TORYS LLP

PE Pulse 2023

Canadian private equity survey

Contents

Executive summary

This PE Pulse 2023 survey report captures the sentiments of industry leaders at an uncertain moment in time. However, uncertainty often breeds opportunity—and, with valuations, access to capital and liquidity under pressure, strong investment opportunities could present themselves for well-positioned buyers throughout 2023.

While GPs have access to billions of dollars of dry powder to deploy, its availability has been decreasing in recent years. In addition, recessionary concerns persist, fueled in part by geopolitical conflicts, and rapidly rising interest rates imposed by central bankers to combat ongoing inflationary pressures.

The Canadian private equity and pension fund leaders we polled in this survey echo this caution.

Overall, there is somewhat less optimism than we have seen in previous years conducting this study. Average size of transactions is not expected to increase from last year. Fundraising is expected to remain challenging, and one-third of respondents expect it to become much more difficult. The economy is not expected to significantly improve in the short-term, and respondents expect inflation and rising interest rates to impact the overall transaction environment more than they did last year.

However, there are encouraging signs. One in seven investment professionals expect to source their most attractive targets from distressed assets. And as the expected pace of interest hikes slows down, the valuations gap between buyers and sellers may be narrowing. Very few of the professionals we surveyed reported higher vendor pricing expectations over the past year, and even fewer expect valuation multiples for new platform investments to grow in 2023. Both data points are departures from previous years.

If that gap continues to close, it is conceivable that 2023 yields an attractive vintage, similar to the vintages generated during previous economic downturns. Private equity firms will have choice opportunities, including among distressed assets.

It’s not just GPs that will need to pick their spots. None of the pension fund stakeholders in our survey expect to increase their passive private equity allocations. Secondary transactions could help free up liquidity, but LPs that wish to commit additional capital may face challenging pricing decisions.

For the first time, this year’s survey polled respondents about investments in energy transition, and responses reflect an increasing focus on ESG. Investment in energy transition in particular is expected to increase—and pension fund stakeholders are especially bullish on this space.

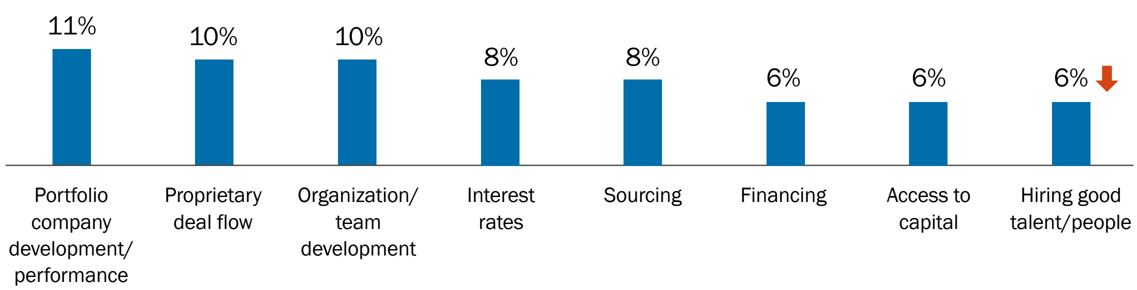
While respondents expect technology to remain the most active sector for private equity investments, the industry/agriculture sector rose sharply in this year’s survey results.

The private equity industry is abuzz with talk of the strong headwinds resulting from the macro environment. While our survey shows that those headwinds are expected to present serious challenges for the months ahead (more than half of our respondents believe the overall transaction environment will worsen a little or a lot compared to 2022), it is interesting and perhaps encouraging that those closest to dealmaking see a number of opportunities ahead for the asset class.

Priorities and challenges

When asked to list the factors that will be critical to success in 2023, respondents cited several items in approximately the same proportions. Most commonly cited were portfolio company development (11%), proprietary deal flow (10%) and organizational development (10%). The trending issue of interest rates followed, along with sourcing (both at 8%).

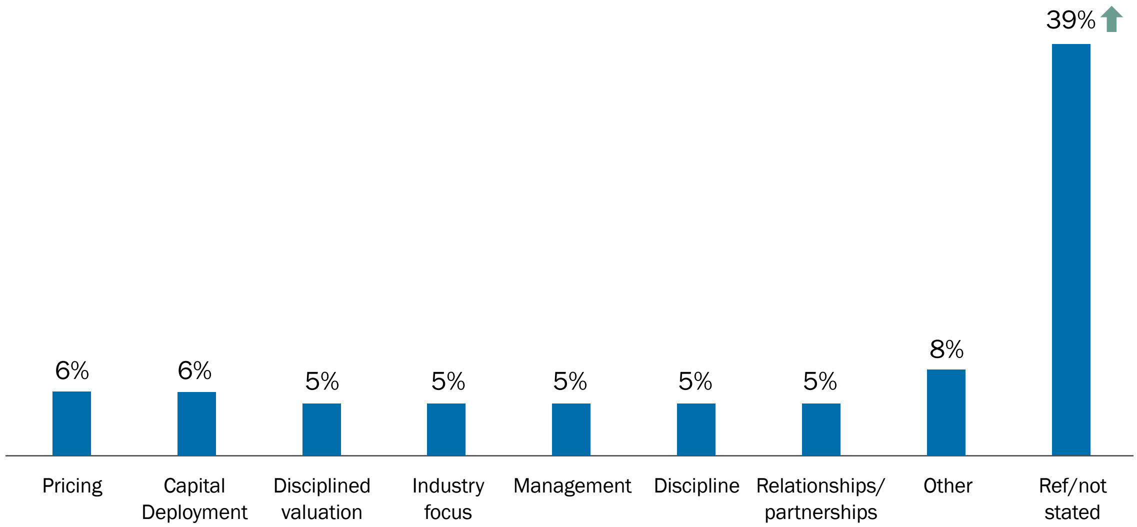
Figure 1) What factors will be critical to your success in 2023? Please list up to 3. (Con't on next page)



	Portfolio company development/ performance	Proprietary deal flow	Organization/ team development	Interest rates	Sourcing	Financing	Access to capital	Hiring good talent/people
2021-22	12%	-	-	8%	4%	8%	-	23%
2020-21	9%	-	-	5%	-	-	-	5%
2019-20	12%	-	-	2%	-	-	-	12%

Note: Only responses of 5% or more in current wave are shown. Mentions <4% not labelled.
Base: All stakeholders: 2022-23 (n=62); 2021-22 (n=52); 2020-21 (n=101); 2019-20 (n=104).

Figure 1 con't) What factors will be critical to your success in 2023? Please list up to 3.



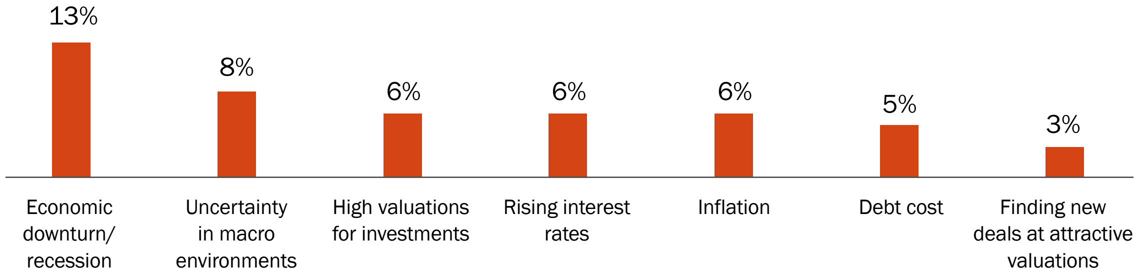
	Pricing	Capital Deployment	Disciplined valuation	Industry focus	Management	Discipline	Relationships/ partnerships	Other	Ref/not stated
2021-22	-	-	15%	-	-	13%	4%	21%	33%
2020-21	-	-	5%	-	-	6%	5%	24%	10%
2019-20	-	-	13%	-	-	8%	5%	24%	13%

Note: Only responses of 5% or more in current wave are shown. Mentions <4% not labelled.
Base: All stakeholders: 2022-23 (n=62); 2021-22 (n=52); 2020-21 (n=101); 2019-20 (n=104).

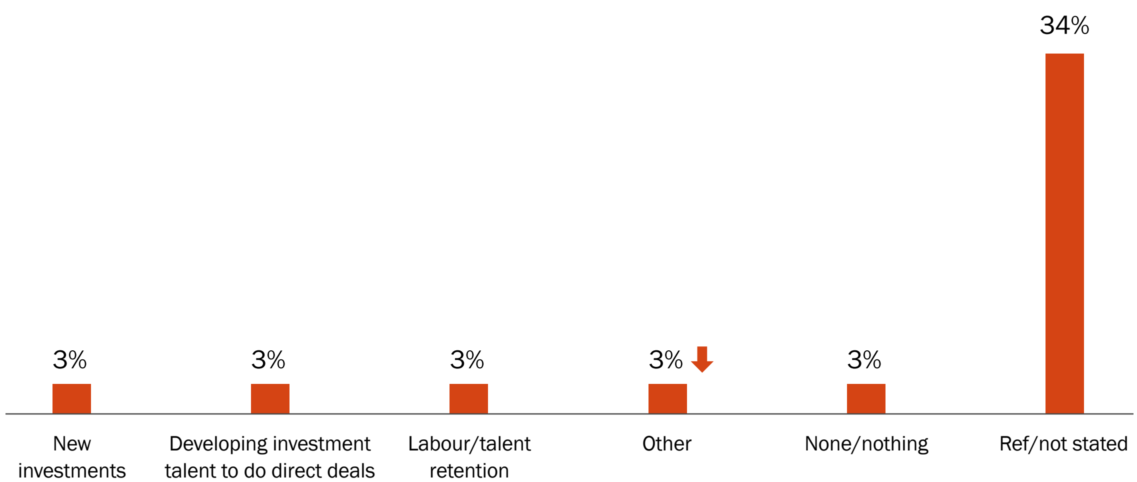
Respondents took a broader perspective when we asked them to identify their biggest challenge this year, with economic downturn/recession topping the list (13%), followed by uncertainty in the macroeconomic environment (8%). Neither item was mentioned by industry stakeholders in past reports. The most notable decline year-over-year concerned talent: only 6% of respondents mention hiring good people as their biggest challenge (vs. 23% last year; 5% the year prior).

Also high on respondents' list of challenges are two closely related economic drivers: inflation and interest rates (both at 6%).

Figure 2) What is the biggest challenge facing you in 2023?



2021-22	-	-	17%	-	-	-	6%
2020-21	-	-	6%	-	-	-	12%
2019-20	-	-	8%	-	-	-	26%



2021-22	-	15%	-	19%	-	-
2020-21	-	-	-	12%	-	-
2019-20	-	-	-	10%	-	-

Note: Only responses of 3% or more in current wave are shown. Mentions <4% not labelled.
Base: All stakeholders: 2022-23 (n=62); 2021-22 (n=52); 2020-21 (n=101); 2019-20 (n=104).

When we asked specifically about the impact of interest rates and inflation on transactions, the response was unequivocal. Decisive percentages of respondents believe the impact this year will worsen compared to last year—for inflation, 56%; for interest rates, 55%.

Figure 3) Relative to 2022, how do you expect the overall transaction environment in 2023 to be impacted by the:

i) Current inflationary environment?

6%	56%
Improve	Worsen

ii) Rising interest rates?

4%	55%
Improve	Worsen

Dealmaking activity

What a difference a year makes. When we last surveyed the market in late 2021, respondents were coming off a record year for private equity dealmaking—and were bullish on 2022. But last year proved challenging, with private equity deals declining in both volume and value. Now, as they gear up for 2023, industry leaders in our survey do not see the picture changing in the short term.

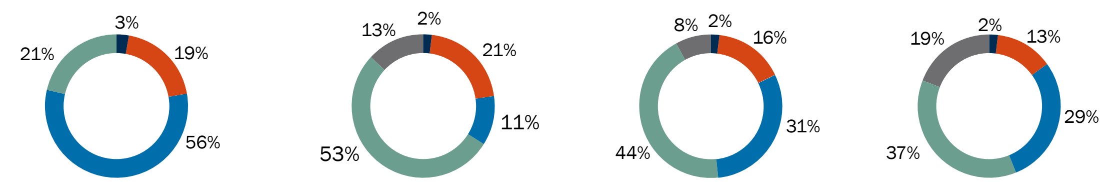
Statistically fewer respondents expect to see greater returns on realized investments (15%, vs. 48% last year and 28% the year prior). When it comes to average size of transactions, just one-quarter (23%) expect it to increase, a 39% decline from last year and a 25% decline from the year before. Still, more than half (56%) expect the size of their transactions to stay the same, and none of our respondents expect transaction size to decrease.

Interestingly, while 31% of private equity stakeholders expect the average size of transactions they make to increase over the next year, no pension fund respondents hold the same view. These pension fund investors, who are often investing in large cap transactions, may be influenced by an increased tightening of the debt markets and the paucity of high yield debt financing, the impacts of which are not as severe for middle market investors.

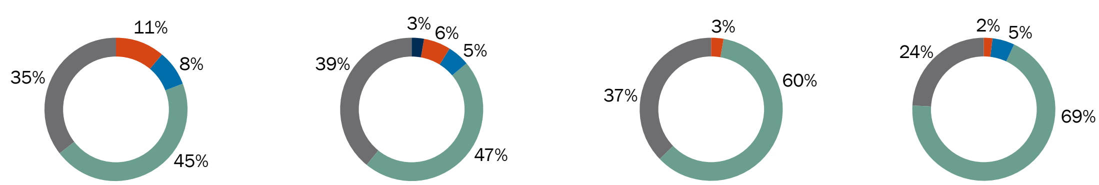
Much of the dampened sentiment can be attributed to the economic outlook. On the domestic front, only 2% of respondents expect the overall economic climate to improve (down from 23% last year). For the global environment, that figure is 3%, down from 19% last year and 40% the year prior. (**See Figure 4**.)

That economic outlook is also bleeding into the expectations of private equity leaders when they think about fundraising. Only one in ten (9%) believe it will be easier to raise new funds in 2023 than it was in 2022—significantly fewer than the year prior (42%) and the lowest number in the four years of this survey. Moreover, more than one-third (38%) of respondents see the fundraising climate becoming much more difficult. That said, a majority of respondents do not seem to be overly concerned—saying fundraising will either remain about the same (18%) or become a little more difficult (36%). (**See Figure 5**.)

Figure 4) Do you expect the following to improve, stay the same or worsen in 2023?



Improve	The average size of the transactions you make*	The overall M&A market activity	The volume of transactions you make**	Returns on realized investments today as compared to five years ago
2022-23	23%	23%	18%	15%
2021-22	62%	31%	33%	48%
2020-21	48%	56%	55%	28%
2019-20	40%	14%	22%	19%



Improve	The deal terms of debt financing	The pricing of debt financing	The overall economic climate, globally	The overall economic climate in Canada
2022-23	11%	10%	3%	2%
2021-22	17%	15%	19%	23%
2020-21	28%	27%	40%	27%
2019-20	13%	18%	9%	9%

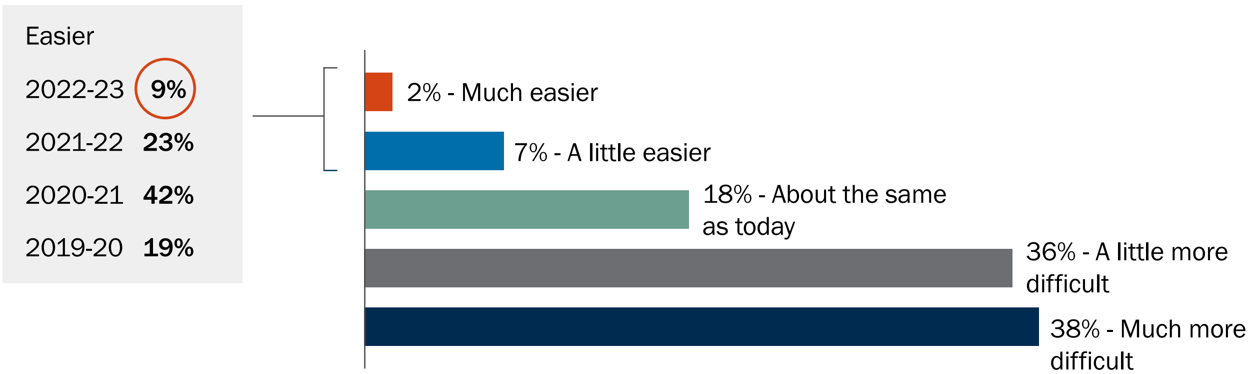
Improve a lot   Improve a little   Stay the same   Worsen a little   Worsen a lot   Don't know

**Equate "improve" with larger; ** equate "improve" with more.*

Data <3% not labelled.

Base: All stakeholders: 2022-23 (n=62); 2021-22 (n=52); 2020-21 (n=101); 2019-20 (n=104).

Figure 5) Do you believe that it will become easier or more difficult to raise new funds in 2023 compared to 2022?



Base: Private equity stakeholders: 2022-23 (n=45); 2021-22 (n=39); 2020-21 (n=76); 2019-20 (n=74).

Another area for opportunity lies with retail investors, who have shown increased interest in private fund investments, and sponsors are making their offerings more accessible to this new market subset. Find out more about this **retail investor trend**.

Private equity allocations

While institutional investors are expected to increase their commitments to private funds in the long-term, the LPs in our survey see a different situation for their 2023 allocations.

None of the pension fund stakeholders we polled expect to increase their passive private-equity allocations this year—a steep drop from 46% last year and 40% the year before. This may be attributed to the drop in public markets generally in the past year, and many LPs are currently overallocated to private fund holdings.

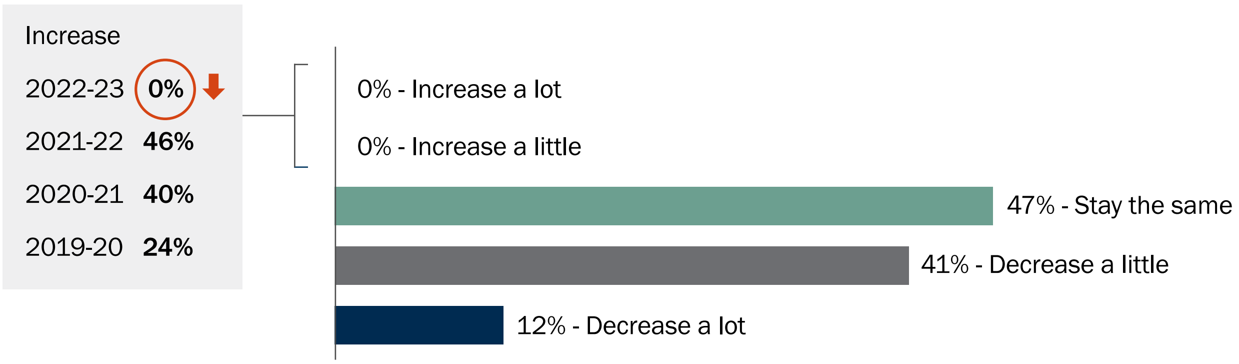
Despite this impact of the “denominator effect” on portfolio balance, nearly nine out of 10 (88%) respondents expect their allocations to largely stay on par with last year’s levels. **Learn more about the denominator effect**. The potential for 2023 fund vintages to be particularly attractive in light of ongoing asset valuation pressures may, at least in part, be driving this continued counter-cyclical commitment to the asset class. (**See Figure 6**.)

When we asked respondents to predict their dealmaking strategy for the year, they shared a wealth of detail.

Several volume-related metrics ticked lower from previous years in statistically significant deltas. Most notably, only one in five (19%) expect competition for new investment opportunities to increase (vs. 58% last year; 43% the year prior). A similar number (18%) expect pressure by or from LPs to provide co-investment opportunities (vs. 39% last year; 53% the year prior). And almost none (3%) expect valuation multiples paid for new platform investments to increase (vs. 39% last year; 47% the year prior).

One area experienced a sharp increase: earn-out provisions. Year-over-year, more than twice as many (52% vs. 23%) expect the percentage of their own deals featuring earn-out provisions to increase. It seems many are not fully convinced

Figure 6) Do you expect your passive private-equity allocations (to fund investments and passive co-investments) to increase, decrease or stay the same?



Base: Pension fund stakeholders: 2022-23 (n=17); 2021-22 (n=13*); 2020-21 (n=25*); 2019-20 (n=29*). *small base size, use with caution.*

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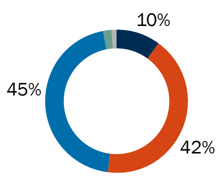
that the expectations gap between buyers and sellers has closed quite yet. They anticipate incorporating earn-outs to solve for the misalignment. **Learn more about managing earn-out provisions**.

In a new focus of our research for this year, we asked stakeholders about one particular aspect of ESG in their investments: energy transition. The responses indicate a full 40% expect to invest more in energy transition this year than they did in 2022. Pension fund stakeholders are more bullish on the space than private equity stakeholders (i.e., 71% vs. 27% of private equity stakeholders expect to invest in such deals). (**See Figure 7**.)

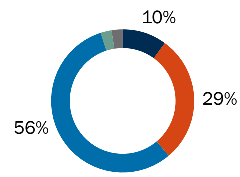
While terms and practices of ESG have yet to be standardized, they have moved relatively quickly from marginal to mainstream. European markets have achieved first mover status in the area, but North American firms are fast following, in part due to pressure from investors.

Figure 7) Do you expect the following to increase, decrease, or stay the same in 2023? (Con't on next page)

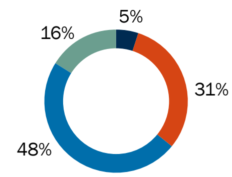
The percentage of your deals featuring earn-out provisions



Your participation in energy transition investment opportunities

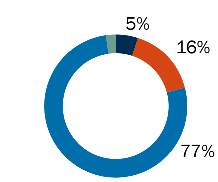


The frequency of LP co-investments in sponsor transactions

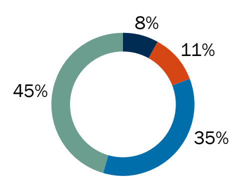


Increase	The percentage of your deals featuring earn-out provisions	Your participation in energy transition investment opportunities	The frequency of LP co-investments in sponsor transactions
2022-23	52% ↑	39%	35%
2021-22	23%	-	37%
2020-21	43%	-	50%
2019-20	29%	-	43%

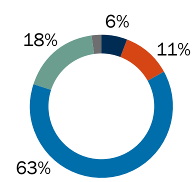
The percentage of your investments outside of Canada



Competition for new investment opportunities



Pressure by or from LPs to provide co-investment opportunities



Increase	The percentage of your investments outside of Canada	Competition for new investment opportunities	Pressure by or from LPs to provide co-investment opportunities
2022-23	21%	19% ↓	18% ↓
2021-22	31%	58%	39%
2020-21	37%	62%	53%
2019-20	34%	64%	58%

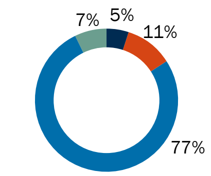
Increase a lot · Increase a little · Stay about the same · Decrease a little · Decrease a lot · Don't know

Data <3% not labelled.

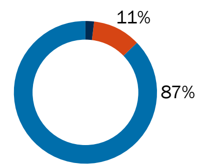
Base: All stakeholders: 2022-23 (n=62); 2021-22 (n=52); 2020-21 (n=101); 2019-20 (n=104).

Figure 7 con't) Do you expect the following to increase, decrease, or stay the same in 2023?

The frequency of use of R&W insurance in your deals



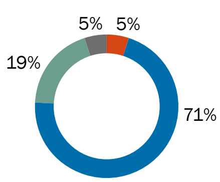
The frequency with which you will make a minority investment (i.e., acquire less than 50% of a transaction)



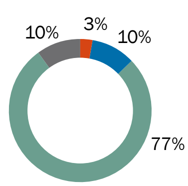
Increase

	The frequency of use of R&W insurance in your deals	The frequency with which you will make a minority investment
2022-23	16%	13%
2021-22	29%	27%
2020-21	30%	23%
2019-20	46%	27%

Your participation in auctions



Valuation multiples paid for new platform investments



Increase

	Your participation in auctions	Valuation multiples paid for new platform investments
2022-23	5%	3%
2021-22	10%	39%
2020-21	14%	47%
2019-20	16%	36%

Increase a lot · Increase a little · Stay about the same · Decrease a little · Decrease a lot · Don't know

Data <3% not labelled.

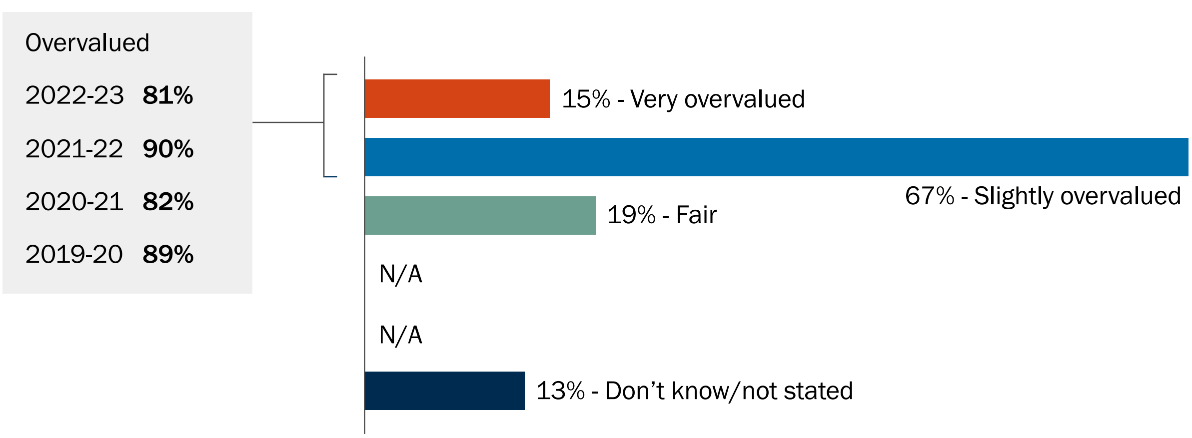
Base: All stakeholders: 2022-23 (n=62); 2021-22 (n=52); 2020-21 (n=101); 2019-20 (n=104).

Valuation multiples

The deal market has become less frothy, and our respondents are seeing this reflected in valuation multiples.

While four in five (81%) of private equity and pension fund stakeholders believe the current level of valuation multiples paid during M&A transactions involving private-equity financing is overvalued, this represents a decrease (9%) from a year ago. Furthermore, sentiment moved considerably from "very overvalued" (15%, down from 27%) to "slightly overvalued" (67%, up from 63%) and "fair" (19%, up from 8%).

Figure 8) Would you say that the current level of valuation multiples paid during M&A transactions involving private-equity financing are:

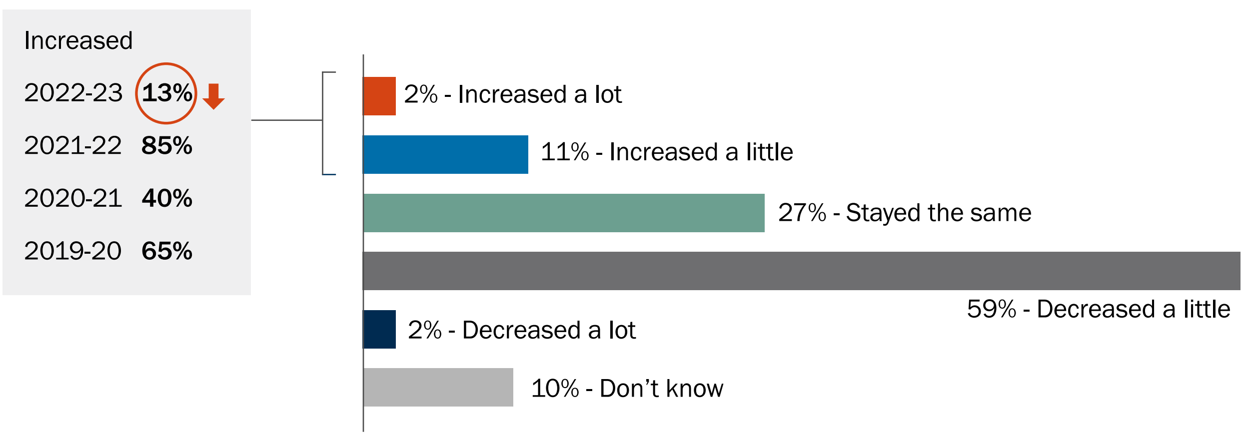


Base: All stakeholders: 2022-23 (n=54); 2021-22 (n=52); 2020-21 (n=101); 2019-20 (n=104).

Along similar lines, just one in eight (13%) of respondents say their vendor pricing expectations increased over the past year—down from 85% last year and statistically fewer compared to all three previous iterations of this survey.

These numbers point to a possible narrowing of the valuations gap between buyers and sellers. Yet this data should be considered in concert with earlier numbers in this study about earn-outs, which are often used to close that gap. In that regard, respondents expect the percentage of their deals featuring earn-out provisions to increase.

Figure 9) Compared to 1 year ago, would you say that vendor pricing expectations have:

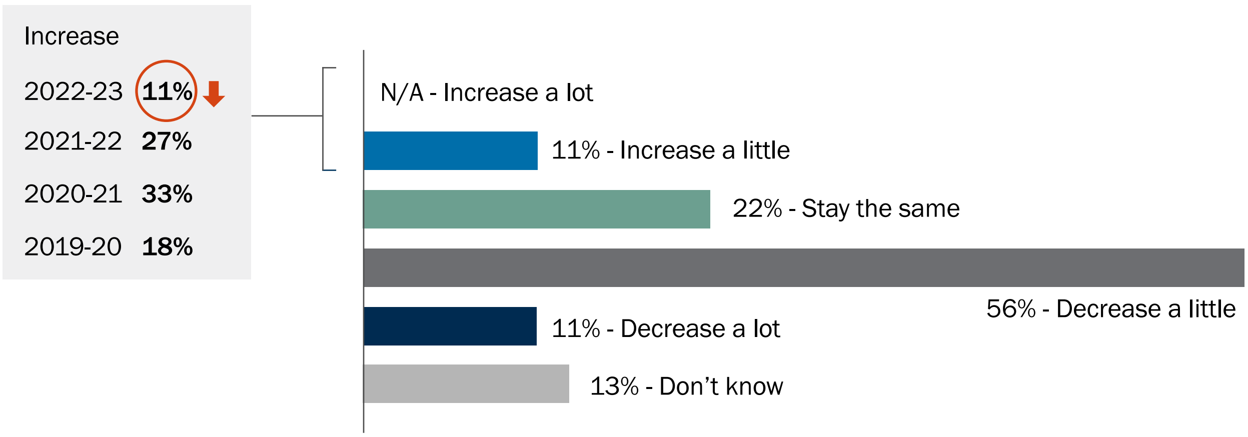


Base: All stakeholders: 2022-23 (n=56); 2021-22 (n=52); 2020-21 (n=101); 2019-20 (n=104).

Only one in ten (11%) respondents expect exit-valuation multiples to increase this year. This is a significant decrease from the past two years (16% from last year; 22% from the year prior). It marks the low point in the four-year history of our survey—though somewhat in line with pre-pandemic views canvassed in late 2019.

Interestingly, pension fund stakeholders are somewhat more likely (88%) than their private equity counterparts (58%) to expect exit-valuation multiples to decrease.

Figure 10) In respect of recent acquisitions, do you expect exit-valuation multiples to increase, decrease or stay the same?



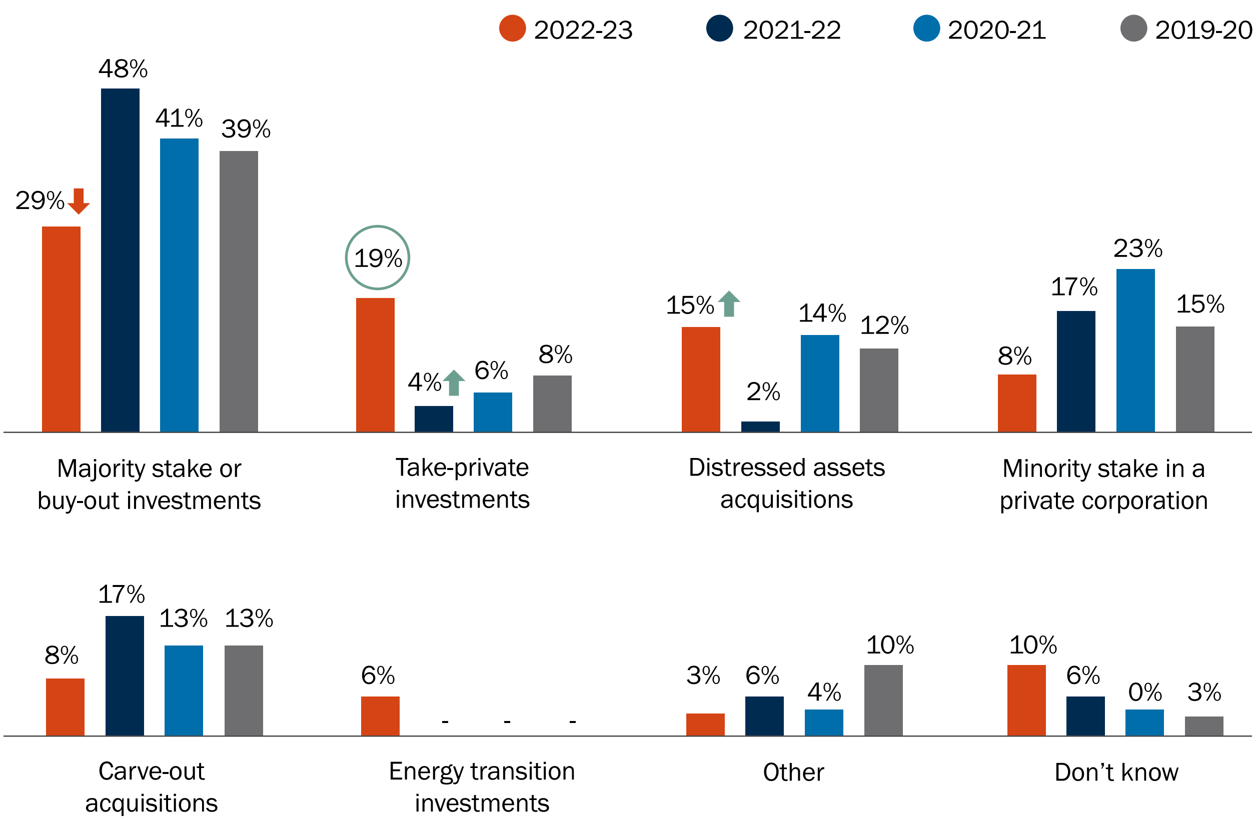
Base: All stakeholders: 2022-23 (n=54); 2021-22 (n=52); 2020-21 (n=101); 2019-20 (n=104).

Private equity targets

The appetite for control transactions has decreased. Just three in ten (29%) of our respondents cited majority stake or buy-out investments as their most attractive targets in 2023—a significant statistical decrease (19%) from 2022.

That does not mean respondents are not seeing other opportunity in the market. Reflecting a widely predicted spike in insolvencies, one in seven (15%) expect to source their most attractive targets from distressed assets (up 13% over last year

Figure 11) What will be the source of the most attractive targets in 2023?



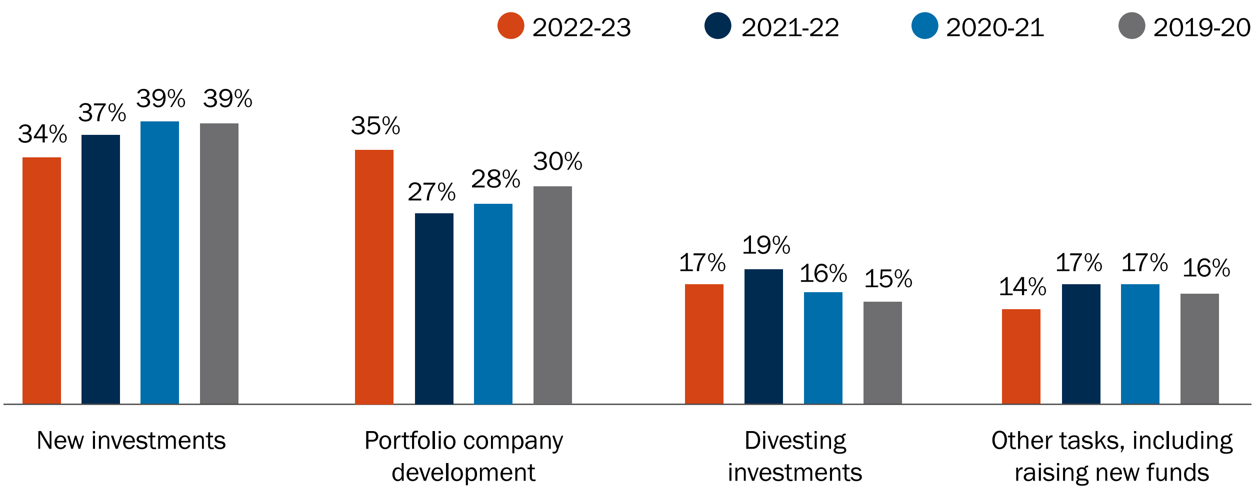
Base: All stakeholders: 2022-23 (n=62); 2021-22 (n=52); 2020-21 (n=101); 2019-20 (n=104).

and on par with prior years). And perhaps echoing a similar downturn in public markets, one in five (19%) of our survey respondents see opportunity in take-private investments (up 15% vs. last year; 13% vs. the year prior).

There is also nuance in the go-private trend. Pension fund stakeholders are about four times as likely (41%) as private equity stakeholders (11%) to cite take-private investments as their most attractive targets in 2022.

Expected time allocations are relatively unchanged year over year, with the bulk of time being spent on new investments and portfolio company development. On average, private equity stakeholders anticipate spending significantly more time on other tasks (16%), relative to their pension fund counterparts (9%).

Figure 12) In 2023, what percentage of your time do you anticipate spending on the following tasks?



Base: All stakeholders: 2022-23 (n=62); 2021-22 (n=52); 2020-21 (n=101); 2019-20 (n=104).

Sector outlook

The technology sector has set the pace for private deals in recent years, and in some ways respondents do not expect that to change anytime soon. Almost half (47%) of respondents expect tech to field the most private equity M&A transactions this year. Also not changing is second position—personal services—with more than one-third (37%) mentioning the sector.

Figure 13) In what industry sector do you expect to see the most merger and acquisition transactions with private-equity involvement in 2023? Please consider all industries, not just the ones that are your primary area of focus. **(Con't on next page)**

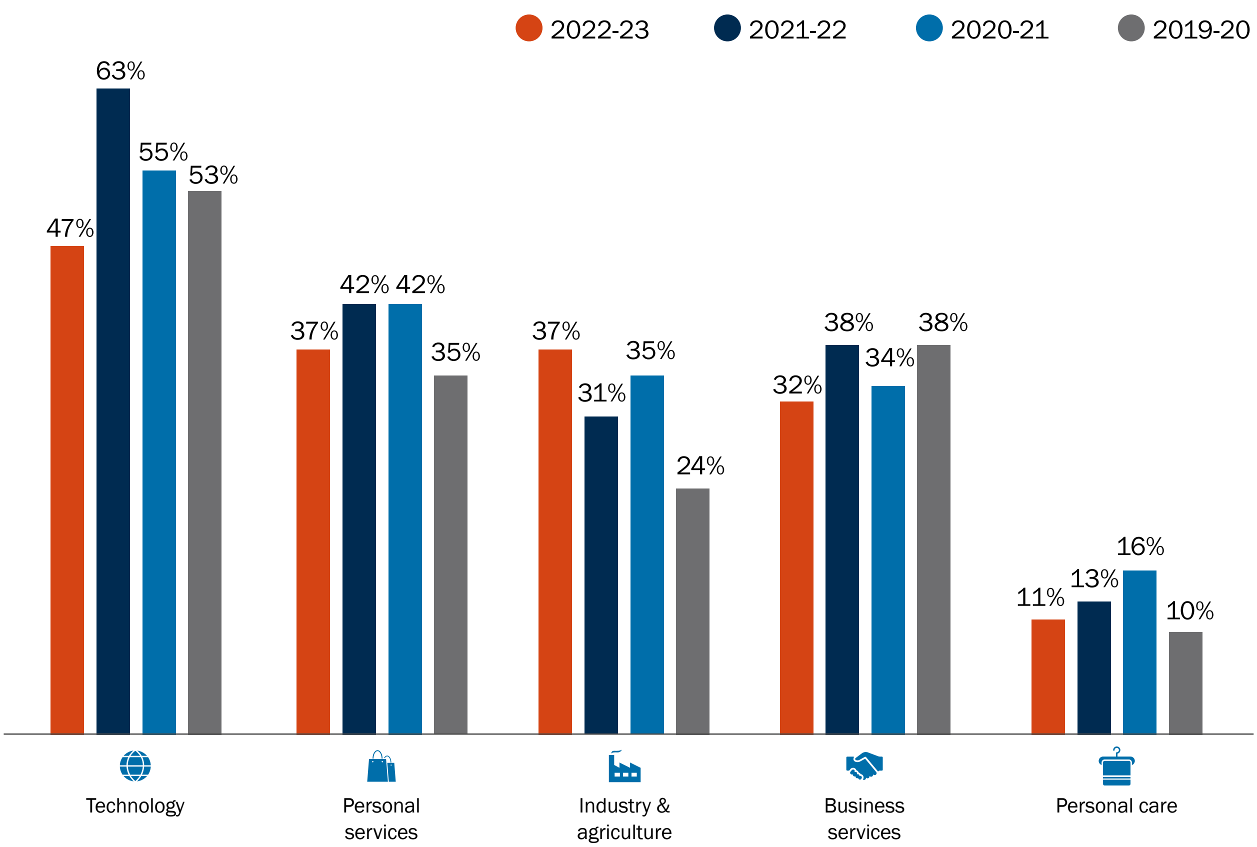
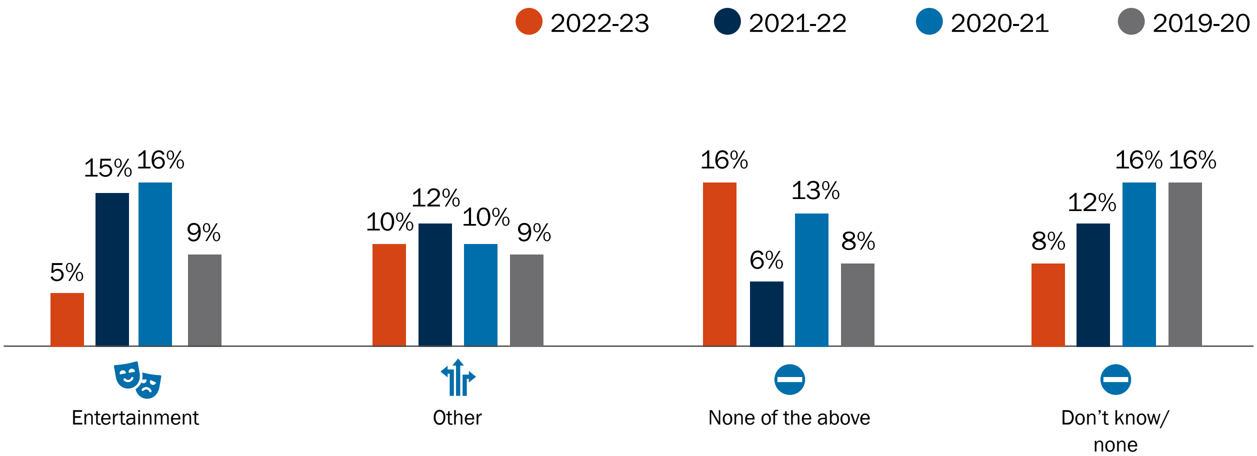


Figure 13 con't) In what industry sector do you expect to see the most merger and acquisition transactions with private-equity involvement in 2023? Please consider all industries, not just the ones that are your primary area of focus.

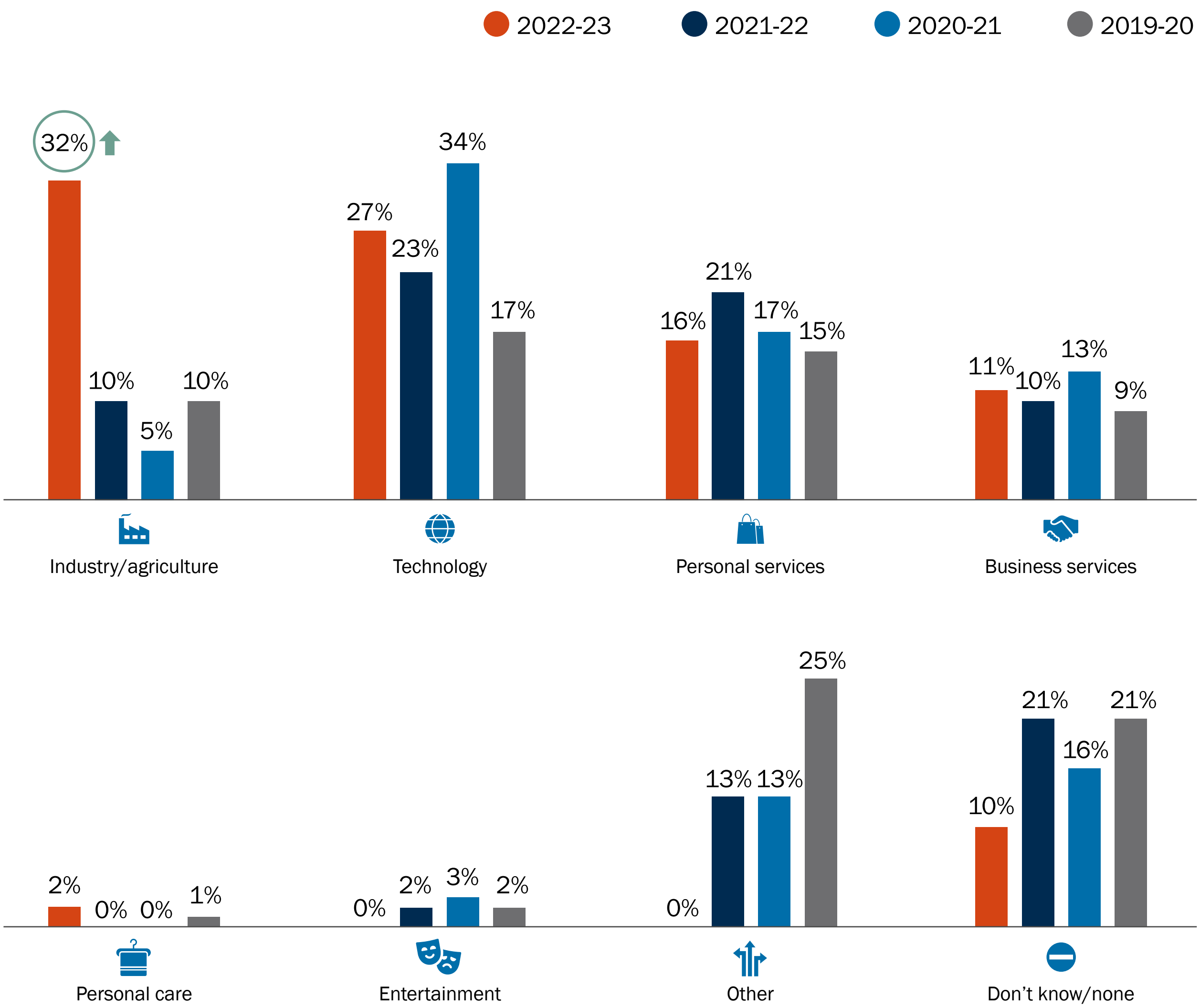


Base: All stakeholders: 2022-23 (n=62); 2021-22 (n=52); 2020-21 (n=101); 2019-20 (n=104).

What has changed year-over-year is the outlook for industry/agriculture. The sector replaced business services as the third-most-cited sector, and it was the only sector to receive more mentions than last year.

Furthermore, when we narrowed the focus to ask stakeholders which sector will offer their fund or group the best sectoral opportunities, industry/agriculture came out on top. In fact, there has been quite a large statistical increase in the number of respondents who feel that way (32% vs. 10% last year; 13% the year prior).

Figure 14) What industry sector do you think will provide the best opportunities for your fund/group, specifically?



Base: All stakeholders: 2022-23 (n=62); 2021-22 (n=52); 2020-21 (n=101); 2019-20 (n=104).

Among industry/agriculture sub-sectors, energy is the biggest riser—possibly reflecting both an appetite for investment in energy transition and a strategy to protect against the impact of inflation with infrastructure investments.

Figure 15) In what industry/agriculture sub-sector do you expect to see the most merger and acquisition transactions with private-equity involvement in 2023? Please consider all industries, not just the ones that are your primary area of focus.

Industry/ agriculture		Energy	Industrials	Food/beverages	Agriculture	Pet food/pet care
37%	2022-23	16%	15%	13%	11%	11%
31%	2021-22	8%	21%	17%	8%	8%
35%	2020-21	15%	17%	18%	7%	7%
24%	2019-20	11%	17%	9%	6%	6%

	Utilities	Automotive	Materials	Paper products	Toys
2022-23	16%	15%	13%	11%	11%
2021-22	8%	21%	17%	8%	8%
2020-21	15%	17%	18%	7%	7%
2019-20	11%	17%	9%	6%	6%

Base: All stakeholders: 2022-23 (n=62); 2021-22 (n=52); 2020-21 (n=101); 2019-20 (n=104).

There has been a large directional decrease in expected M&A transactions for the technology sector over the past year, with the e-commerce (18%; down 24%) and information technology (27%; down 21%) sub-sectors driving much of the decrease.

Figure 16) In what technology sub-sector do you expect to see the most merger and acquisition transactions with private-equity involvement in 2023? Please consider all industries, not just the ones that are your primary area of focus.

Technology		Information technology	Electronics/ computer/software	Internet/e-commerce	Telecom (phone, cell phone, cable)
47%	2022-23	27%	21%	18%	10%
63%	2021-22	48%	33%	42%	23%
55%	2020-21	42%	30%	37%	16%
53%	2019-20	38%	36%	36%	17%

Base: All stakeholders: 2022-23 (n=62); 2021-22 (n=52); 2020-21 (n=101); 2019-20 (n=104).

Personal services came in slightly lower than last year's numbers for expected private equity deals. Across all sub-sectors, save for insurance, there were notable directional decreases, year-over-year, with much of the overall decrease being driven by sizeable declines in healthcare/pharma (26%; down 9%), restaurants (5%; down 7%), consumer discretionary (8%; down 9%) and consumer staples (8%; down 7%).

Figure 17) In what personal services sub-sector do you expect to see the most merger and acquisition transactions with private-equity involvement in 2023? Please consider all industries, not just the ones that are your primary area of focus.

	Personal services	Healthcare/ pharmaceuticals	Consumer discretionary	Insurance	Education	Consumer staples
2022-23	37%	26%	8%	15%	10%	15%
2021-22	42%	35%	17%	15%	13%	15%
2020-21	42%	30%	7%	15%	17%	11%
2019-20	35%	27%	13%	12%	9%	15%

	Restaurants	Travel/tourism	Grocery/ convenience/dept. stores	Real estate/ construction	Government/politics
2022-23	5%	5%	2%	2%	2%
2021-22	12%	6%	8%	4%	0%
2020-21	12%	15%	8%	9%	3%
2019-20	10%	4%	6%	8%	3%

Base: All stakeholders: 2022-23 (n=62); 2021-22 (n=52); 2020-21 (n=101); 2019-20 (n=104).

Meanwhile in business services, there have been small directional decreases in expected transactions across all sub-sectors except for management consulting.

Figure 18) In what business services sub-sector do you expect to see the most merger and acquisition transactions with private-equity involvement in 2023? Please consider all industries, not just the ones that are your primary area of focus.

	Business Services	Financial services	Transportation/ shipping	Management consulting	Advertising/public relations
2022-23	32%	27%	13%	6%	3%
2021-22	38%	29%	17%	6%	6%
2020-21	34%	22%	18%	2%	2%
2019-20	38%	27%	22%	3%	2%

	Marketing/market research	Sales/sales promotion
2022-23	2%	-
2021-22	6%	4%
2020-21	5%	7%
2019-20	7%	10%

Base: All stakeholders: 2022-23 (n=62); 2021-22 (n=52); 2020-21 (n=101); 2019-20 (n=104).

Within the personal care sector, expected transactions for toiletries and fashion/clothing are on par with what was observed last year, whereas beauty/cosmetics are a little lower.

Figure 19) In what personal care sub-sector do you expect to see the most merger and acquisition transactions with private-equity involvement in 2023? Please consider all industries, not just the ones that are your primary area of focus.

Personal care		Beauty/cosmetics	Fashion/clothing	Toiletries
11%	2022-23	8%	3%	-
13%	2021-22	12%	4%	4%
16%	2020-21	14%	5%	4%
10%	2019-20	10%	5%	6%

Base: All stakeholders: 2022-23 (n=62); 2021-22 (n=52); 2020-21 (n=101); 2019-20 (n=104).

Expectations regarding the entertainment sector are directionally lower compared to previous years. There has been considerable movement, with fewer stakeholders expecting to see transactions across most sub-sectors except for television and publishing.

Figure 20) In what entertainment sub-sector do you expect to see the most merger and acquisition transactions with private-equity involvement in 2023? Please consider all industries, not just the ones that are your primary area of focus.

Entertainment		Music	Sports	Video games	Movie theater/ cinema or chain	Publishing
5%	2022-23	3%	3%	3%	-	-
15%	2021-22	10%	8%	2%	4%	4%
16%	2020-21	4%	3%	3%	9%	1%
9%	2019-20	2%	5%	4%	1%	2%

	Television	Film studio	Radio	Other entertainment
2022-23	-	-	-	2%
2021-22	4%	2%	0%	6%
2020-21	0%	3%	0%	5%
2019-20	4%	3%	1%	3%

Base: All stakeholders: 2022-23 (n=62); 2021-22 (n=52); 2020-21 (n=101); 2019-20 (n=104).

In their own words:

Biggest challenges in 2023

“Inflationary pressures.”

“Tough deal environment.”

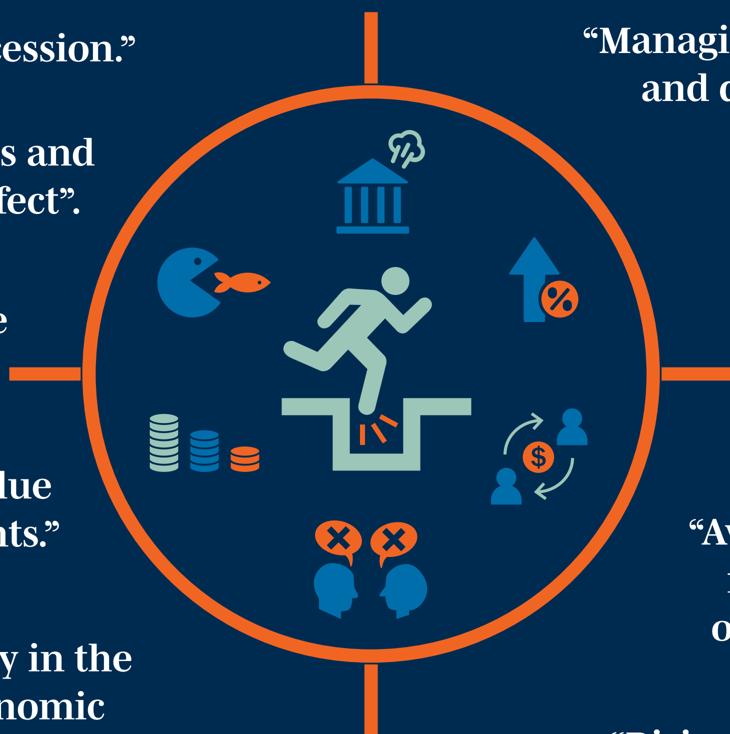
“Raising fresh capital.”

“Potential recession.”

“Managing our businesses and debt servicing.”

“Valuation swings and denominator effect”.

“Finding quality talent.”



“Sticky seller value expectations.”

“Valuation gap between PE and founders.”

“Finding good value in new investments.”

“Available capital for attractive opportunities.”

“Uncertainty in the macroeconomic environment.”

“Rising interest rates.”

“Managing portfolio companies struggling with the reality of the market conditions.”

Funds and secondaries

Half (49%) of stakeholders reported that their organization has considered or participated in a GP-led restructuring—such as, for instance, a continuation fund transaction, where new money provides an exit for existing investors in respect of one or more portfolio assets if they choose not to roll their existing fund interests into a new continuation vehicle. That number is down slightly from last year, though it remains ahead of 2020-21.

GP-led restructurings and other secondary market transactions will most likely continue their strong run this year, helped in part by the need of many pension funds and other institutional investors to access alternative sources of liquidity. Secondary transactions, whether GP- or LP-led, are likely to continue to provide much-needed sources of liquidity for many institutional investors facing overallocation challenges. At the same time, opportunistic buyers could have ample opportunities to acquire fund interests at attractive valuations either through portfolio sales or the purchase of new interests in continuation vehicles. The narrowing valuation gap discussed above also has the potential to help facilitate more of these deals being struck.

Get more on the **role of secondaries in unlocking liquidity**.

While GP-led restructurings present great opportunities for buyers and sellers alike, they do raise important issues around conflicts of interest given the dual role of the fund sponsor in such transactions. The respondents in our survey are cognizant of the challenge. When we asked them to rank strategies to manage these conflicts, they mentioned due diligence of the underlying asset (54%), adopting a leadership role (57%), and having an independent valuation of the underlying asset (61%) most often. We did see some movement from last year: due diligence fell from 90% to 54%, a statistically significant difference.

Figure 21.1) Has your organization considered or otherwise participated in a GP-led restructuring where an asset is spun out of one fund and put into a new fund managed by the same manager (where new money provides an exit for existing investors that choose not to roll their interests into the new fund)?

49% Have considered/participated in a GP-LED restructuring

2022-23

58%

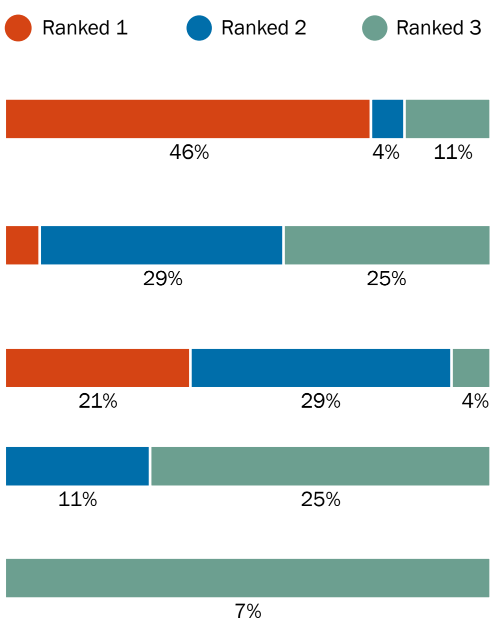
2021-22

43%

2020-21

Base: All stakeholders 2022-23 (n=57); 2021-22 (n=52); 2020-21 (n=101).

Figure 21.2) Most effective actions



	2022-23	2021-22	2020-21
An independent valuation of the underlying asset	61%	90%	72%
Adopt a leadership role on the LPAC or otherwise lobby the LPAC and other LPs to take an active role	61%	83%	88%
Due diligence of the underlying asset	54%	63%	60%
Review of the underlying purchase and sale agreement	36%	33%	47%
Sellers covering the costs associated with transfer	7%	20%	19%

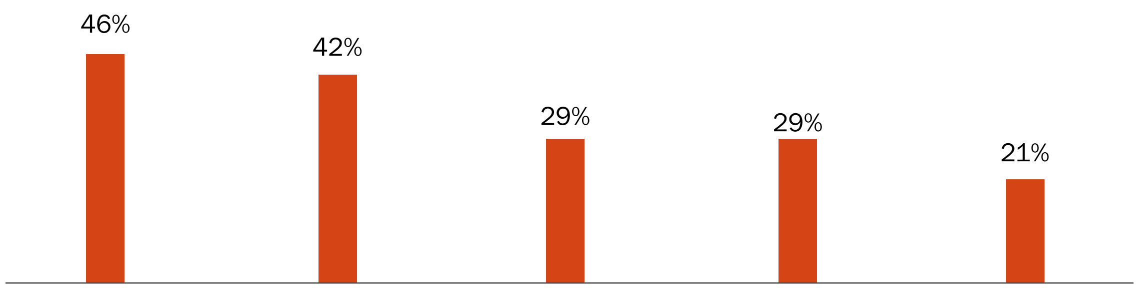
Data <3% not labelled.

Base: Considered/participated in a GP-led restructuring: 2022-23 (n=28); 2021-22 (n=30); 2020-21 (n=43).

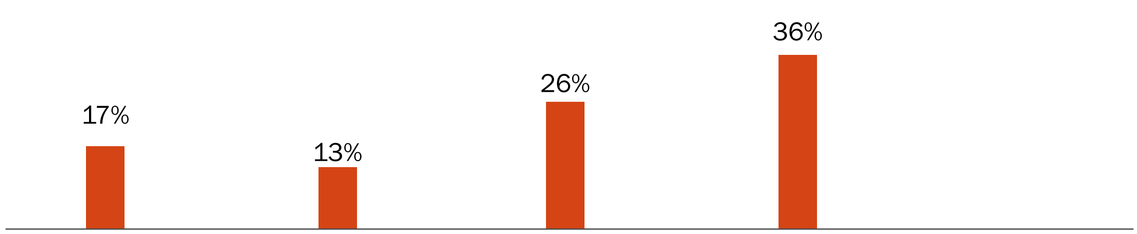
Against this backdrop, termination of the commitment period tops the list (45%) as the term of focus for respondents with their fund investments this year, followed closely by subscription lines and borrowing (42%), with more respondents than in last year's survey saying they spent most of their time on both items. When it comes to all other negotiating terms relating to private fund investments, fewer respondents identified them as priorities as compared to last year.

Co-investment rights ranked second (20%) among respondents' key terms; the top term was a most favoured nations provision that was size based but where the organization also received full disclosure of non-electable side letter provisions (22%). (See Figure 23.)

Figure 22) Which terms did you spend most of your time negotiating in connection with your fund investments in 2022? You can select up to 3 responses.



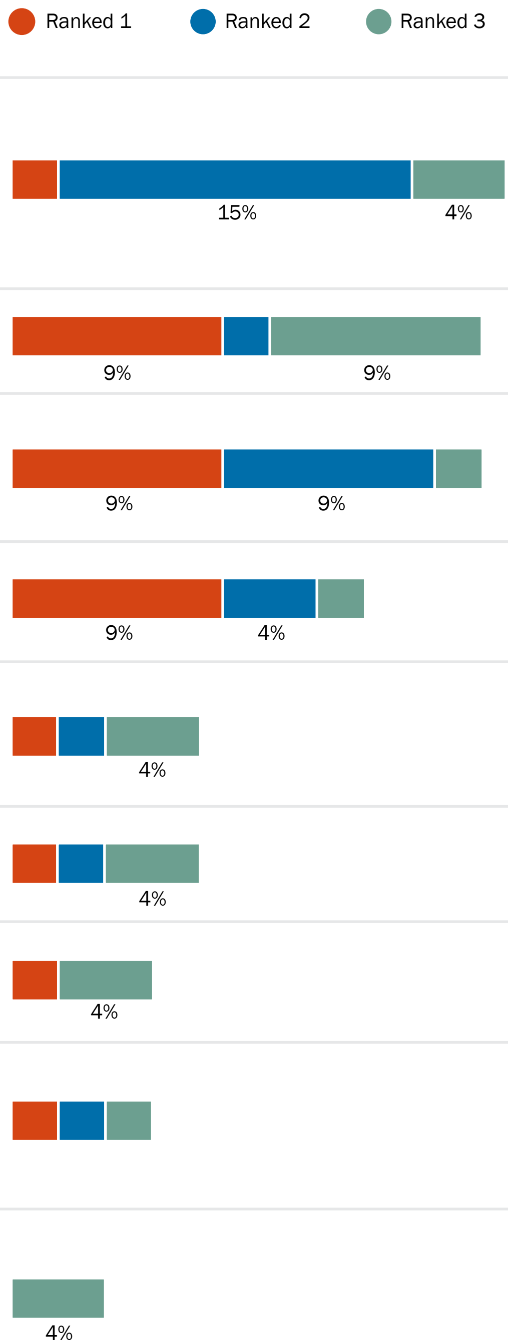
	Termination of commitment period (including key person)	Subscription line and borrowing	Waterfall	Management fee	Partnership expenses (including organizational expenses)
2021-22	25%	33%	35%	33%	27%
2020-21	40%	29%	22%	34%	38%



	Fund termination	GP removal	Don't know	Not applicable
2021-22	19%	19%	-	-
2020-21	11%	16%	-	-

Base: All stakeholders: 2022-23 (n=24); 2021-22 (n=52); 2020-21 (n=101).

Figure 23) In connection with your fund investments in 2022, which of the following side letter terms were of the most importance to your organization? Please rank your top 3.



	2022-23	2021-22	2020-21
A most favored nations provision that was size based but where you received disclosure of non-electable side letter provisions	22%	29%	37%
Co-investment rights	20%	56%	63%
Various reporting requirements specific to your organization	20%	33%	47%
Advisory committee seat	15%	54%	54%
Representations and warranties with respect to the fund	9%	23%	21%
A most favored nations provision not based upon size	9%	21%	15%
Limitations on Borrowing Provisions	7%	19%	27%
Notice of Litigation and/or Indemnification Claims (with regular status updates) Provisions	7%	10%	9%
A restriction on their ability to disclose your organization's name to prospective investors	4%	8%	7%

Don't know: 26%. Data <3% not labelled.

Base: All stakeholders: 2022-23 (n=46); 2021-22 (n=52); 2020-21 (n=101).

Summing it all up

1. Boom, bust and deal

Almost none (3%) of our respondents expect the Canadian economic climate to improve this year. Combine that with respondents' belief that interest rates and inflation will have a more detrimental impact on transactions than they did last year, and it's easy to see why just one-quarter of private equity and pension fund professionals expect the average size of transactions to increase this year. Downward economic trends could also present significant opportunity: one in seven expect to source their most attractive targets from distressed assets.

2. Closing the valuations gap

As frothy market conditions raised valuations over the past few years, buyers grew accustomed to outsized exit prices. Yet as the post-pandemic market normalized valuations, seller expectations have not adjusted, with many using earn-outs to close the buyer-seller gap. While this year's survey results indicate that the gap has not fully closed, there are encouraging signs on valuation multiples and vendor pricing expectations.

3. A mixed bag for fundraising

Only one in ten of our respondents believe it will be easier to raise new funds than in 2022—the lowest proportion in the four years of our survey. More than one-third see fundraising becoming much more difficult. Yet most do not seem overly concerned—saying fundraising will either remain about the same or become a little more difficult—with 2023 fund vintages having the potential to be particularly strong. This latter sentiment is one that we have seen play out in Q1 of 2023 given that there remain many significant ongoing fundraisings.

4. Secondary transactions to the rescue

None of the pension fund stakeholders we polled expect to increase their passive private-equity allocations this year, in part a testament to the impact of the denominator effect but also due to the more conservative outlook that pension fund stakeholders are taking with respect to the market more generally (and therefore wanting to be more judicious about exposure to new investments). Now, with LPs looking to unlock liquidity, secondaries transactions are well primed for a strong run this year, in both the GP- and LP-led varieties.

5. ESG and energy transition investments

While ESG means different things for different organizations, it increasingly means a whole lot for businesses dealing with investments. In this year's survey, a full 40% of respondents said they expect to invest more in energy transition—part of the environmental aspect of the standards. LPs are prioritizing ESG; GPs are looking to craft a strategic response.

Contacts

Guy Berman
gberman@torys.com
416.865.8167

Jared Fontaine
jfontaine@torys.com
212.880.6128

Michael Horwitz
mhorwitz@torys.com
212.880.6296

Amy Johnson-Spina
aspina@torys.com
212.880.6154

Danielle Kline
dkline@torys.com
416.865.7518

Guillaume Lavoie
glavoie@torys.com
514.868.5614

Max Shakin
mshakin@torys.com
212.880.6168

Stefan Stauder
spstauder@torys.com
212.880.6161

Laurie Duke
lduke@torys.com
416.865.7348

Shannon Gotfrit
sgotfrit@torys.com
416.865.8127

Lauren Hulme
lhulme@torys.com
416.865.7383

Neville Jugnauth
njugnauth@torys.com
403.776.3757

Cameron Koziskie
ckoziskie@torys.com
416.865.7684

Jay Romagnoli
jromagnoli@torys.com
212.880.6034

Zehra Sheerazi
zsheerazi@torys.com
416.865.7505

Venera Ziegler
vziegler@torys.com
212.880.6169

Methodology

These are the findings of an Ipsos survey conducted on behalf of Torys LLP.

In total, 42 private equity and pension fund stakeholders completed the survey from start to finish, all of whom did so online except one respondent, who took the survey by telephone. The analysis includes 20 additional partial completes, meaning that overall there are 62 completes and partial completes that will be the focal point of this analysis. The online survey was fielded between November 2 and December 2, 2022.

Survey respondents

Most respondents work for private equity organizations (73%); 27% work for pension funds. Two-thirds (65%) have more than 10 years of experience in the industry, with nearly one-quarter (23%) having worked in the industry for 6 to 10 years.

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Uniquely equipped to serve clients investing in Canada, the U.S. and globally, Torys provides sophisticated solutions for fund formation and alternative investments across asset classes. Canada's most active private equity funds and pension funds and leading international pension and sovereign wealth funds look to us for counsel. We are the only Canadian practice to be ranked in Band 1 by Chambers and Partners for both buyouts and fund formation, and we are recognized for transactional skill and international experience that spans industries.

Our team members in our Toronto, Calgary, Montréal and New York offices work seamlessly together, offering integrated transactional, regulatory, tax and structuring advice on our clients' work, drawing from our long history in the private equity industry and our understanding of changing market terms and industry practices.

About Torys LLP

Torys is a respected international business law firm with a reputation for quality, innovation and teamwork. Clients look to us for their largest and most complex transactions, as well as for ongoing matters in which strategic advice is key.

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