastructure secondaries evergreen fund to market in the US as we work to ensure we have quality evergreen options in each of the private asset classes. The next phase may be driven by end clients seeking private evergreen vehicles tailored to express specific market views, potentially focused on particular sectors or sub-sectors.

VM: We have reached a stage of maturity and scale with our evergreen platform whereby we now have the ability to build model portfolios based on different internal evergreen solutions for clients. We can take that customised approach to the next level by creating programmes with specific risk profiles. A lot of wealth allocators that we meet find that quite compelling, so we think that will give us some further tailwinds in the near term. ■

Michael Hutten is a partner and head of Pantheon's private wealth division, and Victor Mayer is head of international private wealth and a member of Pantheon's European investment team

Important disclosure

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